DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HAITI

INVESTMENT SECTOR LOAN (989/SF-HA)
REFORMULATION PROPOSAL

The preparation of this document was coordinated by Andres Marchant and Bárbara Szaszkiewicz (RE2/OD3), with the participation of: Corinne Cathala, Ana Maria Linares (RE2/EN2); Paulina González-Pose, Mark Homonoff, Wolfgang Munar (RE2/SO2); Luis Hidalgo, Carlos Trujillo (RE2/FI2), Augusto Ruiz-Eldredge and José Justiniano (Consultants); Gerard Johnson, Astrid Wynter, Serge Ambroise, Pierre-Richard Oriol, Juan Carlos Páez, Andres Suárez Sandoval and Patrice Joseph (COF/CHA); María Eugenia Nepote-Cit (LEG), Javier Jiménez-Mosquera (LEG), and Adriana Arroyave-Shipley (ROS/DAU).

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I. REACTIVATION OF BANK LENDING: BACKGROUND AND CONTEXT

A. Background

1.1 The Bank's portfolio has remained inactive since February 8, 2002, when the Bank placed Haiti's loans in non-accrual status. Annex I summarizes the composition of the portfolio at that time. The Bank remained engaged in key development areas through the Country Office and the ongoing and planned technical assistance program, thus preserving its country knowledge and turnaround capacity.

1.2 By mid-2002, the deepening institutional and economic crisis, led the Bank to initiate, with Board support, a technical dialogue with the Government with a view to reactivate and update its loan portfolio in preparation for eventual re-engagement. The sequence of steps and actions leading to the program reformulation and modifications included in this package are summarized below.

1.3 In May 2002, Management concluded that reactivation was essential to help preserve key institutions and prevent delays in resuming development efforts once arrears have been cleared. It was further decided that the Bank's loan program should be reactivated as soon as arrears were settled. On June 19, 2002, the Board of Executive Directors of the Bank endorsed a set of Management proposals (CS-3442-1), to launch a gradual reactivation process, through a technical mission, to work with the Government on an arrangement to clear arrears to the Bank and start consolidating the inactive portfolio, including a review of the continued relevance and priority of the pending loans referred to in Annex I.

1.4 A first technical mission visited Haiti from July 29 through August 2, 2002. The terms of reference of the technical mission encompassed, among others, the following objectives: (a) initiate discussions towards the arrangement for the payment of arrears; (b) discuss with the Government the country's development strategy and priorities; (c) based on the above, assess the situation on the loans under execution; (d) assess the requirements for, and start work on, the updating of the four ratified loans, namely:

- Secondary and Tertiary Roads Rehabilitation and Maintenance (991/SF-HA).
- Organization & Rationalization Health Sector (1009/SF-HA);
- Potable Water and Sanitation Sector Reform (1010/SF-HA); and,
- Basic Education Program (1016/SF-HA);

(e) inform the Government of the decision to cancel the Technical Cooperation Loan for Decentralization (972-SF/HA); and, (f) explore with the authorities the possibility of reformulating the Investment Sector Loan (989/SF-HA).

1.5 As conveyed in the technical mission's report to the Board (GN-2212-1), the mission (i) agreed on the arrangements for the settlement of arrears, formalized in

a letter addressed by the Minister of Finance to the Bank in August 2002; (ii) discussed the Government's medium-term development objectives, based on improving public sector governance and management, providing productive support and investing in the development of human capital, as well as their short-term priorities and relevance of existing Bank activities; and (iii) concurred on the requirements and scope of the program modifications for the reactivation of current Bank loan operations in Haiti.

1.6 Based on the above agreements, the mission elaborated an Action Plan for reactivation, to prepare for the eventual resumption of the Bank's lending activities. The recommendations articulated in the action plan, included, among others, the completion of the technical work and of the documentation on the modification or reformulation of the above mentioned Bank operations for consideration by the Board.

1.7 The Bank's initiative was boosted on September 4, 2002, when the OAS adopted Resolution 822, which explicitly encourages the IFIs to work with the Government to remove financial and technical obstacles to normalization of economic cooperation. Furthermore, around that time the IMF resumed its dialogue on the preparation of a Staff Monitored Program (SMP) for FY 2002/2003.

1.8 On September 11, 2002, the Executive Directors supported the proposed program modifications included in Management's Action Plan, articulated in the above-mentioned Technical Mission Report, as part of Management proposals leading to the reactivation of the Bank's activities in Haiti. In November 2002, a second Technical Mission substantially completed discussions on the program modifications/reformulation of pending loans and on the status of old remaining loans.

1.9 The Bank's normalization efforts were further supported by Haiti's agreement with the IMF on a new SMP, and by OAS Res. 1959, adopted at the General Assembly held in Santiago, on June 10, 2003. In its article 8, the Resolution singled out progress in the strive by IFIs towards removing technical and financial obstacles to re-engagement. The Resolution makes specific reference to Finance Minister's Gustave announcement to the IDB on May 21, 2003, that Haiti had secured financing to settle Haiti's arrears. It further welcomes CARICOM's pledge to facilitate clearance of these arrears and the approval by IMF Management of the new SMP program (June 10, 2003).

B. Portfolio Review and Consolidation

1.10 The detailed review of portfolio relevance and reactivation requirements was carried out with the intensive involvement, and participation in the missions, of all the relevant units of the Administration (RE2, FIN, LEG, ROS/DAU), COF/CHA staff and the Haitian authorities. The two missions reached agreement in Haiti on the changes required to update and activate a relevant portfolio immediately

following the clearance of arrears. The outcomes of subsequent technical work, on the different elements associated with the reactivation of Bank operations, underlie the actions addressed in this note.

1.11 These actions build on: (1) Government's decision to cancel six of the seven old loans under execution, due mainly to the fact that these projects had substantially achieved their objectives, and the relatively small undisbursed balances; (2) Government's decision to maintain the active status of the Fund for Economic and Social Assistance (FAES, 983/SF-HA), due to this Fund's importance in implementing the Government's development and poverty reduction activities; (3) Bank's decision to cancel the Technical Cooperation Loan for Decentralization; and, (4) program modifications required for each of the four ratified loans and the reformulation of the Investment Sector Loan. The resulting Bank portfolio is summarized in Annex I.

1.12 In addition, the Government and the mission agreed to review and consolidate the country's ongoing technical cooperation program to assist priority capacity building objectives as well as to reactivate those technical cooperations linked to strengthening the execution of the modified programs (Annex I).

C. Context of the Reactivation

1.13 Since 1997, Haiti has experienced a prolonged institutional crisis that has led to the loss of external assistance, low investment, postponement of important structural reforms, and insufficient growth to reduce the high rate of poverty. The crisis in public institutions and a lack of finance also resulted in a marked deterioration in social and economic infrastructures, which further limited the country's growth prospects, and worsened already precarious social conditions.

1.14 The already fragile economic situation worsened further in the last year, already marked by wide spread poverty and declining real incomes, reflecting negative GDP growth, rising inflation and widening fiscal and external deficits. International reserves dwindled and external arrears accumulated vis-à-vis the IFIs (IDB, World Bank).

1.15 The crisis eroded democratic institutions, delayed and eventually blocked ratification by Parliament of Bank loans. The Government's progress on its reform and poverty reduction programs has been impaired and key policy and sector reforms, embedded in donor's programs as conditions to external aid disbursements, stalled. This situation also hampered the implementation of Haiti's largely foreign-funded development program, including the Bank's projects, to support essential public agencies and services.

1.16 The adverse effect of the situation on policy and project implementation and recurring arrears, thwarted the impact of the Bank's projects and resulted in the Bank being unable to authorize new loan operations since 1998. Institutionalization of the public sector also failed, making it necessary to create specialized executing agencies in relevant ministries, which had no lasting

institutional impact. Most state modernization initiatives were frustrated and anticipated strengthening of governance and institutional capacity did not materialize.

1.17 Following the suspension of most external assistance to the public sector due to recurring arrears and institutional impasse, the remaining donor support, mostly humanitarian aid, is being channeled through non-Governmental organizations. Despite their importance in preserving some basic delivery capacities in the social sectors, these interventions generally focus on humanitarian and short-term issues, without systematic attention to developing national institutions and capabilities.

1.18 In early 2003, the authorities began taking corrective fiscal and monetary action to stabilize the economy. They are pursuing a one year economic and financial program, with a view to creating the conditions for sustainable growth and poverty reduction and initiating key reforms. The authorities have indicated their intention to implement a 12-month SMP covering April 2003-March 2004. The authorities' goal is to develop a medium term economic and structural reform program, including governance improvements, that could be supported by renewed donor assistance.

1.19 Over the SMP program period, the Government is to develop a strategy to identify financing for the comprehensive clearance of Haiti's external arrears, in consultation with the IMF and the World Bank. The authorities envisage a sequenced process, starting with the creditors, like the IDB, that are most advanced in the process of reactivating their operational programs.

1.20 The critical challenge facing Haiti in the short term is to restore as soon as possible the external net positive flows needed to generate sustained economic growth and reduce poverty. The reactivation of the Bank's lending, and the IMF's support to the recently implemented Government stabilization program, is expected to create leverage for a broader re-engagement by the international community and an eventual normalization of Haiti's relations with all donors.

1.21 As a result, public institutions face important challenges in areas such as capacity for the formulation and implementation of public programs and policies, including development of regulatory powers and provision of public services (health, education, electricity, roads, water and sanitation).

1.22 These factors are among the highest priorities of the ongoing reactivation dialogue with the Government. The general background of social and infrastructure deterioration in recent years supports the continued relevance of the updated and consolidated portfolio of loans presented to the Board. The Government has also confirmed the priority of operations in the sectors addressed by the modified loans.

1.23 Through reactivation of its pending operations, the Bank will reinstate its capacity for a strong role in terms of institutional building and policy reform support in

Haiti. Moreover, it has maintained close aid coordination with key multilateral and bilateral players in the country, which leaves it in a sound position to ensure complementarity and synergy of its operations with other donors through the re-engagement process.

II. FRAMEWORK FOR PROGRAM MODIFICATIONS

2.1 Public sector project implementation capacities have been eroded in both human and financial terms as a result of the prolonged crisis. It is recognized that execution capacity is a real constraint in the current situation. As a result, the Bank's response to the current institutional situation seeks not only to aim for simpler project design and increased attention to institutional development, but also to strengthen its portfolio management and monitoring effort under the reactivation exercise. This approach seeks to introduce a more flexible approach to the reactivation program, both to speed up implementation and to introduce timely adjustments when required through increased supervision and mid-term reviews.

2.2 Within this context, the proposed reactivation supports efforts to meet immediate development challenges by restoring a framework to help increase provision of basic services, while helping maintain essential institutional implementation and service delivery capacities.

2.3 The Bank technical teams responsible for these loans therefore agreed with their Haitian counterparts to focus the modifications on the simplification of the design and execution arrangements, to speed up initiation of program activities and facilitate this implementation and supervision, including measurable mechanisms to ensure close monitoring and performance evaluation. Procurement of goods and services will follow Bank rules as initially established.

2.4 In order to tackle weak institutional capacities, the Bank has focused on providing project specific support. Each of the four modified investment projects contains elements aimed at securing their effective implementation. The creation of special implementation units embedded in the Executor's organizational structure is contemplated in all four projects, as is technical cooperation aimed at helping the Government to accelerate disbursements. This initial effort will be complemented with close monitoring of the implementation process, through project launch workshops, intensified supervision and mid-term evaluations, with a view to identifying required adjustments in project design in response to evolving institutional and country needs.

2.5 In addition, the Bank is also striving to help achieve improvements in basic institutional capacity, which will support project sustainability and facilitate future development efforts. Ongoing and planned technical assistance operations are aimed at reinforcing ministerial capacities.

2.6 With respect to counterpart funding for the four investment projects, the Bank has been active in seeking possible ways to alleviate the burden upon the local authorities through cofinancing. The topic, however, along with execution mechanisms, will remain at the forefront of the reactivation dialogue.

A. The old portfolio

2.7 As of August 2, 2002, the Government decided to cancel six of the seven old operations in the portfolio, all of which were in their final stages of execution. These include: Institutional Strengthening of the Banque de la Republique d'Haiti (990/SF-HA), Road Maintenance and Rehabilitation National Program (945/SF-HA), Pont Sonde-Mirebalais Highways and Access Roads (838/SF-HA), Emergency and Economic Recovery Program II (962/SF-HA), Swine Repopulation (738/SF-HA) and Additional Financing Artibonite II (845/SF-HA).

2.8 With respect to the seventh loan (983/SF-HA) the authorities decided to maintain the active status of the Social Investment Help Fund (FAES) loan, approved in 1996, due to the high priority placed on the social projects that the FAES executes. The Government has requested an extension of the final disbursement date to June 2004, to use the remaining balance of US$1.6 million. This will allow for the completion of project selection, analysis, contracting, and execution of works.

B. The four investment loans ratified in December 2000

2.9 The loans ratified in December 2000, support four sectors (Health, Water, Education and Roads), key to sustainable development and poverty reduction. The deterioration of economic and social conditions and basic infrastructure in recent years emphasizes the continued relevance and growing demand for such development assistance. The Government confirmed the high priority of the activities addressed by the four ratified loans for: (a) rehabilitation of basic infrastructure like roads and water supply; and, (b) for restarting and expanding key social services, particularly basic health and education.

2.10 After an extensive assessment by the Bank and Haitian technical teams of the objectives and programs supported by these four investment loans, it was jointly concluded that the composition and activities supported by these operations remain highly relevant, without need for reformulation.

2.11 Modifications were introduced to simplify and speed up project implementation and to strengthen supervision mechanisms for monitoring and evaluation. Moreover, the parallel reactivation of the already approved non-reimbursable technical cooperations linked to the implementation of these loans will reinforce the institutional execution capacities. These are: Activation of Basic Education Program (ATN/SF-7230-HA); Activation of Rural Roads Project (ATN/SF-7292); and Activation of the Water Reform Project (ATN/SF-7167-HA.

2.12 The four investment projects support modernization initiatives that imply significant departures from earlier institutional arrangements for internal control, project execution and decision-making existing at the time of Bank approval of these operations. The audit and evaluation arrangements in the modified projects reflect current Bank requirements, that take into account the execution mechanisms, the level of complexity of institutional arrangements and the degree of decentralization of the respective operations supported by the projects.

2.13 The design and implementation arrangements for these projects include measures to ensure greater flexibility and oversight. In particular, these include: (a) review of conditions prior to first disbursement, to speed the flow of initial funds for the different programs supported by these loans; (b) revising the project cost tables; (c) simplifying the execution mechanisms to cater to current implementation capacities; (e) organizing project launch workshops to review performance indicators in all critical components, as well as auditing, reporting, acquisitions, records and inspections and monitoring and evaluation mechanisms.

2.14 In addition, these investment loans, now consider a mid-term evaluation as a tool to assess the institutional and execution aspects, including: (i) cost structure; (ii) intermediate results achieved; (iii) compliance with objectives and performance targets related to effectiveness and efficiency; and, (iv) financial transparency and accountability in resource use.

2.15 Taking into consideration the need to strengthen institutional capacity, the modified contracts include accounting and auditing requirements that highlight responsibility and accountability in all program operations and executing agencies.

2.16 With regard to provisions related to transparency, control and external auditing, the documents include the need to maintain separate bank accounts for Bank and counterpart funds and specify the accounting requirements to be implemented in all the participating agencies in the project (executing agency and co-executors).

2.17 In terms of auditing, the modified contracts include the provision of an operational and financial audit with two reports, one semi-annual and the annual report at the end of the period. The audit would be undertaken by a private firm of independent auditors acceptable to the Bank, in accordance with terms of reference approved by the Bank. The cost of the audits has been included in the Bank financing. The cost was estimated considering the execution period expected. Additional fees may be necessary if delays in project execution occur.

C. The Investment Sector Loan and the Technical Cooperation Loan for Decentralization

2.18 In the case of the Investment Sector Loan (ISL), which the Haitian Parliament recently ratified (June 18, 2003), the Government and the Bank agreed to a reformulation, framed within the overall objective of the Program.

2.19 Explicitly, the Government and the mission concurred that changes in the Investment Sector Loan's original components were needed to reorient this operation towards current development priorities. As originally conceived, this operation aimed at stimulating private sector initiatives and economic growth. It was now agreed to insert it within a policy framework linked to: (i) strengthening governance in public sector management, through improvements in fiscal transparency and public finance administration; (ii) financial sector reforms through enhancement in regulation and supervision of banks and savings and loans cooperatives; and, (iii) prevention of money laundering.

2.20 In this reformulation proposal of the ISL, the executing agency will be the Ministry of Economic Affairs and Finance (MEF). Previously, the operation had four executing agencies (the MEF, the Ministry of Planning and External Cooperation, the Prime Minister as the presiding officer of the Public Enterprise Modernization Commission, and Banque de la République d'Haïti, which complicated coordination and implementation. The proposed approach seeks to modernize the program and adapt it to the country's institutional capacity, significantly reducing the conditionalities and adjusting the operation so that it can be disbursed in two tranches and have a single executing agency. To streamline execution, it is proposed that the MEF be assigned sole responsibility inasmuch as it possesses the necessary capacity and experience to carry out the program. The Central Bank will also have to be involved, especially in execution of the financial sector component, along with other ministries and participating institutions.

2.21 Concerning the Technical Cooperation Loan for Decentralization (972/SF-HA), this operation was cancelled by the Bank effective March 31, 2003.

2.22 The gist of the modifications for each of the four investment loans and the proposed reformulation of the Investment Sector Loan are highlighted in the following section.

2.23 The details of the reformulation for the Investment Sector Loan (989/SF-HA) are presented in Annex II. Detailed modifications associated with the Secondary and Tertiary Roads Rehabilitation and Maintenance Program (991/SF-HA); Organization & Rationalization of the Health Sector Program (1009/SF-HA); Potable Water & Sanitation Sector Reform Program (1010/SF-HA) and the Basic Education Program (1016/SF-HA), are available in the technical files of RE2/OD3.

III. INVESTMENT SECTOR LOAN (989/SF-HA). SUMMARY HIGHLIGHTS OF REFORMULATION PROPOSAL[1]

3.1 On 11 December 1996, the Board of Executive Directors approved the Investment Sector Loan Program (ISL) for Haiti. The objective of the program was to stimulate private-sector initiative and economic growth by lowering risk and transaction costs in the markets that allocate basic economic resources. The program had four components: (a) legal and regulatory reform of the financial sector; (b) secured transactions reform; (c) stabilization of state banks; and (d) private-sector participation in management and ownership of the electricity sector.

3.2 The operation was approved as a loan in the amount of US$50 million, consisting of an initial fixed tranche of US$10 million and three floating tranches, calculated as follows: (1) US$15 million for the tranche corresponding to the financial sector; (2) US$10 million for the tranche for state banks; and (3) US$15 million for the electricity sector tranche. The program as originally approved was overly ambitious and complex, with a total of 39 conditions (17 for the fixed tranche, 10 for the financial sector tranche, 8 for the state bank tranche, and 4 for the electricity sector tranche). There were four executing agencies: the Ministry of Economic Affairs and Finance, the Ministry of Planning and External Cooperation, the Prime Minister as the presiding officer of the Public Enterprise Modernization Commission, and Banque de la République d'Haïti. Although the loan contract was signed in January 1997, the loan was only recently ratified by the Parliament on June 18, 2003.

3.3 The proposed reformulation calls for: (a) reducing the number of components from four to two; (b) merging the tranches for the components on financial regulation and state banks into a single US$35 million tranche under the heading "modernization of the financial sector"; (c) replacing the tranche for the electricity sector component with a US$15 million component for governance and public-sector transparency; (d) streamlining the operation by eliminating conditionalities or replacing them with new conditions; and (e) concentrating execution responsibility in one agency.

3.4 The resulting reformulation proposal includes a number of policy reforms that are implementable by the Government and would create suitable conditions for policy dialogue between the Government of Haiti and the Bank. By significantly streamlining project design, reducing the conditionalities, restructuring the operation so that it could disburse in two tranches, and using a single executing agency, the proposed program strengthens ownership and enhances its expected impact.

3.5 As mentioned above, the reformulated program would disburse in two tranches. The conditionality attached to the first tranche would reflect the very significant reforms already implemented in the financial sector, as well as the advances made

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[1] See Annex II for detailed Reformulation Proposal.

in the state banks component as of loan approval. The new first tranche would thus combine the fixed tranche, the floating tranche for financial regulation, and a portion of the floating tranche for state banks.

3.6 The second tranche conditionality would comprise a set of activities under a component aimed at (i) deepening financial reform and (ii) enhancing public-sector transparency and governance through the implementation of an annual budget process and the control of the hitherto discretional use of the ministries' current accounts. This new component would replace the energy sector component, which would be eliminated.

3.7 This reformulation proposal is presented for Board approval.

IV. SUMMARY HIGHLIGHTS OF MODIFICATIONS TO THE INVESTMENT PROGRAMS[2]

1. Basic Education Program (1016/SF-HA)

4.1 **Background:** This Program was developed under the 10-year National Plan for Education and Training (PNEF) adopted by the Government in 1997 to guide all investments in the sector. The current Government has also endorsed the PNEF, thus, the institutional and policy framework for the loan remains unchanged. This loan was developed in close collaboration with the World Bank (WB), which had prepared a parallel loan for US$28 million. However, in late 1998 the WB decided to stop processing new loans for Haiti. Both projects were prepared as parallel complementary rather than integrated operations, therefore, the cancellation of the WB component does not affect the objectives of the IDB loan. The lack of WB funding does mean, however, that activities that were to be financed by the WB such as pre-service teacher training, will have to be delayed or covered by other donors.

4.2 **Summary of Program Modifications**: The Bank and the Government agreed on a series of modifications to reflect changed needs of the basic education sector and the withdrawal of World Bank financing by modifying the contract accordingly. Agreement was also reached on the following:

- Updating dates in contract clauses that refer to the timeframe for the fulfillment of special conditions or completion of specific tasks, including the date for final disbursement
- Updating the log frame and its indicators, and removing the log frame from the body of the contract and including it instead in the Project Execution Manual so that any adjustments in the log frame during execution will not require contract amendment
- Updating the list of schools eligible for rehabilitation and reconstruction based on transparent and operational criteria

[2] Detailed Program Modifications are available in the Technical Files of RE2/OD3.

- Including a provision for reimbursement of eligible expenditures chargeable to the loan that were incurred by the borrower on or after September 30, 1998 and up to the date of this contract, in accordance with Policy OP/504
- Modifying several other dates set in the contract to better reflect the reality in Haiti or to facilitate execution, e.g. extending the date for the borrower to present baseline data for each key indicator to ensure the setting of accurate baselines given that school enrollment is often delayed due to the inability to pay fees or buy uniforms; and modifying the date for presentation of the Financing and Maintenance Plan required for any reconstruction or new construction of schools to within 12 months of the date of the special disbursement rather than 12 months after the effective date of the contract

4.3 The modifications to the contract are essential to facilitate execution to reflect the reality of reduced financing without the participation of the WB. Since the overall context and the national goals and priorities for the education sector have been maintained, the project constitutes a technically valid and viable approach to meet the objectives set forth in the loan.

4.4 **Prior Conditions:** The status with respect to fulfillment of the prior conditions is as follows: Three of the prior conditions were met in 2001. These conditions must be updated in order for the GOH to request the special disbursement of US$300,000 to launch the Program and finance the work to meet the other prior and special contractual conditions. All three of these conditions merely represent updating of past actions in order to be considered complied with. For instance, the authorized signatures have to be updated as the personnel at the Ministry has changed; the code of accounts have to be updated to reflect the modifications to the contract when approved, and the request for the special disbursement would have to be re-submitted. Significant advance has been made on some of the other prior conditions but the Government has yet to submit officially to the Bank evidence that these conditions have been fulfilled. For example, the Bank has reviewed a draft Project Execution Manual that was completed in 2001 with assistance from the European Union but the Manual has never been officially submitted to the IDB. It is our opinion that very little work would be required to bring the Manual up to date in terms of the contract modifications, new unit costs and time lines. A technical cooperation for US$90,000, ATN/SF-7230-HA, was approved in 2000 to finance some activities to prepare for the launch of the program. The operation's disbursement period has expired and the Government has requested an extension.

2. Potable Water and Sanitation Reform (1010/SF-HA)

4.5 **Background**: This Program was designed to support the reform of the water and sanitation sector in Haiti through an operation to: (i) improve the regulatory framework for the provision of services and (ii) provide financing for priority investments in 10 secondary cities and 50 rural and peri-urban systems. The Program´s strategy made investment financing conditional on the passage of a Water and Sanitation Sector Law. To complement the Bank loan, the MIF

approved a technical assistance operation to support sector reform and the establishment of a regulatory agency (ATN/MT-6097).

4.6 **Summary of Program modifications:** The Bank and the Government of Haiti (GOH) reviewed the Program´s strategy to simplify execution and allow priority investments before the passage of the law in five secondary cities in parallel with the reform process. Under the modification, the Bank could disburse up to $20 million to allow the GOH to finance rehabilitation works in five cities (Les Cayes, Ouanaminthe, Port-de-Paix, Jacmel, St. Marc) where rehabilitation plans are already available. This approach would allow the GOH to test the main elements of the reform. The modification can be executed under the current regulatory framework and will not change the Program´s objectives. The MIF operation associated with the loan was also modified to permit the disbursement of funds for the establishment of some regulatory capacity within the MTPTC.

4.7 Other modifications have been made to streamline the Program´s execution such as: (i) administering investment funds through a financing agreement between the Ministry of Economy and Finance, the Ministry of Public Works, Transport and Communications (MTPTC) and SNEP, rather than by contracting a commercial bank; and (ii) restructuring the conditions precedent to disbursement of funds.

4.8 **Conditions precedent to first disbursement**. The GOH has submitted the Operating Regulations but these need to be updated to take into account the changes in Program design. The GOH has complied with all other general conditions but some may require updating, such as the work plan for the first year of execution. We believe that updating the Operational Regulations and the first year work plan can be completed in short order.

3. Secondary and Tertiary Roads Rehabilitation and Maintenance Program (991/SF-HA)

4.9 **Background:** The Program supports the rehabilitation of part of the road network, the restructuring of transport activities of the Ministry of Public Works, Transport and Communications (MTPTC) and the creation of a National Road Maintenance Fund (FNER).

4.10 **Summary of Program Modifications:** The Bank and the Government agreed to modify the Program in order to postpone the entry into effect of the FNER, so as to meet immediate rehabilitation and maintenance needs of approximately 200 Km of secondary roads and 300 Km of tertiary roads for communities at the national level, with particular focus on the southern and eastern regions of the country. Such regions are currently facing a precarious situation due to the heavy rainfall during May 2002. For works on secondary roads, the Program includes US$12 million and the MTPTC already has designs and bidding documents. Works on tertiary roads will be carried out with labor intensive methods instead of contractual arrangements with contracting firms, and will be financed with the loan proceeds, amounting to US$21.6 million, of which US$430,000 for

administrative costs, US$18.8 million for the investment component, and US$2.3 million for the institutional strengthening component. This approach will emphasize employment generation in poorer communities.

4.11 **Key Aspects:** In order to ensure smooth launching of this Program, it is important that the following actions be also taken: (i) hiring of the Program Facilitator, to advise the Executing Unit in the follow up and monitoring of the commitments concerning compliance with bidding conditions, adequate application of performance indicators, application of the Operating Regulations, verification of the training process for key staff of the MTPTC and performance of the various consultants involved, as well as the preparation of periodic review meetings on the execution of the different Program components; (ii) presentation by the UEC for the Bank's approval of the methodology and program to work with local communities to help carry out the activities related to rehabilitation and maintenance through labor intensive means; and, (iii) the realization of a Launch Workshop at the beginning of the Program, in order to ensure, through an execution plan, adequate compliance with the commitments and responsibilities established under the Program.

4.12 **Conditions precedent to First Disbursement**: Seven out of the 11 prior conditions stipulated in the loan contract have been met. However, due to lapsed time and proposed modifications to the contract, it will be necessary to revise and update the fulfillment of those conditions already met. Compliance with the remaining four conditions and updating of those already met is expected to be achieved without problems.

4. Program for Organization and Rationalization of the Health Sector (1009/SF-HA)

4.13 **Background.** The Bank conducted technical discussion with the Haitian Ministry of Public Health and Population (MPHP) and reviewed the loan's goals and activities in relation to current and emerging health priorities in the Country. Based on this assessment a set of modifications was agreed.

4.14 **Summary of Program Modifications.** The modifications agreed with the Government include: (i) adjusting the scope and scale of activities in all project components to a single phase, and thus, shortening the execution period; (ii) matching the original three objectives to three components instead of five; (iii) adjustment of the per capita cost of the basic package of services in component 1; (iv) concentration of the activities in the original components 2 and 3 to the development of those core public health functions that are feasible to be executed in a single-phase operation; and,(v) simplification of the execution mechanisms.

4.15 **Conditions precedent to first disbursement.** Original conditions prior to first disbursement were reduced from five to two, one of which has been further simplified, and the inclusion of a special condition prior to the disbursement of

resources for the Pilot Program of Extension of Coverage in Maternal and Child Health Services.

V. RECOMMENDATIONS

5.1 Regarding the Investment Sector Loan (989/SF-HA), the changes contained in the reformulation proposal attached herewith do not change the objectives of the program. However, as they involve important modifications of the conditionality and the components of the program, Management considers it necessary to submit the proposed reformulation to the Board of Executive Directors for approval.

5.2 Inform the Board of Executive Directors on the modifications introduced to the following loans: Potable Water and Sanitation Sector Reform (1010/SF-HA), Basic Education Program (1016/SF/HA), Organization and Rationalization of the Health Sector (1009/SF-HA), Rural and Secondary Roads (991/SF-HA), FAES (983/SF-HA). The program modifications detailed in this note and its technical annexes, do not change the objectives of the original programs and Management, in accordance with the authority delegated by the Board of Executive Directors, has formalized these modifications.

HAITI
BANK PORTFOLIO CONSOLIDATION AS OF JUNE 30, 2003

Project	Name	Loan Nr	Amount in US$ millions		Approval Date	Status
			Approved	Available		
Old Portfolio						
HA0037	Social Investment Help Fund	983/SF-HA	27.0	1.6	13-Nov-96	Pending reactivation
HA0041	Road Maintenance & Rehabilitation National Program	945/SF-HA	45.0	0	8-Feb-95	Cancelled
HA0049	Pont. Sonde-Mirebalais Hwy/Access Roads	838/SF-HA	48.5	0	28-Mar-90	Cancelled
HA0050	Emergency & Economic Recovery Program II	962/SF-HA	50.0	0	29-Nov-95	Cancelled
HA0061	Swine Repopulation	738/SF-HA	13.2	0	15-Dec-83	Cancelled
HA0078	Additional Financing Artibonite II	845/SF-HA	13.3	0	7-Nov-90	Cancelled
HA0091	Institutional Strengthening Banque Republique D'Haiti	990/SF-HA	2.5	0	11-Dec-96	Cancelled
	Subtotal			**1.6**		
Loans Pending Reactivation						
HA0014	Potable Water & Sanitation Sector Reform	1010/SF-HA	54.0	54.0	12-Aug-98	Ratified
HA0038	Basic Education Program	1016/SF-HA	19.4	19.4	30-Sep-98	Ratified
HA0045	Organization & Rationalization Health Sector	1009/SF-HA	22.5	22.5	12-Aug-98	Ratified
HA0075	Rural and Secondary Roads	991/SF-HA	50.0	50.0	5-Mar-97	Ratified
HA0046	Investment Sector Loan	989/SF-HA	50.0	50.0	11-Dec-96	Ratified June 18, 2003
HA0060	Techn. Cooperation Loan for Decentralization	972/SF-HA	3.0	0	21-Feb-96	Cancelled
	Subtotal			**195.9**		
	TOTAL			**197.5**		

HAITI

TECHNICAL COOPERATIONS UNDER EXECUTION AS OF JUNE 30, 2003

Number	Name	Amount (US$ thousands)	Available amount (US$ thousands)
ATN/SF-5543-HA	Action Plan C and D Countries	1.556.9	254.0
ATN/JC-6489-HA	Training Reform Transition	750.0	254.0
ATN/SF-6701-HA	Urban Initiatives for Port-Au-Prince	730.0	67.0
ATN/SF-6731-HA	Electricity Sector's Modernization Program	150.0	102.0
ATN/SF-6898-HA	Preparation of Census 2001	150.0	11.0
ATN/SF-7227-HA	Local Governance Initiative	150.0	150.0
ATN/SF-7228-HA	Preparation Local Development Program	150.0	28.0
ATN/SF-7229-HA	Support to Project Implementation	150.0	150.0
ATN/SF-7230-HA	Activation of Basic Education Program	95.0	95.0
ATN/SF-7246-HA	Reinforcement of National Accounts II	115.0	62.0
ATN/SF-7289-HA	Risk Management & Disaster Prevention	75.0	4.0
ATN/SF-7290-HA	Strengthening Comm. Groups in Coastal Areas	135.0	31.0
ATN/SF-7291-HA	Preparation Environmental Action Plan	90.0	90.0
ATN/SF-7292-HA	Activation of Rural Roads Program	100.0	100.0
ATN/SF-7686-HA	Program to Support HIV/AIDS Strategy	1.000.0	865.0
ATN/SF-7757-HA	Support for Vulnerable Children	90.0	30.0
ATN/SF-7760-HA	Support to Civil Registry of Haiti	90.0	79.0
ATN/SF-7763-HA	Renewable Alternative Energy	90.0	28.0
ATN/SF-8054-HA	Construction Techniques with Bambou	13.2	7.0
ATN/SF-8080-HA	Support to Haiti's Poverty Map	15.0	15.0
ATN/SF-8145-HA	Poverty Map Validation, Production and Dissemination	110.0	110.0
ATN/SF-8146-HA	Inventory of NGOs	150.0	150.0
ATN/SF-8157-HA	Institutional Strengthening Initiatives	950.0	950.0
ATN/SF-8256-HA	Organic Agriculture Practices	18.0	6.0
	SUBTOTAL	**6.923.1**	**3.638.0**
FOMIN			
ATN/MT-6097-HA	Establishment Potable Water Agency	965.0	965.0
ATN/ME-6646-HA	Strengthening Textile Subsector	370.0	138.0
ATN/MH-6696-HA	Private Training Market Initiative	2.000.0	1.504.0
ATN/ME-8131-HA	Institutional Strengthening of Micro Credit National S.A.	300.0	300.0
	SUBTOTAL	**3.635.0**	**2.907.0**
	TOTAL	**10.558.1**	**6.545.0**

HAITI
Program HA-0046
Investment Sector Loan (989/SF-HA)
Reformulation Proposal

Project title:	Investment Sector Loan
Project number:	HA-0046
Borrower and guarantor:	Republic of Haiti
Executing agency:	Ministry of Economic Affairs and Finance
Amount:	US$50 million
Source:	Fund for Special Operations
Approval date:	11 December 1996
Date of disbursement in full:	23 October 2005

I. BACKGROUND

1.1 Haiti has a population of over 8 million and per capita income of around US$500, the lowest in Latin America and the Caribbean. It is the only country in the region listed in the United Nations Human Development Report 2002 in the "low human development" category. It has the highest rate of adult illiteracy in the region: one out of every two adult Haitians is illiterate (in Central America the percentage of illiterate adults is below 35%); and it has the region's lowest life expectancy: 53 years, compared with over 65 years in the Central American countries. Over one half the population (56%) is undernourished, which is twice the level of any other country in the region. It also has the highest rate of mortality among children under 5: for every 1,000 live births, 125 children die before age 5, a level that is also twice that of any other Central American country. Per capita electricity use is 40 kilowatt-hours, equivalent to 13% of the level in countries such as Guatemala, Honduras, and Nicaragua, and 2.5% of countries such as Mexico. Over the past two decades, GDP posted negative cumulative growth of –3.6%, while the population grew 62%, which implies a reduction in per capita income of over 40% for the period. Over the past five years, the political situation in Haiti has resulted in a sharp decrease in external aid, low investment levels, delays in structural reforms, and negative economic growth. This has led to a fragile macroeconomic situation, as described in

paragraph 2.2, which exacerbates the country's poverty and hinders political stability.

1.2 During the mission that visited Port-au-Prince in late July 2002, the Bank reestablished its dialogue with the government. At that time, the Government of Haiti expressed its firm intention of pursing a policy reform package built around three strategic pillars: strengthen governance, build productive capacity, and develop human resources. Discussions with the Minister of Economic Affairs and Finance and his team culminated in agreement on the following areas of Bank action and support for the short term as a means to jump-start economic growth: (a) modernization of the financial sector with emphasis on strengthening the prudential framework of the banking system and nonbank financial institutions, and efforts to eliminate money-laundering; (b) strengthening of public finances with emphasis on transparency, more effective revenue collection, and more efficient public spending; and (c) rehabilitation of infrastructure (energy, transportation, telecommunications, and water and sanitation) with special attention to job creation.

1.3 Designing and launching a program of reforms and investments to reactivate Haiti's economy is a complex task. With a tax burden equivalent to 8% of output, the country's per capita GDP of US$500 limits per capita public spending capacity to US$40 per year. Accordingly, the challenge for sustainable growth in Haiti will require a continuous and prolonged reform and investment effort by the government, and this will only be possible with large-scale and sustained support from multilateral agencies. As for the Bank, in addition to the four investment projects being reformulated, support for economic recovery will involve a series of investment projects and policy-based loans (PBLs) that will be defined and agreed upon in the future. It is against this backdrop that the Government of Haiti has requested reformulation of the present operation, which would represent the Bank's initial support towards backing this reform initiative.

A. The investment sector loan

1.4 On 11 December 1996, the Board of Executive Directors approved the Investment Sector Loan Program (ISL) for Haiti. The objective of the program was to stimulate private-sector initiative and economic growth by lowering risk and transaction costs in the markets that allocate basic economic resources. The program had four components: (a) legal and regulatory reform of the financial sector; (b) secured transactions reform; (c) stabilization of state banks; and (d) private-sector participation in management and ownership of the electricity sector.

1.5 The operation was approved as a loan in the amount of US$50 million, consisting of an initial fixed tranche of US$10 million and three floating tranches, calculated as follows: (1) US$15 million for the tranche corresponding to the financial sector; (2) US$10 million for the tranche for state banks; and (3) US$15 million for the

electricity sector tranche. The program as originally approved was overly ambitious and complex, with a total of 39 conditions (17 for the fixed tranche, 10 for the financial sector tranche, 8 for the state bank tranche, and 4 for the electricity sector tranche). There were four executing agencies: the Ministry of Economic Affairs and Finance, the Ministry of Planning and External Cooperation, the Prime Minister as the presiding officer of the Public Enterprise Modernization Commission, and Banque de la République d'Haïti. Although the loan contract was signed in January 1997, the loan was never ratified by the Parliament. The deadline for ratification expired on 23 July 2001.

1.6 The proposed reformulation calls for: (a) reducing the number of components and tranches from four to two; (b) merging the tranches for the components on financial regulation and state banks into a single US$35 million tranche under the heading "modernization of the financial sector"; (c) replacing the tranche for the electricity sector component with a US$15 million component for governance and public-sector transparency; (d) streamlining the operation by eliminating conditionalities and replacing them with new conditions; and (e) reducing the number of executing agencies from four to one.

II. IMPLEMENTATION STATUS OF THE REFORMS INCLUDED IN THE PROJECT

A. The macroeconomic component

2.1 The objective of this component was to maintain a macroeconomic environment based on sound monetary and fiscal policies that is conducive to private-sector-led growth in the productive sectors. Conditions: "*The Government will present, to the satisfaction of the Bank: (a) evidence of establishment of a sound macroeconomic framework consistent with the objectives of the loan; and (b) evidence of implementation of the programs and policies described in the policy letter.*"

2.2 Haiti's macroeconomic performance has been weak in recent years. Persistent macroeconomic imbalances, low reserve levels, and political instability leave Haiti very vulnerable to external shocks. Its export sector is the region's smallest, accounting for only 8% of GDP in 2001, as compared with 18% for Latin America as a whole. The internal political crisis has led to suspension of external budgetary aid and a sharp cut-back in disbursements of concessionary lending during the past five years, estimated at US$500 million. As a result, the country is relying ever more heavily on foreign remittances (which represent 15% of GDP) to obtain foreign exchange.

2.3 In 2001, real output dropped 1.7% and the fiscal deficit stood at 2.7% of GDP. The deterioration of public finances stemmed from a lack of fiscal resources created mainly by the decision to maintain hydrocarbon prices at their same level despite

the increase in international oil prices. The deficit is also attributable to exceptional spending on the elections. The government submitted the budget for fiscal year 2001-2002 to the Parliament, something it had not done since 1996-97, and approval was given by both houses in June 2002. The fiscal gap was financed by having the Central Bank issue more money and by allowing external payments to fall into arrears. This expanded liquidity was sterilized by bond issues, which pushed interest rates up and tightened credit for the private sector, which was already experiencing low demand. Exports fell 3% owing to low international prices and the drop-off in demand from buyers in the United States caused by uncertainty that Haitian industry would be able to honor contracts as a result of the uncertain sociopolitical environment. Despite the high level of remittances from Haitians working abroad (nearly US$600 million), the disequilibrium in the balance-of-payments current account was 4.8% of GDP. Over the past three years, Banque de la République d'Haïti has lost reserves amounting to almost US$50 million a year. The banking system has also been affected by the economic situation, as witnessed by the increase in the past-due portfolio.

2.4 In 2002 the already difficult economic situation worsened due to the unresolved political crisis and restrictions on external financing. Per capita income and employment fell sharply, and financing of the fiscal deficit by the central bank and by allowing external debt service payments to fall into arrears increased. Concurrently, inflation climbed, bank deposits fell, and capital flight and intense pressure on the exchange rate led to a fall in international reserves. The central bank's international reserves are currently equal to only a week of imports. To remedy this situation, Haiti reached agreement in June 2003 with the International Monetary Fund (IMF) on a staff-monitored program (SMP), as a first step towards obtaining financial support from that institution.

2.5 The policy letter contained the activities that were part of the original operation and has been redrafted to reflect the reformulated proposal.

B. Financial regulation component

2.6 The principal objective of the financial sector reform was to establish a modern legal, regulatory, and institutional framework to address, firstly, the banking system weaknesses that represented the greatest risk. Conditions: "*The Government will present, to the satisfaction of the Bank, evidence of legal effectiveness and banking sector compliance with: (I) prudential norms (capital adequacy; portfolio provisioning; risk concentration in related parties; foreign-exchange reserve position); (II) existing regulatory and reporting requirements; (III) uniform chart of accounts and accounting policies and procedures for commercial banks; (IV) consolidated financial reporting standards for banks and their associated companies; and (V) preparation and approval of draft versions of the General Banking Act and the Central Bank Act.*"

2.7 Despite the institutional and political crisis, as of June 2002 the government had implemented substantial reforms that fulfill all the conditions included in the floating tranche for the financial regulation component, except for the condition on legislative approval of the draft versions of the Central Bank Act and the General Banking Act. All the prudential regulations, consistent with the Basle principles, had been issued and implemented. Despite the difficult sociopolitical landscape in the country, Banque de la République d'Haïti has strengthened its banking system regulation and oversight capacity in the past two years. Bank oversight is effected twice a year through on-site inspections throughout the system, including state banks. The two pieces of draft legislation have been prepared and reviewed by an international consultant and are being discussed by Banque de la République d'Haïti and the IMF.

2.8 Despite the remarkable advances posted in the area of financial banking entities (the target of the program supported by the ISL), a major problem emerged in 2002 in relation to credit unions. These unregulated, nonbanking financial entities that take deposits from the public have been gaining importance within Haiti's financial sector. Hundreds of new credit unions have been created in recent years, gathering deposits from the public and offering high interest rates (5% to 15% monthly), apparently under pyramid-type operations that depend on continued inflows of deposits rather than on investments. In recent months, a number of credit unions have been unable to pay interest and honor deposit withdrawal requests. The government has passed legislation establishing that this sector will henceforth be under the oversight authority of Banque de la République d'Haïti (BRH), which will help remedy this problem. The legislation gives BRH a period of one year to devise prudential regulations and adequate oversight structures for credit unions. In the meantime, a transitory action plan has been implemented to address the problem faced by savers who had deposits at credit unions that later went bankrupt.

2.9 The government also submitted to the Parliament draft legislation on money-laundering and drug-trafficking, approved respectively in February and August 2001. Since then, important headway has been made in this area. In October 2001, Haiti was admitted to the Caribbean Financial Action Task Force (CFATF). In May 2002, a coordinator was appointed for the national committee on drug control; the same person will chair the committee on money-laundering. Numerous information and training events have been organized with commercial banks, members of the Department of Justice, and the police. To ensure the sustainability of these laws, a financial intelligence unit will be set up to monitor illicit activities.

C. Secured transactions component

2.10 The objective of this component was to establish a legal and institutional framework for chattel mortgage conducive to the efficient creation, perfection, and execution of secured transactions. Conditions: *"The Government will present, to the satisfaction of the Bank, evidence that the law establishing a legal framework for*

chattel mortgage and the corresponding lien registry system has been presented to the Parliament and approved."

2.11 The draft legislation was prepared by Bank-financed consultants in consultation with the government and the private sector. The proposed legislation has not yet been ratified by the Parliament.

D. The state banks component

2.12 The objective of this tranche was to bring Banque Nationale de Crédit (BNC) and Banque Populaire Haïtienne (BPH) into conformity with all prudential norms and regulatory measures required to establish their soundness. Conditions: *"The Government will present, to the satisfaction of the Bank, evidence that: (I) Banque de la République d'Haïti, with support from international experts, will conduct a diagnostic assessment of BNC; (II) neither Banque de la République d'Haïti nor the Fonds de développement industriel [Industrial Development Fund] (FDI) has increased their balances of credit outstanding to BNC or to BPH as of September 1996; (III) neither BNC nor BPH has been capitalized beyond the levels of September 1996; and (IV) a plan of corrective measures has been defined for BNC to conform with prudential norms and regulatory and reporting requirements needed to establish soundness of the bank."*

2.13 Although the ISL project was never implemented, a number of advances were made towards reducing the predominant role of state banks in the economy. In 1997, the commercial state banks BNC and BPH accounted for 25% of the banking system. BNC was the country's second largest commercial bank and BPH was the smallest. Banque de la République d'Haïti supervised the full assessment of BNC, conducted by an international consultant, and established an action plan of corrective measures to have it conform to the legal and prudential framework and ensure its soundness. As of March 2003, the two banks owned 9% of the system's total assets. BNC's loan portfolio at end-March 2003 was 736 million gourdes, below March 1998 levels of 891 million gourdes, representing only 3% of the Haitian banking system's total loans. During this same period, its staff was cut to less than one half. BPH held less than 2% of all the system's loans and has also cut back its staff.

E. The electricity sector component

2.14 The objective of this component was to improve productive and allocative efficiency in the electric power sector through private-sector participation in the management and/or ownership of the firm Électricité d'Haïti (ÉdH) (the state electric utility) within an appropriate legal and regulatory framework. Conditions: *"The Government will present, to the satisfaction of the Bank, evidence that: (a) a legal and regulatory framework has been established that is conducive to private-sector participation in the electricity sector in the form of management contracts, leasing or concession agreements, or equity ownership; (b) the Public Enterprise Modernization Commission (CMEP) has accepted the contractual obligations and*

responsibilities incumbent upon the executing agency of the electricity sector component, and has ratified its commitment to carry out the activities of that component (as specified in the contract); (c) the CMEP's technical secretariat is functioning and staffed with qualified personnel, and has the legal authority to act as executing agency of operation ATN/MT-5334; (d) an official invitation has been sent to the short list of consultants selected to present proposals for preparation of bidding documents and the legal framework for electricity sector reform; (e) a letter of agreement has been signed by the Government of Haiti and Caisse française de développement/Canadian International Development Agency (CIDA) stipulating terms and conditions of the extended, reinforced technical-assistance contract for ÉdH; (f) a legal and regulatory framework has entered into effect (with attesting legal opinion) that ensures: (i) legal effectiveness of the contract described in article (b) of this paragraph, (ii) adequate regulation of the electricity sector; (iii) competition; and (iv) legal effectiveness (with attesting legal opinion) of a contract that defines the conditions for participation by a private-sector agent in the management and/or ownership of ÉdH in the form of a management contract, leasing or concession agreement, or equity holding, in accordance with the principles set forth in the policy letter."

2.15 By way of a note dated 28 August 1998, the CMEP accepted the contractual obligations and responsibilities incumbent upon it as executing agency and ratified its commitment to carry out the respective program activities. A technical coordinator was appointed, along with the necessary staff to implement the component; and the Bank was authorized to recruit a supervisor for the program. The short list of consultants was used to invite the firm of SOGEMA-CRS/DESSAU for Électricité d'Haïti and the law firm of Foley, Hoag and Elliot to prepare the legal and regulatory framework for the electricity sector. The letter of agreement was signed by Caisse française /CIDA with the terms and conditions of the extended technical-assistance contract for ÉdH. All the preceding conditions were fulfilled. Draft legislation was prepared for regulating the electricity sector, and the option of capitalization was selected over that of privatization. The draft will need to be reviewed before it is submitted to the Parliament. In addition, PARIBAS was hired to prepare the financial and technical studies for inviting investors interested in capitalizing ÉdH.

2.16 Notwithstanding the support provided by the Bank, especially through the Multilateral Investment Fund (MIF) and the Bank's Private Sector Department (PRI), it was not possible to make any progress in the process of ÉdH privatization. An updated, comprehensive diagnostic assessment of the sector is now needed. Given the increasing deterioration of the electric power system, a number of interesting solutions involving private and public partnerships were established in cities such as Cap-Haïtien and Jacmel.

III. THE PROPOSED REFORMULATION

3.1 The following reformulation proposal includes a number of policy reforms that could be implemented and would create suitable conditions for policy dialogue between the Government of Haiti and the Bank. The proposed program seeks to streamline the project and adapt it to the country's institutional capacity, significantly reducing the conditionalities and adjusting the operation so that it can be disbursed in two tranches and have a single executing agency.

3.2 The program objective remains unchanged, i.e., "*to stimulate private-sector initiative and economic growth by lowering risk and transaction costs in the markets that allocate basic economic resources*." To achieve this, the program will focus its efforts on ensuring that, by the end of the implementation phase: the banking and nonbanking financial sector is regulated; all banking institutions comply with the Basle principles; fiscal management is transparent; and the normal budget preparation process interrupted in 1996 has been reestablished.

A. Components and conditions

3.3 The reformulated program would have only two tranches. The first tranche of up to US$35 million would be the result of merging into a new tranche: the fixed tranche, the floating tranche on financial regulation and a portion of the floating tranche on state banks. This first tranche includes all the reforms already implemented in the financial sector, as well as the advances made in the state banks component as of loan approval. All these important reforms are considered special conditions prior to the disbursement of the first tranche.

3.4 The second tranche of up to US$15 million would comprise a set of activities under a component aimed at (i) deepening financial reform and (ii) enhancing public-sector transparency and governance through implementation of an annual budget process and control of discretional use of the ministries' current accounts. This new component would replace the energy sector component, which would be eliminated.

3.5 ***Macroeconomic program***. A macroeconomic environment needs to be maintained that is based on sound monetary and fiscal policies and is conducive to private-sector-led growth in the productive sectors. In order to reestablish economic stability the Government adopted a macroeconomic program supported by the IMF under a Staff Monitored Program (SMP), approved by the Management of the IMF on June 10, 2003.

3.6 ***Modernization of the financial sector.*** The reformulation of this component would group activities to modernize the legal and regulatory framework for the financial sector together with the proposed reforms to the state banks. The new policy matrix would reflect the necessary reforms already implemented to attain the program's

objectives. The conditions for the first tranche of this component would require presenting evidence that: (a) the full set of prudential regulations (portfolio classification and provisioning, risk concentration in related parties and insider lending, and capital adequacy), in accordance with the Basle principles, have been issued and are being applied in the banking system; (b) a uniform chart of accounts and accounting policies and procedures for commercial banks have been implemented; (c) standards have been adopted that require the banks and their associated companies to present consolidated financial reports; (d) the prudential regulations on the foreign-exchange reserve position have entered into effect; (e) a diagnostic assessment has been conducted of Banque Nationale de Crédit (BNC); (f) BNC did not expand its loan portfolio between March 1998 and March 2003; (g) the legislation against money-laundering has been passed into law; and (h) the Parliament has approved the credit union act. Conditions (a), (b), (c), (d), and (e) are part of the original matrix. The Administration has verified compliance with prior conditions before submitting the current proposal for consideration by the Board of Executive Directors.

3.7 For the second tranche, the following conditions would be required: (a) that the private banking system is complying with the prudential norms, regulations, and reporting requirements; (b) that prudential and oversight norms have been established and are being applied for credit unions; (c) the government has implemented an adjustment plan to bring BNC into conformity with the prudential norms; (d) an action plan to address the problem of failed credit unions is being carried out to the Bank's satisfaction; and (e) the financial intelligence unit to monitor money-laundering is fully operational.

3.8 ***Governance and public-sector transparency.*** The objective of this component is to support better governance by intensifying fiscal transparency and accountability in budget execution. This component would replace the electricity sector component and would include activities aimed at: (a) improving the budget process through approval of a mechanism for the formulation and implementation of annual budgets; (b) approving the 2003 budget, as well as drafting the 2004 budget and bringing it before Parliament; (c) limiting discretional use of ministries' current accounts for emergency spending only; and (d) disseminating information on fiscal spending.

3.9 Progress towards fiscal transparency is vital for macroeconomic performance and renewed growth with support from the international donor community. The government has indicated its intention to improve governance and, with this in mind, has committed to preparing without delay a budget proposal for fiscal 2004 and to limiting the discretional use of ministries' current accounts exclusively to emergency spending. It is worth noting that Haiti recently approved a budget for fiscal 2003, something it had not done since 1996-97.

3.10 ***Electricity sector***. In parallel with execution of the sector loan and given the complexity of the electricity sector, the program will support the government in seeking sustainable solutions for the sector but would not include conditions. The Bank will hire a consultant to review existing documentation and studies and prepare an integral diagnostic study of the sector (state of infrastructure, political situation, institutional and financial considerations). Based on that study and the situation in the country, the consultant will recommend strategy options for the short and medium term to remedy the energy problem. With support from the consultant, the Bank and the government will engage in policy dialogue to consider the options. The intention is to bring about, through some kind of reform arrangement, an increase in the supply of electricity in both quantity and quality on a sustainable basis. An action plan will be agreed upon once a strategy option has been selected.

B. Executing agency

3.11 The executing agency would be the Ministry of Economic Affairs and Finance (MEF). The operation currently has four executing agencies (the MEF, the Ministry of Planning and External Cooperation, the Prime Minister as the presiding officer of the Public Enterprise Modernization Commission, and Banque de la République d'Haïti), which complicates coordination and implementation. To streamline execution, it is proposed that the MEF be assigned sole responsibility inasmuch as it possesses the necessary capacity and experience to carry out the program. The central bank will also have to be involved, especially in execution of the financial sector component, along with other ministries and participating institutions.

C. Deadline for effectiveness

3.12 Inasmuch as the deadline for loan effectiveness expired on 23 July 2001, the Board is asked to extend the deadline for an additional 27 months, to 23 October 2003.

IV. RATIONALE AND RISKS

4.1 The proposed reformulation of operation 989/SF-HA presented herein changes neither the program's general objective nor the original amount of financing. It reduces the number of conditions and components; it replaces the four tranches with two (eliminating the floating tranches and subtranches); and it reduces from four to one the number of executing agencies. The project teams feels that the proposed changes constitute a viable alternative for implementing the operation.

4.2 The specific objectives of the financial reform component remain unchanged except for the approval of the banking legislation. The objective of the state banks component would be reformulated in the direction of rationalizing BNC's operations. The proposed replacement of the energy sector component with a component on governance and transparency in fiscal management is the result of a

decision by the government to seek political consensus on the country's privatization process.

4.3 Since the time the ISL was approved, sociopolitical conditions in Haiti have changed dramatically. Some of the conditions contained in the 1996 Policy Letter are no longer relevant. Other reforms, such as the capitalization or privatization of the electricity sector, cannot feasibly be implemented because the government is now rethinking the privatization process in light of sweeping changes in the economic, social, and political scenario. In the current circumstances, financial sector stability, sustainability of anti-money-laundering efforts, and the activities under the component on governance and public-sector transparency are more relevant for the country. The current fragility of the banking system—owing to the difficult economic situation and the problems caused by the credit unions—indicates that stability of the financial sector is one of the top priorities to be addressed. The flight of foreign-currency bank deposits put heavy pressure on the exchange rate and precipitated a sharp drop in international reserves. This compounded the problem of external debt in arrears and the lack of attention to the population's basic needs. Accordingly, the proposal to increase the amount of the first tranche would be an acknowledgement of the reforms already implemented under difficult political conditions and the country's commitment to deepen them further. More transparent management of public finances and greater efficiency in state spending are also urgently needed. These arguments all justify the reformulation proposed by the project team. At the same time, it is important to keep in mind that, at the current juncture, Bank financing through the ISL is the only source of financial balance-of-payment support for Haiti.

4.4 The greatest risk to the operation would be posed by deterioration of the political and social situation. The program would be affected by failure to advance with the reform process and, consequently, by nonfulfillment of the loan conditions. However, the government has expressed its commitment to this agenda, which implies structural advances with the reforms. Also, without approval of the Bank's support program, the country's economic deterioration would be exacerbated.

4.5 The program will include the following performance indicators: (1) central bank supervision of 100% of private and public banks; (2) enactment and enforcement of 100% of regulations and prudential norms governing credit unions; (3) implementation of the plan to bring the BNC into line with prudential norms; (4) reduction of the number of ministries' current accounts to one per ministry by September 2003 until March 2004; (5) monthly posting on the Internet of data on national budget performance; and (6) the number of cases identified under the Money-Laundering Act.

4.6 The borrower will open an account at the central bank for the accounting, control, and audit of loan transactions.

V. RECOMMENDATION

5.1 Pursuant to document CS-3442-1 and bearing in mind that the proposed reformulation does not entail any change to the program's objectives but significant changes to the components and their conditions, Management presents for approval by the Board of Executive Directors a proposal to amend the present operation, and recommends approval under the terms set forth in chapter III above and in the annexes hereto.

5.2 The Government of Haiti has cleared its arrears to the Bank in full and for this reason the Administration recommends to the Executive Directors the approval of the proposed modifications to this document and the disbursemnet of the first tranche of this operation.

5.3 The loan will be disbursed in two tranches: (i) the first one in the amount of up to US$35 million, and (ii) the second in the amount of up to US$15 million. The deadline for disbursement in full will be 24 months after the effective date of the loan contract.

Haiti
Investment Sector Loan (989/SF-HA)
Proposed Reformulation
Economic Policy

REFORMULATED POLICY MATRIX					
Policy area	**Objective**	**Measures to be taken before disbursement of the first tranche (US$35 million)**	**Means of verification**	**Conditions for disbursement of the second tranche (US$15 million)**	**Means of verification**
Macro-economic program	Maintain a macroeconomic setting based on sound monetary and fiscal policy conducive to private-sector-led growth of the productive sectors	The government is to present, to the Bank's satisfaction: evidence that it has established a macroeconomic framework compatible with the ISL program's objectives evidence that it has prepared a new policy letter	Macroeconomic report Copy of the signed letter	The government is to present, to the Bank's satisfaction: (evidence that it has established a macroeconomic framework compatible with the ISL program's objectives evidence that it is implementing the policy letter	Macroeconomic report Report of international consultant

Note on disbursement schedule and conditionality matrix:

The first tranche of the loan will be eligible for disbursement after Board approval of the reformulated version and fulfillment of the conditions precedent required for effectiveness of the loan contract between the Bank and the Republic of Haiti.

The balance of the loan amount will be allocated to a second tranche, to be disbursed upon fulfillment of its specific conditions. The two disbursements will be contingent upon a macroeconomic setting being in place that is favorable and compatible with the program objectives, and fulfillment of the policy objectives and programs described in the policy letter.

NOTE: The first-tranche conditions marked with a diamond (♦) are required actions for launching the sequence of the proposed reform and had been fulfilled by the time of the reformulation mission.

REFORMULATED POLICY MATRIX FOR INVESTMENT SECTOR LOAN 989/SF-HA					
Policy area	**Objective**	**Measures to be taken before disbursement of the first tranche**	**Means of verification**	**Conditions for disbursement of the second tranche**	**Means of verification**
1. Modernization of the financial sector	Establish a legal and regulatory framework conducive to maintaining a financial sector that is modern, secure, and competitive.	The government is to present, to the Bank's satisfaction, evidence of:		The government is to present, to the Bank's satisfaction, evidence that:	
		(iii) enactment of prudential regulations on foreign-exchange reserve position ♦	Publication in *Le Moniteur* (the official gazette)	(i) the banking system continues to observe and comply with existing prudential norms and regulatory and reporting requirements	Report of external consultant
		(iv) enactment of prudential regulations on: (1) portfolio classification and provisioning, (2) risk concentration in related parties and insider lending, and (3) capital adequacy ♦	Publication in *Le Moniteur*	(ii) prudential and oversight norms for credit unions have been established and are being observed, and an action plan to address the problem of failed credit unions is being carried out to the Bank's satisfaction	Report of external consultant
		(v) adoption of a chart of accounts and uniform accounting policies and procedures for commercial banks ♦	Publication in *Le Moniteur*	(iii) the government has implemented an adjustment plan to bring BNC into conformity with the prudential norms	Report of external consultant
		(vi) adoption of standards that require banks and their associated companies to present consolidated financial reports ♦	Publication in *Le Moniteur*	(iv) the Financial Intelligence Unit to monitor illicit transactions is fully operational	Report of the Justice Ministry
		(vii) completion of a diagnostic study of the BNC by an international consultant ♦	Consultant's report		
		(viii) the BNC did not expand its loan portfolio between March 1998 and March 2003 ♦	Report of external consultant		
		(ix) promulgation of the Money-Laundering Act ♦	Publication in *Le Moniteur*		
		(x) promulgation of the Credit Unions Act	Publication in *Le Moniteur*		

REFORMULATED POLICY MATRIX FOR INVESTMENT SECTOR LOAN 989/SF-HA					
Policy area	**Objective**	**Measures to be taken before disbursement of the first tranche**	**Means of verification**	**Conditions for disbursement of the second tranche**	**Means of verification**
2. Governance and public-sector transparency	Improve the fiscal transparency and management capacity of public administration			The government is to present, to the Bank's satisfaction, evidence that: ▪ a mechanism has been introduced for budget formulation and implementation, the 2003 budget has been approved, and the 2004 budget has been drafted and brought before Parliament ▪ discretional use of ministries' current accounts is limited exclusively to emergency spending ▪ the MEF has begun to disseminate data on budget performance	Verification by external consultant and official publication Report of external consultant Copy of the MEF publications