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**Assessing the Investment Climate in Haiti:
Policy Challenges**

*Martha N. Kelley*¹

Summary

Haiti, the poorest country in the Western hemisphere, faces image problems that are unique in the Caribbean region. Haiti competes with other, more attractive destinations in the region for private capital inflows. For the past fifteen years, favorable conditions to support reconstruction and restructuring of the economy have not existed for long enough periods to introduce lasting reforms. Political and economic risk factors have discouraged productive private investment although domestic enterprises continued to make limited investments in Haiti. The stock of foreign investment is not very large, reflecting the country's lack of attractiveness to foreign capital over a prolonged period of time. There are no quick or easy solutions to the complex problems affecting Haiti's investment climate. Overcoming perceptions of risk and political instability will not be a short-term process. Consistent actions from the Haitian authorities to address economic reform priorities will be crucial as investors assess developments on the ground. It is also vital to express political commitment at the highest levels to improve the environment for investment and entrepreneurial activity. The private sector can and should play a substantial role in advising the government through a consistent and enduring policy dialogue intended to provide specific policy recommendations. Haiti has important comparative advantages, even if they are not fully realized and are not yet driving foreign direct investment decisions. There is a growing recognition that private capital flows will play an important part in revitalizing Haiti's economy and in creating jobs. There is less agreement on how to tackle the factors inhibiting investment flows. Eventually, FDI will have to be complemented by well-targeted financial assistance from multilateral and bilateral donors.

1 Martha N. Kelley is a Foreign Service Officer assigned as Economic Counselor at the U.S. Embassy in Port au Prince, Haiti. The views expressed in this paper are her own and do not reflect those of either the U.S. Embassy in Port au Prince or the State Department.

Introduction

The diagnosis of Haiti's investment climate is remarkably consistent over time. Since the early 1990s, the problems have been identified many times over. Haiti faces image problems that are unique in the Caribbean region and its reputation vis-a-vis other regional destinations for FDI is not favorable. In this brief paper, it is not possible to review all of the root causes of Haiti's difficult investment climate, nor is it possible to provide an adequate account of the complicated political and economic history that created the dilemmas faced by the Haitian authorities and private sector today. It is important to recognize that constraints to investment and business activity in Haiti today are not merely the result of inappropriate policy choices. History and politics played a major part in preventing perceptible movement along the path to sustainable economic growth. Expert observers of the Haitian scene believe that reconstruction of the economy will require a substantial transformation of the traditional role of government.² Equally important will be a significant readjustment of the relationship between the private sector and the authorities.

Background

Haiti, the poorest country in the hemisphere, has a fragile and troubled history of democracy. Since the end of the Duvalier era in 1986, consistently favorable conditions to support reconstruction and restructuring of the economy have not existed.

Rural to urban migration. During the 1980s, the continued impact of soil erosion and population growth exacerbated the inability of the agricultural sector to support rural peasant farmers. Accelerating rural to urban migration led to unsustainable population pressure and huge social disparities in urban areas, especially in the capital of Port au Prince. Over 35 percent of the country's population now lives in cities. Port au Prince now holds an estimated 2.2 million people, more than four times its estimated capacity and around 25 percent of the country's estimated total population. Urban infrastructure and services were and are inadequate to support even a much smaller population. The capital city is characterized by dilapidated infrastructure, poor sanitation, inadequate water, electricity and transportation, close to non-existence social services, crowding, extensive slum areas and lack of employment opportunities.

The post-embargo economy. Political instability after 1986 had a direct and negative effect on prospects for economic stabilization and development. The international embargo of Haiti from 1991-1994 had many adverse effects on the economy, causing loss of international markets and loss of income to those working directly and indirectly in export-oriented sectors. The embargo had a dramatic impact on Haiti's industrialized sector, which was concentrated in assembly operations (garments/textiles, toys, electronics). At its height in the 1980s, the assembly sector accounted for over 80,000 jobs. By the end of the embargo in late 1994, some estimates suggest there were fewer than 5,000 jobs remaining. Today, the sector accounts for about 20,000 jobs and has never recovered its former strength, as many companies moved their operations to other countries or went bankrupt.

Imperfect markets. During the Duvalier period and into the early 1990s, private sector activity did not occur in a context of free and competitive markets. Traditionally, selected individuals or families gained access to monopoly or quasi-monopoly rents through their personal and financial relationships with senior government officials. Powerful families in the past opposed privatization and made profits by controlling the importation of flour, cement and other key items. While such monopolies are no longer institutionalized, domestic markets remain imperfect, marked by distortions and lack of genuine competition.

Disincentives to invest. Historically, important actors in the private sector lacked experience with competitive markets and were not compelled to invest "on a level playing field" with competitors, given

2 Georges A. Fauriol, "Harnessing International Resources," in *Haitian Frustrations: Dilemmas for U.S. Policy*. A Report of the CSIS Americas Program. Editor, Georges A. Fauriol. The Center for Strategic and International Studies, Washington D.C. 1995.

the structure of the economy. Some of the key players consolidated their positions and amassed fortunes in the private sector through access to special favors from government officials. Political and economic risk factors discouraged productive investment, although some industrial production survived the embargo years. The distorted structure of Haiti's economy encouraged investment in import-based commercial enterprises; large profits were derived from marking up the imported merchandise. At times of political volatility, risk was largely limited to warehouse inventories.

Changing perspectives on investment. A new and younger generation of entrepreneurs in Haiti does not approach business and investment decisions in the same manner as the older generation. Anecdotal evidence suggests that younger entrepreneurs are sophisticated and open to the promise of new technology, management strategies and marketing approaches. Until that younger generation controls the capital of family-held businesses, however, it will be constrained from striking out in new directions without access to other sources of financing. A growing exodus of young, well-educated professionals and business people from Haiti may weaken the eventual scope for innovation as the torch is passed from the older generation.

Factors Affecting Haiti's Investment Climate

It is no secret that foreign investors have been wary of Haiti in recent years. The stock of foreign investment in the country is not very large, reflecting the country's lack of attractiveness to foreign capital over a prolonged period of time. Political instability and concerns about physical security are among the factors affecting external perceptions of Haiti as a place to invest and do business. A number of urgent problems are affecting the investment climate but, unfortunately, few of them are susceptible to quick fixes. These problems includes:

- *Deteriorated physical/social infrastructure*
 - Poor, inadequate and unreliable, electricity, water, telecommunications, roads
 - Insufficient and poor quality schools, clinics, housing;
- *Macroeconomic policy destabilized by a ballooning public sector deficit*
 - Direct deficit financing by central bank crowds out private sector access to credit
 - Absence of accountability and transparency in public sector finances
- *A reputation for political instability and potential violence*
- *Insecurity*
 - Criminal activity and drug trafficking;
 - Police the sole force of order in the country;
- *Weak institutions in government and society*
- *Governance issues*
 - Inadequate legal and regulatory framework
 - Weak and corrupt judiciary and related institutions
 - Poor prospects for dispute resolution
 - Over-reliance on personal relationships with government to resolve issues
 - Corruption at all levels of government and state-owned enterprises
 - Dysfunctional government bureaucracy; red tape; harassment
 - Lack of capacity to enforce existing or new laws
- *Inconsistent application of economic policies*
- *Insufficient domestic sources of investment capital.*

Haiti suffers by comparison with other countries in the Caribbean region. The climate for foreign direct investment (FDI) is inhospitable, even though the country has many of the same inherent advantages as other Caribbean states by virtue of geography. The reality is that Haiti competes with other destinations in the region for private capital inflows. Neighbors like Dominican Republic, just over the border, are far ahead of Haiti in creating the enabling environment to attract investment.

Inadequate financial resources. Haiti's enduring economic crisis has no simple or easy solutions. The urgent need for poverty reduction will have a dominant influence in development planning. Social sector investment has been badly neglected in Haiti, constrained by lack of resources and inadequate policy planning. To create a large number of jobs in urban areas will be an enormous challenge, one that requires large amounts of capital. Improving the investment climate is vital. Haiti historically has depended on foreign assistance inflows to finance public works, infrastructure projects and social sector investments. There is a growing recognition that private capital flows will play an important part in revitalizing Haiti's economy over the medium to long term to create jobs. There is less agreement on how to tackle the factors inhibiting investment flows. Eventually, FDI will have to be complemented by well-targeted financial assistance from multilateral and bilateral donors.

Prospects for Investment: Haiti's Potential

Contrary to the conventional wisdom, *Haiti does have important comparative advantages*, even if they are not fully realized and are not yet driving foreign direct investment decisions. Key advantages for Haiti include:

- *Proximity to the U.S. market, 700 miles away*
 - Short shipping times to U.S. ports
 - Quick response to needs created by just-in-time inventory systems
- *Large potential labor force of reliable, hard working, trainable workers who want employment*
 - Recently praised by major U.S. companies importing garments sewn in Haiti
 - Potential for higher labor productivity.

There are sectors in which Haiti can be competitive.

Assembly operations. Haiti's industrialized sector traditionally was concentrated in textile assembly. Before the 1991 embargo, it was more diversified and included other assembly operations (toys, electronics, medical equipment). The textile assembly sector benefits from trade preferences, notably the U.S. Caribbean Basin Trade Partnership Act (CBTPA) of 2000 that provides for duty/quota-free entry of apparel made from U.S. fabrics formed from U.S. yarns. Duty/quota-free treatment is also available for certain knit apparel made from fabrics formed in the Caribbean Basin region, provided that U.S. yarns are used, and for designated "hand loomed, handmade, or folklore" articles. Haiti and 23 other countries in the Caribbean were designated as CBTPA beneficiaries on October 2, 2000.

U.S.-based retailers are beginning to show greater interest in Haiti's textile assembly potential. Large companies with mass-market name recognition are sourcing garments again in Haiti after a difficult period marked by poor international publicity for Haiti's garment assembly business. Several of those U.S. firms have expressed cautious optimism about Haiti's future potential based on the factors cited above (proximity to the U.S. market and quality of labor force).

Agro-business and food-processing. Production facilities once existed in Port au Prince for food and fruit processing (products like mango sauce/chutney; frozen fruit puree, canning and plantain chips). Reluctance by domestic entrepreneurs to risk investing in productive enterprises has limited activity in this sector but some experts believe it has potential.

Exports of fruits and non-traditional crops. Mango exports to the U.S. are enjoying a modest but sustained success, based on cooperative efforts between Haitian exporters, local treatment facilities and the U.S. Department of Agriculture Animal Plant Health Inspection Service (APHIS). Entrepreneurs describe other potential exports. One exporter raised Chinese vegetables for air shipment to the New York market in the late 1990s. Although the business was profitable, he ceased operations because political instability made it impossible to assure transportation of the crop to the Port au Prince airport over bad roads. Agricultural economists working for bilateral donors are looking at economic prospects for niche export crops like shade-grown coffee.

Arts and handicraft products. Haitian handicrafts are exported within the Caribbean region and to the U.S. on a relatively small-scale basis. There is room for growth in this sub-sector. Small-scale Haitian producers need access to working capital and well-developed marketing networks. There is an existing export sector for Haitian art and handicraft products but it does not operate on a large scale. Products include traditional metal work, paintings, wood carving, stone sculpture, embroidered textiles and modern copies of ritual items like voodoo flags.

Services. There is potentially significant demand within Haiti for a range of service businesses. A crop of fledging entrepreneurs in the field of information technology is starting to offer an array of new, small-scale ventures including cyber cafes and Internet service providers. The future for service-oriented businesses will depend in part on prospects for economic growth in Haiti over the medium term.

Factors Influencing Domestic Investors

Domestic investors recognize the opportunities in their own country and many are interested in expanding their own investments. The primary constraint at this time is continuing concern about political stability and lack of information about the future direction of government economic policy. There are well-established firms that made investments over the past few years, although it was considered risky by the Haitian private sector at the time. Some express regrets; others are prepared to ride out the transitional stage of establishing a new government. Most domestic investors are waiting for greater political stability before they embark on major new projects. There are a few notable exceptions. Domestic banks are investing in new branches in the provinces, primarily to capture potential deposits in the under-banked hinterlands.

Another important constraint to domestic investment in Haiti is lack of financing. While domestic firms have ideas and plans for investment, they cannot raise the required capital in Haiti. Intermediation through the banking system is poor, and Haiti's capital market is not highly developed. Another disincentive is the high level of domestic interest rates (30% and over), a reflection of macroeconomic disequilibrium and the crowding out of private investment by the public sector. Many domestic firms are highly leveraged. While it is difficult to generalize, a significant number of firms are signaling an interest in working with foreign investors to benefit from their capital, technical expertise and modern management techniques.

Policy and Political Will

Overcoming perceptions of risk and political instability will not be a short-term process for the Haitian authorities. Actions will speak louder than words, as investors assess developments on the ground. It is also crucial to express political commitment at the highest levels to improve the environment for investment and entrepreneurial activity.

There is broad agreement among experts and within Haiti's private sector on what needs to be done. The recognized list of actions includes, inter alia:

- *Restore macroeconomic stability*
 - Reduce the fiscal deficit
- *Overhaul management of public finances*
 - Improve central government expenditure management, accountability and transparency
 - Introduce structural measures to increase collection of government revenue
- *Improve the enabling environment for business and investment*
 - Remove bottlenecks and impediments to economic activity
 - Rebuild institutions responsible for enforcing rule of law, sanctity of contracts and respect for property rights
 - Strengthen police capacity to maintain order and enforce laws
 - Reduce government red tape and harassment

- Enforce policies to combat corruption
- Introduce measures to reduce waste, fraud and mismanagement
- *Encourage competition in all sectors of the economy*
 - Restructure or privatize the major state-owned enterprises;
 - Put an end to public and private sector monopolies
- *Develop policies to encourage and support entrepreneurs, business start-ups*
 - Encourage job-creating private initiative
 - Convey political will to build a strong private sector

There is less unanimity on the short list of urgent priorities. Given the urgent challenges of the Haitian situation, it is difficult to know where to start. The private sector can and should play a substantial role in advising the government through a consistent and enduring policy dialogue intended to provide specific policy recommendations.

Seeking foreign investors. A new government was inaugurated on February 7, 2001. President Jean-Bertrand Aristide, Prime Minister Jean-Marie Charestal and members of their government are signaling interest in attracting FDI to Haiti. President Aristide's inaugural address outlined an ambitious set of goals and promises. The new government recognizes the need for private capital flows to reinvigorate Haiti's economy and implement the new President's stated goals. The renewed emphasis on attracting FDI is driven in part by the low level of multilateral and bilateral assistance inflows, a situation largely attributable to political factors. The resumption of foreign assistance is likely to depend upon progress toward achieving a sustainable accord to address the current political impasse and a greater degree of reconciliation among the current political protagonists and civil society. There is a growing awareness that foreign assistance, when it does resume, may not be adequate to address the complex and extensive requirements of Haiti's economic crisis.

Draft investment code. Under the previous government led by President Rene Preval and Prime Ministry Jacques Alexis, a new draft investment code was prepared with private sector advice and input. It is expected to replace a patchwork of older, antiquated laws and regulations. Haiti's commercial code and bankruptcy law each date to 1826 and have not been revised since 1944. The new draft investment code is considered by the Haitian private sector to be liberal. While the draft code is now under consideration by Haiti's Parliament, it may be amended before it becomes law. In its current form, key features include:

- Non-discrimination and national treatment provisions (scope and details of the commitments require clarification)
- Repatriation of profits
- Guarantee of property rights
- Protection against expropriation
 - Unless required for public use
 - Accompanied by payment of fair compensation determined by experts
- Protection of intellectual property
- Investment incentives for priority sectors, to include
 - 5 to 10 year tax holidays
 - Exemption or reduced rates for customs and income tax
- Sectors eligible for incentives include:
 - Enterprises exporting all production
 - Agriculture
 - Handicrafts and hand-made products
 - Industrial production
 - Tourism
 - "Special regimes" (not specified but described as enterprises with strategic importance or high priority in the national socio-economic development plan)

A new investment code does not automatically provide solutions to Haiti's investment climate problems. It is not a magic formula. A new code, when passed by the Haitian Parliament, will not draw investors to Haiti by itself. Enacting new laws is a fairly straightforward procedure. Enforcing them credibly is another matter. It is not clear that investment incentives are the main factor of interest for prospective investors, who may be more concerned about basic infrastructure, security and governance issues.

Other legal and international instruments

Haiti signed the 1966 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID) but has not yet ratified the Convention. Haiti also is a signatory to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitration Awards, which provides for the enforcement of an agreement to arbitrate present and future commercial disputes. Under the convention, courts of a contracting state can enforce such an agreement by referring the parties to arbitration. Haiti is not a signatory to the Inter-American-U.S. Convention on International Commercial Arbitration of 1975 (the Panama Convention).

Weak enforcement mechanisms, inefficient courts and judges' poor knowledge of commercial law dilute the effectiveness of statutory protections available to investors under the laws and regulations currently in force.

Haitian law is deficient in a number of areas, including: operation of the judicial system; organization and operation of the executive branch; publication of laws, regulations and official notices; establishment of companies; land tenure and real property law and procedures; bank and credit operations; insurance and pension regulation; accounting standards; civil status documentation; customs law and administration; and regulation of market concentration and competition.

Although these deficiencies hinder business activities, they are not specifically aimed at foreign firms and appear to have an equally negative effect on both foreign and local enterprises.

Privatization

Privatization in Haiti – often re-labeled as modernization or restructuring – is under consideration again in the context of a new government. The previous government privatized two relatively small state-owned enterprises, a flour mill and a cement plant, retaining an equity stake in each enterprise (about 35%) but relinquishing management control to foreign and domestic investors. Some observers believe the failure of the Preval government to proceed with privatization of the larger public entities (electricity, telecommunications, port, airport, state banks) sent a negative signal to prospective private investors. Donor-financed technical work by consultants in the mid-nineties to prepare the enterprises for privatization is starting to lose its relevance and may have to be updated.

The new government has not yet publicly announced plans to restructure or privatize the important state-owned enterprises. Considerable discussion is taking place behind the scenes. Political considerations, technical issues, financing and social implications are reportedly part of the internal debate.

There are considerable efficiency gains to be realized by opening sectors to competition that are now reserved for public sector monopolies. Restructured or privatized public enterprises are likely to provide an improved quality of service and better management of scarce resources. At the present time, Haiti suffers immeasurable economic losses because the public electricity generation and distribution system is unreliable and deficient. The public port charges the highest fees in the region. The state-owned telecommunications company operates a telephone system that is costly, unreliable and unable to provide new fixed telephone lines. All of the major state-owned enterprises in Haiti employ excessive numbers of workers and do not produce transparent financial accounts demonstrating how they have used public resources.

Policy alternatives: A new way of looking at Haiti

It's the private sector. The private sector in Haiti points to the need for public policy that improves the environment for business and entrepreneurial activity. To create the basis for sustainable growth, a stronger and healthier private sector will be essential. The government lacks the financial and managerial resources to embark upon extensive public investment programs. Even when foreign assistance inflows resume at some future date, the needs are far too great to be met by government investment and public sector programs. Public works projects provide only temporary employment, often at high cost. Sustainable job creation will be driven by the private sector. Small and medium enterprises will provide most of the jobs. FDI and domestic formal sector investment will play an important complementary role. There is potential for job creation in the industrial sector if political risk and financial constraints can be eased. However, the modern externally-oriented economy cannot address all of Haiti's employment needs.

Helping small and medium enterprises. The vast majority of Haitians earn a living through participation in small or medium enterprises in the informal sector. An important priority in Haiti is the implementation of policies designed to strengthen SMEs. Most experts recognize the inherent productivity of the informal sector in Haiti. A variety of policy tools are required:

- Programs to help identify markets, build capacity through teaching basic business and technical skills;
- Outreach to women business owners;
- Provision of credit on appropriate terms;
- Media outreach efforts to encourage entrepreneurialism.

Radio is the most effective medium in Haiti to reach urban and rural populations. Radio shows or spots encouraging entrepreneurs or identifying best practices and success stories are among the ideas under discussion. A small investment in outreach programs could make a significant difference.

Micro-credit programs in Haiti, a fairly recent innovation, look promising. While the programs reach only a fraction of Haitian citizens, they represent a new form of financing for a population that exists largely outside the formal credit market. Several mechanisms are used: lending through cooperatives or local groups or through specialized programs launched via commercial banks. Establishing the new micro-credit programs required a new way of thinking to overcome traditional cultural divides. Special training was needed for bank staff unaccustomed to dealing with SME operators who speak only Haitian kreyol (not French) or who may not be literate.

Private sector-government dialogue. A fragmented private sector needs to unify, overcome political and historical differences and establish an institutionalized mechanism to channel economic policy recommendations to the authorities. The private sector perceives itself as weak and lacking in political leverage. Moreover, the government cannot solve Haiti's economic problems independently. The private sector is the repository of considerable expertise. Its business associations and leaders have done a great deal of thinking about the economic crisis and options for addressing known bottlenecks in the economy. A concerted effort to crystallize the collective wisdom into a tailored set of priority policy recommendations would be a constructive start to a renewed dialogue with a new government.

Re-energizing the Haitian Diaspora. The so-called "Tenth Department" is a valuable resource for the country's future. Haitians who reside in other countries represent an under-utilized asset. Many, though not all, are professionals and successful business operators. Quite a few are active in religious, social and development projects designed to improve life in their hometowns or provinces. The Diaspora represents a potential pool of investors who are knowledgeable about the country's unique environment. They also have the advantages of family connections, language ability and cultural ties to Haiti. In recognition of this reality, the new government is reaching out to prospective investors in the North American Diaspora.

Corporate responsibility. In Haiti's assembly sector, multinational and large companies in the U.S., as buyers of the output, are requiring that Haitian suppliers meet the conditions spelled out in their internal company codes of conduct for worker health and safety in the plants (lighting, emergency exits, standards for cleaning, etc). Not all assembly plants are shipping to companies that require suppliers and contractors to adhere to such standards but it is a new and growing phenomenon.

Regional involvement. Haiti could derive considerable benefit from strengthening its ties to regional organizations including Caricom, Caribbean Financial Action Task Force (CFATF) and the Organization of American States. Working with regional organizations would enable Haiti to take advantage of linkages and learn from the experiences of neighbors with respect to policy formulation, capacity building and, eventually, investment promotion. Modest technical assistance may also be available for selected policy issues. Right across the border in the Dominican Republic is an excellent example of what can be done to establish a positive enabling environment for economic activity and investment. There are encouraging initial signs of new cross-border cooperation, both at the government and private sector level. Entrepreneurs in both Haiti and the Dominican Republic are expressing interest in developing joint venture manufacturing in future free zones located in the border region.