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The Haitian Economy and the HOPE Act

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Summary

In December 2006, the 109th Congress passed the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2006 (HOPE I), which included special trade rules that give preferential access to U.S. imports of Haitian apparel. These rules were intended to promote investment in the apparel industry as one element of a broader economic growth and development plan. HOPE I allowed for the duty-free treatment of select apparel imports from Haiti made from less expensive third-country inputs (e.g., non-regional yarns, fabrics, and components), provided Haiti met rules of origin and eligibility criteria that required making progress on worker rights, poverty reduction, and anti-corruption measures. Early assessments of the effectiveness of HOPE I, however, were disappointing. The 110th Congress responded by amending HOPE I in the Hemispheric Opportunity through Partnership Encouragement Act of 2008 (HOPE II). HOPE II extends the preferences for 10 years, expands coverage of duty-free treatment to more apparel products, particularly knit articles, and simplifies the rules, making them easier to use. Early evidence suggests that apparel production and exports are responding to these changes.

HOPE II also amended the eligibility requirements by requiring Haiti to create a new independent Labor Ombudsman's Office and establish the Technical Assistance Improvement and Compliance Needs Assessment and Remediation (TAICNAR) Program. The TAICNAR program provides for the United Nations International Labor Organization (ILO) to operate a firm-level inspection and monitoring program to help Haitian apparel factories comply with meeting core labor standards, Haitian labor laws, and occupational health and safety rules. It would apply to those firms that agree to register for the program as a prerequisite for utilizing the tariff preferences. The TAICNAR program is also designed to help Haiti develop its own capacity to monitor compliance of apparel producers in meeting core labor standards.

The earthquake that rocked Haiti on January 12, 2010, caused considerable damage to the apparel sector, although much has been done to get capacity back to at least 80% of pre-earthquake levels. Early estimates of rebuilding costs for the industry begin at $25 million to refurbish damaged buildings, replace machinery, and train new employees. The apparel world moves quickly, and the greatest fear is that U.S. buyers will abandon Haiti for other production sites just as the apparel industry was making strides in redevelopment. Although buyers are reportedly willing to stay with Haiti factories, the sentiment could shift quickly if production is unable to return to levels adequate to meet orders. The U.S. Congress could respond by amending the tariff preferences and rules of origin in HOPE II to provide additional incentives for investors to operate in Haiti. First, the 55% value-added rule could be lowered, presumably allowing more firms to take advantage of the preference. Second, there is a capped (70 million square meter equivalents—SMEs) provision for both knit and woven articles that allows duty-free treatment for apparel made from third-country inputs with no value-added requirement. The rule is attractive for many apparel producers of varying size and capabilities in Haiti and the caps could be increased, exclusions reduced, or either eliminated. Third, Congress could reduce the 3-for-1 earned import allowance rule to a 2-for-1 or 1-for-1 rule. Other options might include a more comprehensive extension of tariff preferences to other manufactured goods or a broader elimination of tariffs across the board. The tradeoff would be the possible reduction in the use of U.S.-made yarns and fabrics in Haiti apparel production. Although Haiti is not a large producer by worldwide standards, U.S. firms may wish to minimize any possible negative effects on their industry.

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Haiti's economic, political, and social development has been on a slow track since the transition from dictatorship to democracy began in the mid-1980s. The devastating earthquake of January 12, 2010 was a major setback to what little progress had already been made. Haiti struggled with providing basic needs even prior to the catastrophe, but currently is without the physical, political, and economic infrastructure to provide adequately for its citizens. As the massive humanitarian relief effort continues, planning for Haiti's economic reconstruction and development is also underway.[1] The transition from disaster relief to a national redevelopment strategy is essential, and by all accounts, must be comprehensive, directed at all sectors of the economy, and guided by the Haitian government in cooperation with the United Nations and other international assistance organizations.

The U.S. Congress has long taken a comprehensive view of aid to Haiti, annually appropriating funds in support of security, humanitarian relief, and development assistance. Yet, the Haitian economy even before the earthquake had experienced extremely slow growth in output, employment, and productivity. One important step that reflects the nexus of congressional interest and Haitian need is the HOPE Act. In December 2006, the 109th Congress passed the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2006 (HOPE I)[2] to assist Haiti with expanding its apparel trade as a way to help stimulate economic growth and employment. The Act included special rules for the duty-free treatment of select apparel imports from Haiti, particularly those made from less expensive third-country inputs, provided Haiti met rules of origin and eligibility criteria that require making progress on worker rights, poverty reduction, and anti-corruption measures.

Early assessments of the effectiveness of HOPE I, however, were disappointing and the 110th Congress responded in 2008 by amending it with HOPE II.[3] HOPE II extends the preferences for 10 years, expands coverage of duty-free treatment to more apparel products, and simplifies the rules of origin to make them easier to use. In providing preferential access to Haitian apparel imports irrespective of the source of materials used, the HOPE Act gives Haitian firms a competitive advantage in the U.S. market, which is intended to attract long-term foreign investment to Haiti's primary export industry. The act also provides a new requirement to ensure that participating apparel firms comply with internationally recognized core labor standards. In the aftermath of the earthquake, congressional interest has surfaced in amending the HOPE Act again to increase incentives for investors. This report discusses the HOPE Act as it relates to U.S. trade policy, the Haitian economy, and post-earthquake reconstruction efforts.

Political and Social Challenges to Haitian Development

Any discussion of Haiti's current social and political situation is now clouded by the massive destruction caused by the January 2010 earthquake. By all accounts Haiti is unable to provide basic services without large amounts of international aid. President Préval continues to govern, meeting with his cabinet ministers and helping to coordinate international relief efforts. But even

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[1] For details and updates on relief efforts, see CRS Report R41023, *Haiti Earthquake: Crisis and Response*, by Rhoda Margesson and Maureen Taft-Morales

[2] Title V of the Tax Relief and Health Care Act of 2006 (H.R. 6111/P.L. 109-432).

[3] Title XV of the Food, Conservation, and Energy Act of 2008 (H.R. 6124/P.L. 110-246)—the "Farm Bill."

as Haiti begins the process of emerging from the immediate catastrophe, it still faces social and political problems deeply rooted in its historical development patterns.

Figure 1. Map of Haiti

Source: Map Resources. Adapted by CRS.

Haiti occupies the western third of Hispanola, a Caribbean island it shares with the Dominican Republic (see **Figure 1**). Haiti has endured a long post-colonial history of poverty, political repression, and underdevelopment, a trend that continues to challenge the sustainability of Haiti's fragile political stability. Since the end of the Duvalier dictatorship in 1986, Haiti has struggled to institutionalize democracy, and so far has been unable to overcome a legacy of weak governance, economic inequality, and social unrest. The presidency has alternated largely between Jean-Bertrand Aristide and René Préval, both of whom struggled to establish a broadly accepted government, in part for the lack of progress in changing the legacy of inequality in Haitian society. President Préval's second administration, begun in 2006, initially sparked a ray of hope among the masses, but his government has since been marred by decisions that have weakened his support and raised doubts about fledgling institutional democracy. The earthquake has worsened an already difficult political situation.[4]

[4] For an analysis of Haiti's authoritarian tradition and obstacles to democratization, see Fatton, Robert Jr. *Haiti's Predatory Republic: The Unending Transition to Democracy*. Boulder: Lynne Reinier Publishers. 2002.

The post-dictatorial political system is new, fragile, and in many ways, susceptible to criticism that it has failed to establish a fully functioning government. After three years into his second non-consecutive term, Préval's leadership, vision, and strategy to address long-standing poverty and unemployment have come under question. The transitory terms of his prime ministers, along with delays in both holding Senate elections, and in initiating widely supported constitutional reform (particularly to amend a repetitive, expensive, and so far unworkable electoral system) have compromised the government's legitimacy. The multiparty system, rather than consolidating politics, may be slipping further into factional partisanship, leading to low voter turnout, evidence for some of the failure to promote a "political culture of participation."[5] Multiple observers note that the government bureaucracy suffers from a historic endemic corruption, acting to enrich itself while failing to delivery basic services to the Haitian people.[6]

Political tensions emerged once again during the Senate runoff elections that took place on June 21, 2009. The dominant party of President Préval gained 5 of the 11 seats, but the numbers mask a broader discontent within Haitian society. Turnout was exceedingly poor, estimated at 10% or less of registered voters, and scattered violence marred any overall sense of a society exercising its democratic privileges, not to mention the cancellation of voting in one province. The elections took place amid serious protests by medical students after classes failed to resume, and by society as a whole over an emotional debate on raising the minimum wage, which congress eventually passed and President Préval signed into law. Some constituents have questioned Préval's commitment to the populist platform that helped bring him to power as he pursues a pragmatic middle path to governance.[7] In the wake of the current disaster, Préval's leadership will be fully tested, even if electoral politics are temporarily suspended.

Haiti's uneven social structure lies at the heart of its state of recurring crisis. Haitian society has small middle and working classes, and is dominated by the chasm between a tiny minority of wealthy elite and the impoverished masses, the latter of which have little power or participation in governing. Politics since the transition to democracy in 1986 has not altered this precarious relationship. The highly skewed distribution of power and resources, and the underlying fear it generates, have made the transition to democracy difficult. Haiti's political future appears tenuous as long as entrenched economic and social patterns remain unchanged.[8]

Research on the sustainability of young democracies suggests that Haiti occupies the category of highly vulnerable countries. Initial conditions that correlate with a reversal of democracy include poor economic performance overall, low per capita income, highly skewed income and asset distribution, and weak political institutions that have difficulty enforcing checks and balances on executive power.[9] The Préval government is already feeling the pressures that poor economic performance places on governments, compounded by the effects of the earthquake. Strong support from the international community will need to be effective in alleviating suffering and providing hope to help rebuild political as well as economic momentum.

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[5] Perito, Robert M. *Haiti: Hope for the Future*. United States Institute of Peace. Special Report 188. June 2007. p. 6.

[6] Fatton, *Haiti's Predatory Republic*, pp. 10, 14 and 112-17; Transparency International. *Corruption Perceptions Index, 2008* (Haiti ranked 177 out of 180) and; U.S. Department of State. *Haiti: Country Report on Human Rights Practices, 2007*. March 2008. pp. 1 and 8.

[7] Jonathan M. Katz, "Many Haitians Say Away from Polls, Senate Seats Contested in Runoff Elections," *South Florida Sun-Sentinel*, June 22, 2009, p. 10A.

[8] Fatton, *Haiti's Predatory Republic*, pp. 197-205 and Perito, *Haiti: Hope for the Future*, pp. 2-7.

[9] Ethan B. Kapstein and Nathan Converse, "Why Democracies Fail," *Journal of Democracy*, vol. 19, no. 4 (October 2008), pp. 57-68.

Prior to the earthquake, security was reportedly improving, although it remained a persistent problem, rooted in the history of violence stemming from political and economic inequality.[10] It manifested in the often random violence of gangs and paramilitary groups. Security is currently being enforced by the United Nations Stabilization Mission in Haiti (MINUSTAH), but relief efforts also include the addition of U.S. and U.N. troops. Despite some concerns with sovereignty issues, there is no doubt that the current situation requires a strong foreign military presence for the foreseeable future. The ability of MINUSTAH to handle a possible escalation of social upheaval is an important question given the country's desperate situation, although the temporary deployment of U.S. forces has helped maintain stability.

Economic Background

Even prior to the earthquake, economic growth and development was hindered by this often marginally functional political and social landscape. Internally, many doubted that the Haitian government could deliver on changing the day-to-day conditions of a population immersed in poverty. Externally, vast amounts of foreign aid expose the legacy challenge to development in a country devoid of the basic cornerstones of growth. The restoration of growth remains the primary economic goal and is a necessary condition for development. The post-earthquake challenge involves nearly the wholesale reconstruction of an economy. Even if Haiti can emerge from the earthquake's devastation and policies can be designed and resources brought to bear, igniting a sustainable growth trend will not provide the foundation for long-term political and social stability if it cannot begin to address the underlying extreme social inequality.

Macroeconomic Performance and Policy Responses

Haiti's dismal economic growth trend epitomizes its long-term development paralysis. From 1960 to 2000, annual average per capita income actually declined -0.7%, by far the worst performance in the Western Hemisphere. Growth was achieved briefly in the 1970s, led by export-oriented assembly industries, but Haiti experienced a prolonged economic downturn in the 1980s, as did most countries in the region, leading to social and political unrest that ultimately contributed to the overthrow of the Duvalier dictatorship in 1986.

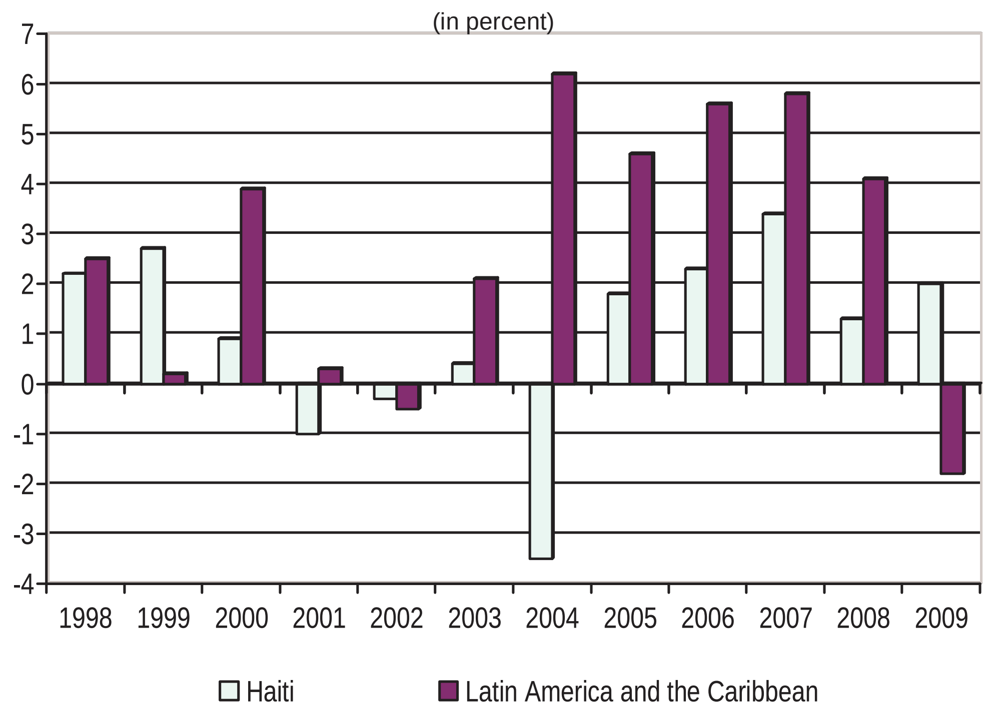
In 1991, following an interim government, Aristide emerged briefly as the first elected president, only to be deposed by a military coup within a few months. To force the return of the democratically elected government, the United States and other countries responded with a trade embargo under the auspices of the Organization of the American States (OAS) and the United Nations (UN). Although its success in changing political behavior has been questioned, its economic effects were concrete and devastating. Haiti was already experiencing a decline in output, employment, and income, but the trend mushroomed during the 1991-1994 embargo. The embargo targeted fuel imports (not food, but supplies were delayed), and all exports. Overall, by 1994, per capita income had fallen by 30% in three years and unemployment peaked at 75%.[11]

[10] United Nations. Security Council Report. *Haiti*. April 2006. Available at http://www.securitycouncil.org.

[11] Gibbons, Elizabeth D. *Sanctions in Haiti: Human Rights and Democracy under Assault*. Westport: Praeger Publishers. 1999. pp. 13 and 18.

Sector effects were highly pronounced. Employment in the assembly manufacturing industry (e.g. apparel, electronics, sporting goods), centered in Port-au-Prince, fell by over 80%, shedding 32,000 jobs. One estimate of the multiplier effect suggests that the embargo eliminated some 200,000 jobs in the formal sector.[12] Most assembly plants closed permanently, with only apparel rebounding slightly in the aftermath of the embargo. The inability to import agricultural inputs such as fertilizers and seeds, or to export agricultural goods had similarly devastating effects on that sector's production. In addition, because oil imports were blocked, there was a sudden increase in the use of charcoal, accelerating the ecologically destructive trends in deforestation and soil erosion, further damaging agricultural production.[13]

Figure 2. Growth in GDP, 1998-2009



Source: United Nations. Economic Commission on Latin America and the Caribbean. *Statistical Yearbook for Latin America and the Caribbean 2009*. January 2010. p. 77.

Trade was renewed in 1995, but economic growth oscillated for the next decade, hampered by recession, flooding, and ongoing political turmoil. In the post-embargo period, annual GDP growth for the decade ending 2006 averaged only 1.1%, lower than Haiti's 1.4% average population growth rate, a recipe for perpetuating chronic unemployment, poverty, and emigration pressures. As seen in **Figure 2**, Haiti's economic growth has generally lagged badly compared to Latin America and the Caribbean (LAC) as a whole, a region that is itself known for its poor long-term growth record. Growth has been positive since 2005, but averaged only slightly more

[12] Ibid., p. 11, citing United Nations data.

[13] Ibid., pp. 10-14 and The World Bank. *Haiti: Options and Opportunities for Inclusive Growth*. Washington, D.C. June 1, 2006. pp. 1-5.

than 2.0% per year.[14] There are many domestic and international issues facing Haiti, but sustainability of its long-term growth is at the core of its development challenge (see data in **Appendix**).

Haiti is the poorest country in the region. Over 70% of the population lives on less than $2 per day. Inequality is extreme; Haiti has the most highly skewed income patterns in the Americas, with nearly half of the nation's earnings going to the top 10% of the income distribution, while the bottom 10% earns less than 1% of national income.[15] Inflation has made matters worse, causing real wages to fall by half from 2000 to 2008, despite a major adjustment in 2003 (see data in **Appendix**). The 2009 global recession although painful, arrested inflation, causing real interest rates to fall along with food and energy prices.

The 2009 debate over increasing the minimum wage produced protests and political conflagration, an outrage that attests to the importance that the Haitian people place on the need for policy responses to address persistent poverty. There is little doubt that failure to adjust the minimum wage in line with inflation had deeply eroded the purchasing power of most Haitians. The Haitian Congress proposed to more than double the minimum wage across the board from the equivalent of $1.80 to $5.00 per day. There was disagreement among President Préval's advisors on supporting this level of increase because employers argued that such large cost increases could force worker layoffs and potentially bankrupt some firms, particularly small and medium-sized businesses.[16]

As a compromise, President Préval agreed to a minimum wage of $5.00 per day for workers in all sectors except apparel, who received an adjustment to $3.25, with the law requiring parity within a few years. Apparel manufacturers argued that fully trained and efficient apparel sewers already earned in excess of the new minimum wage in any case. Their real marginal cost of the raise was associated with increased expenses for training, vacation, and other paid absences. Shortly after the wage increase took effect, there were reported employment responses. Two prominent employment sectors, retail gasoline and private security, both reported employment decreases as adjustments to high wage costs. Gasoline stations, for example, reduced or eliminated afternoon-evening shifts, a time when retail sales tended to diminish.[17] Whether this employment trend will continue over the long run is unknown and perhaps irrelevant in the short run given current conditions.

To address the need for a strategic industrial development plan, President Préval established a Presidential Commission on Competitiveness in 2009. Its primary goal was to enact a development strategy based on improving productivity, diversifying the economy, and creating new employment opportunities in the short term. This ambitious plan envisioned the creation of 500,000 jobs within three years by targeting key industries in agriculture, services, and manufacturing sectors that could be started up or expanded relatively quickly. Specifically, the plan calls for investment in five "growth clusters" (fruits and tubers, animal husbandry, tourism,

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[14] United Nations Economic Commission on Latin America and the Caribbean. *Statistical Yearbook for Latin America and the Caribbean, 2009.* Santiago, January 2010. p. 77.

[15] This is one measure of poverty. Compare with neighboring Dominican Republic with 16% of the population living on less than $2 per day. World Bank. *World Development Indicators 2009*, pp. 67 and 72.

[16] Mo Wang, *Haiti's Minimum Wage Battle*, Council on Hemispheric Affairs, August 19, 2009 and author's interviews in Port-au-Prince, November 5-11, 2009.

[17] Author's interviews in Port-au-Prince, November 5-11, 2009.

garment production, and business process outsourcing), with additional resources committed to "support sectors" such as infrastructure, finance, information technology, education, and enhanced business climate.[18]

While the plan is bold, history suggests it will not be easy to achieve. It does, nonetheless, reflect a serious effort to present a comprehensive analytical approach that covers both short-term and long-term development goals. Success in the short term is critical if any progress is to be made in reducing poverty and the concomitant penchant for social unrest. It will be an important plan to monitor, not only as a gauge of Haiti's economic success, but because it will likely raise expectations that problems can begin to be addressed in the near future, which may entail a higher degree of political risk. Most importantly, it may provide the basis for Haiti's emergence from the economic catastrophe it currently faces, including an assessment of the Haitian government's role in planning and bringing about redevelopment.

Despite these plans, Haiti's growth trend has suffered from the global downturn, which reduced remittances, exports, and public revenue, presenting a risk to Haiti's economic recovery program. Projections of average annual rates of growth are only between 1% and 2%. To consolidate what little gains have been made in reinvigorating growth, Haiti will have to address a core area of domestic policy, the lack of productivity growth.

Persistently low or negative productivity is the result of negligible investment in private enterprise, as well as human and social capital such as education, health care, and infrastructure. It is pronounced in the agricultural sector, where primitive methods and ancient equipment perpetuate low yields, lack of growth in cultivated land, and inadequate food supplies, much of this because of the sector's "decapitalization" during the 1991-1994 trade embargo. Investment in manufacturing has also been sparse, jeopardizing prospects for longer-term growth.[19] Improvements in public administration, especially those that might address widely perceived problems of crime, corruption, and bureaucratic efficiency, along with private sector gains, could provide the basis for progress under the Préval development plan.[20] A critical reconstruction question for both the public and private sectors is whether to rebuild as quickly as possible to meet immediate needs, or invest the additional time and money to rebuild at higher standards.

Sector Issues

Slow growth is also an obvious constraint at the sector level. Agricultural production represents 30% of GDP and employs up to 70% of the work force, mostly dedicated to subsistence farming. Output has stagnated for decades and declined for five years in a row until expanding by 3.0% in 2007. Agricultural growth is limited by the small amount of arable land, overuse of soil, and poor irrigation. It is also constrained by poor rural infrastructure, destructive agricultural practices, and frequent hurricanes and other natural disasters. Rice, sugar, and coffee are produced at a fraction of levels achieved decades earlier. Haiti currently produces little of these traditional exports and output of staples has long been insufficient to meet domestic food needs. Haiti, therefore, must

[18] Presidential Commission on Competitiveness—Groupe de Travail sur la Competitivite (GC), *Shared Vision for an Inclusive and Prosperous Haiti*, Draft Report, Port-au-Prince, July 2009, pp. 33-46.

[19] See United Nations. Economic Commission on Latin America and the Caribbean. *Economic Survey of Latin America and the Caribbean, 2006-2007*. Santiago, July 2007. pp. 256-259; Global Insight. *Haiti*. May 29, 2007; The World Bank, *Haiti: Options and Opportunities for Inclusive Growth*, pp. 5-6; and Gibbons, *Sanctions in Haiti*, pp. 15-16.

[20] Presidential Commission on Competitiveness , *Shared Vision for an Inclusive and Prosperous Haiti*, pp. 18 and 22.

import large amounts of food stuffs. Rising international prices of basic foods exposed Haiti's vulnerability to price shocks and its limited ability to feed itself, as seen in the food riots that occurred in April 2008.[21] The subsequent collapse in commodity prices, although a problem for much of the region, helped alleviate some of Haiti's import bill, at least in the short run.

Manufacturing constitutes only 7.6% of GDP and has shown no growth over the past decade until recently. It, nonetheless, is the major foreign exchange earner and holds out some promise for employment growth. Manufacturing is dominated by food processing (47.2%) and apparel assembly (21.1%). Construction and public works account for another 7.7% of GDP and grew by 6.3% over the last two years. These trends reflect recent, new public sector investment and provide one option for employment growth of low-skilled workers. The services sector constitutes 51% of GDP and is led by restaurant and hotel industries, which together account for 27% of GDP. It grew by nearly 6% in 2007. Tourism is not a major factor, but core ingredients of a tourist industry are present in Haiti, should confidence return in Haiti's ability to maintain political and economic stability.[22]

Foreign Trade and Investment

Haiti has a historically unhealthy dependence on foreign commerce and finance, from the colonial days of the sugar trade to the current assistance provided by developed countries. Total trade (exports plus imports) equals 60% of GDP, but the trade imbalance is large with a deficit equal to 33% of GDP. Haiti is in a difficult position because slow growth in output and exports means that it must rely on foreign sources for basic commodities such as food and oil, as well as manufactured and capital goods. The problem is often made worse by deteriorating terms of trade, when prices of oil and other commodity imports rise relative to prices of Haiti's exports.

Haiti's trade relationship with the world is dominated by the United States, with which it ran a $494 million deficit in 2008. Haiti exports primarily apparel, which accounts for 75%-80% of foreign exchange earnings and for 92% of total exports to the United States. Cacao, mangoes, and coffee compose the small basket (4%) of agricultural exports.[23] In 2008, the United States accounted for 78.2% of Haiti's exports followed in order of magnitude by the European Union (7.4%), Thailand (3.6%), and Canada (3.3%)—see **Figure 3**. The United States also accounted for 53.5% of Haiti's imports followed by Latin America (11.6%), the European Union (8.8%), and China (7.1%).

A return to economic growth is critical to finance the trade deficit in the long run. In the near term, however, there is no alternative to relying on foreign sources of income, principally remittances, foreign aid, and grants. Transfers finance Haiti's fiscal and current account deficits, but they are a poor substitute for production and export-driven financing. They promote long-term dependency and create technical problems, such as exchange rate appreciation that exacerbates Haiti's structural trade deficit, with no concomitant growth in productivity or output that is typically associated with an export-driven exchange rate appreciation. These transfers, so necessary for Haiti's short-term survival, are dependent on the fortunes of expatriate citizens and

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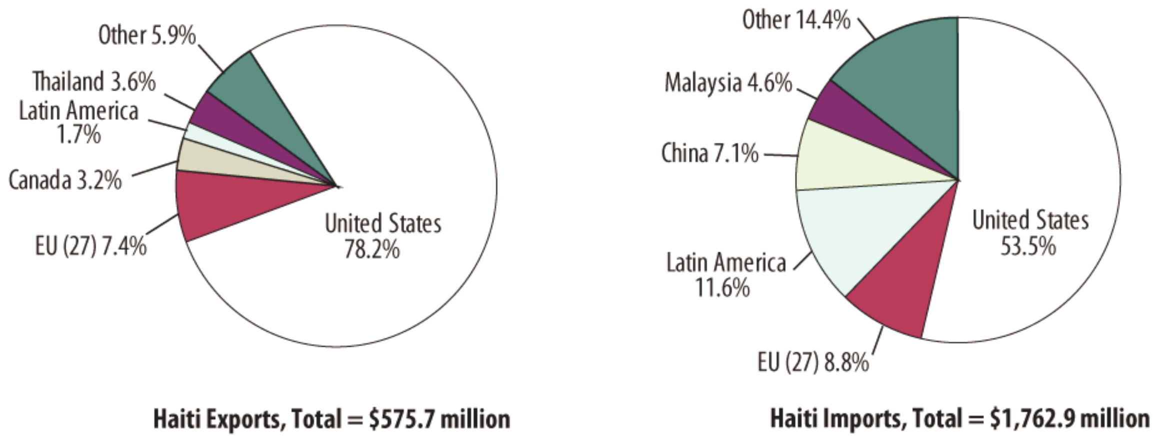
[21] République d'Haiti. Minitere de l'Economie et des Finances. Institut Haitien de Statistique et d'Informatique. *Les Comptes Economiques en 2007* and Banque de la République D'Haiti. *Produit Interieur Brut Par Secteur*; ECLAC, *Statistical Yearbook for Latin America and the Caribbean 2007.* IHS Global Insight, *Haiti*, February 23, 2009.

[22] Ibid.

[23] U.S. Department of Commerce data reported in the World Trade Atlas.

the generosity of foreign governments, diminishing Haiti's control over the future of its economic well-being.[24]

Figure 3. Haiti Direction of Trade, 2008



Data Source: Global Trade Atlas.

Haiti has a poorly diversified export sector, overly dependent on one type of product and a single foreign market, a strategy that has so far shown little lasting positive effect on long-term development.[25] The risk to this export structure became increasingly clear with the U.S. economic downturn, which reduced demand for Haitian goods (falling 7.5% year-over-year). As the Commission on Competitiveness notes, reliance on U.S. trade preferences for apparel exports represents a long-term opportunity, but only if the sector can be expanded into greater value-added activities and other sectors of the economy begin to contribute more to growth in output and exports.[26]

Haiti's trade dependence is most pronounced on the import side. Haiti imports manufactured goods, machinery, transportation equipment, raw materials, energy, and food. It is unable to produce most of these needs and will be a large net importer for the indefinite future. Haiti's vulnerability became acute over the last decade with the rise in food and energy prices, which has had a huge budgetary effect. From 2002 to 2007, the value of food and energy imports rose 57% and 159% respectively, even as volume declined slightly. In 2008, petroleum accounted for 25%-30% of total imports. This trend points to two fundamental problems. First, higher commodity prices make food and energy imports more expensive, decreasing Haitian purchasing power. Second, to compensate, there is a compounding substitution effect, in which other goods must be given up to spend more on food and energy. This effect may be seen in the decline of imports of manufactured goods, which fell by 37% from 2002 to 2007.[27]

[24] This point is made by the IMF, which speaks to the need for Haiti eventually to return to a more normal pattern of investment and export-led growth rather than rely on international donors indefinitely. International Monetary Fund. *Haiti: Selected Issues and Statistical Appendix*. IMF Country Report No. 07/292. August 2007. p. 17.

[25] Dupuy, Alex. Globalization, the World Bank, and the Haitian Economy. In: Knight, Franklin W. And Teresita Martínez-Vergne, eds. *Contemporary Caribbean Cultures and Societies in a Global Context*. Chapel Hill: University of North Carolina Press. 2005. pp. 51-52.

[26] Presidential Commission on Competitiveness, *Shared Vision for an Inclusive and Prosperous Haiti*, pp. 44.

[27] Ibid., *Importations d' Haiti*, February 2008.

Foreign direct investment (FDI) in Haiti has been historically very low. Net FDI inflows ranged from $4 million in 2000 to $14 million in 2004, and then spiked to $160 million in 2006, before falling to $30 million in 2008. The large increase appears to be related to an investment boost in construction and tourist industries, which seems to be limited in duration. Construction activity in the public and private sector has expanded briskly, but FDI inflows were not expected to continue at this recent higher level.[28] One approach to attracting FDI to Haiti rests on reinvigorating the apparel industry, a strategy that the U.S. Congress supports with the HOPE Act.

Apparel Production in Haiti

Although agriculture is the single most important sector of the Haitian economy for both jobs and output, apparel assembly is the core export industry and one promising source of employment growth in the formal sector. Apparel production is a globally competitive industry that often relies on a multi-country chain of production. Fiber, yarn, and fabric production is capital intensive and provides the opportunity for the greatest value added. Garment assembly, by contrast, is highly labor intensive, offering thinner profit margins. Assembly factories are far less expensive to build than textile mills and location of production is often a secondary consideration to levels of vertical integration and global networks, use of technology, ability to demonstrate socially responsible production, and overall cost containment. The attraction of apparel assembly is the relatively low levels of investment and skills required to operate this entry-level segment of the industry. In theory, it not only provides opportunity for quick job growth, but also for advancement into the higher value-added work as investment, experience, contacts, and labor skills progress.[29]

Haiti is a prime candidate for redeveloping the apparel exporting industry because assembly requires an abundance of low-skill labor, but relies on relatively simple technology and small capital investment. Therefore, production naturally gravitates toward locations with low labor costs. Although Haiti's labor costs are not as low as those in some Asian countries, they are the lowest in the region, allowing Haiti to niche into apparel assembly. As shall be discussed, at the margin, U.S. trade preferences and relatively relaxed rules of origin can provide a critical benefit.[30]

The fortunes of the apparel sector to date, however, have paralleled the broader trends of the economy, which have been subject to tremendous social and political turbulence. Historically, the apparel heyday in Haiti lasted from the 1960s through the end of the Duvalier dictatorship in 1986. The troubled transition to democracy, including the 1991 military coup and trade embargo that followed, caused a massive downturn in production for years. Since 1994, the Haiti apparel industry has entered into a slow and tentative period of rebuilding.

At its peak in the 1980s, Haitian apparel industry sources estimate that the number of jobs ranged upward of 100,000. The 1991-1994 trade embargo effectively closed apparel operations, causing

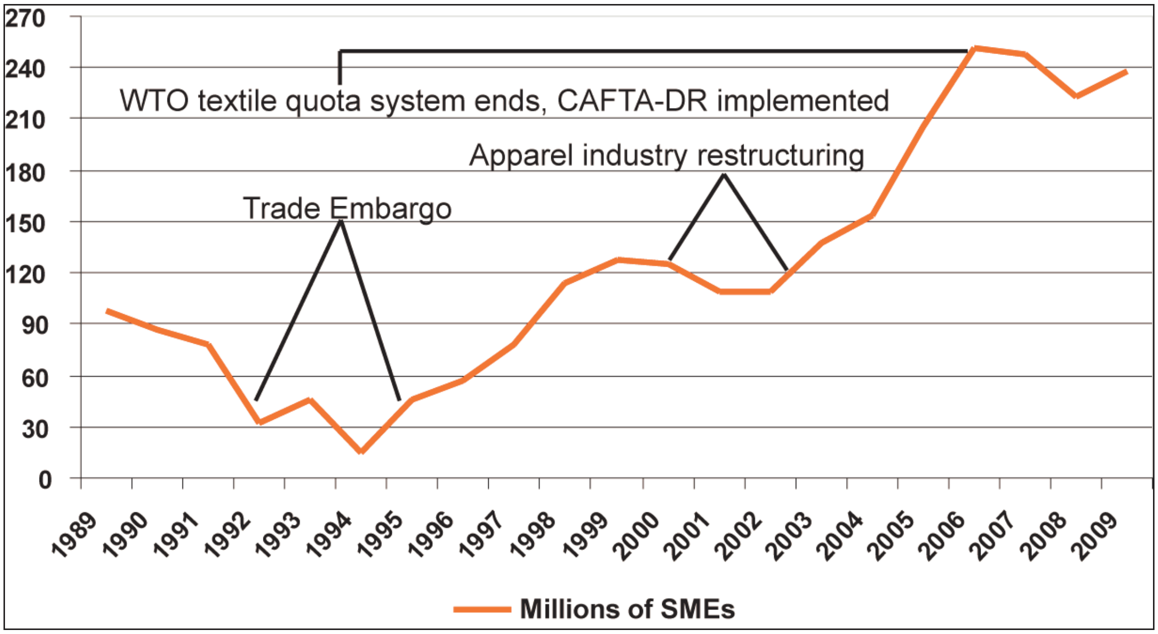
[28] Ibid., Résumé de la Balance des Paiements d'Haiti, February 2008 and Economic Commission on Latin America and the Caribbean, *Economic Survey of Latin America and the Caribbean, 2006-2007,* p. 259.

[29] CARANA Corporation, *Garment Manufacturing in Haiti: An Economic Analysis of the Cost Structure and Recommendations for the Way Forward*, Prepared for CHF International Haiti, June 14, 2009, pp. 5-7.

[30] Paul Brenton and Mombert Hoppe, *Clothing and Export Diversification: Still a Route to Growth for Low-Income Countries?*, The World Bank, Policy Research Working Paper 4343, Washington, D.C., September 2007, pp. 2-10.

employment to fall to near zero for a short time, as many apparel manufacturers apparently left Haiti for Honduras and other sites in the region. In its rebuilding, Haitian apparel firms estimate that employment has doubled to between 25,000 and 30,000 since the original HOPE legislation was passed in 2006.[31]

Figure 4. U.S. Imports of Haitian Apparel, 1989-2009



Source: U.S. Department of Commerce. International Trade Administration. Office of Textiles and Apparel. http://otexa.ita.doc.gov/

Firm-level apparel output data are not readily available, but because over 90% of apparel production is exported to the United States, U.S. import data can serve as a reasonable proxy for production trends. **Figure 4** shows the trend of U.S. imports of Haitian apparel by volume. Note that imports were falling in the tumultuous aftermath of the Duvalier dictatorship, hitting bottom during the 1991-1994 trade embargo. With a temporary return to relative political calm, U.S. imports (again as a reflection of output) rose, but fell again after 2000 as production was lost to competition and continuing political uncertainty kept investors at bay.

Growth renewed after 2002 with industry restructuring. By 2006, a new downturn is noticeable, likely related to two events that occurred at that time: the end of global textile quotas put in place under the World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC), and implementation of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR), which shifted regional U.S. tariff preferences for apparel in favor of Central America.[32] The downturn continued into 2008, likely reflecting the effects of the global financial crisis, but returned to growth in 2009.

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[31] Correspondence with Haitian apparel representatives, February 2010, and prepared statement by Haitian apparel representatives before the USITC and United States International Trade Commission. *Textiles and Apparel Effects of Special Rules for Haiti on Trade Markets and Industries*. Investigation No. TR-5003-1. November 8, 2007. p. 2-1.

[32] Ibid.

Haiti's apparel industry faces many challenges. Domestically, the lack of industrial space, the high cost of capital and utilities, and poor infrastructure top the list. Externally, highly efficient competitors both in the region and in Asia will continue to challenge Haiti's low-cost export strategy. The required use of higher-cost U.S. inputs (e.g., yarns, fabrics, components) for duty-tree entry into the United States has also been a problem, much of it addressed in the HOPE II Act (see "HOPE II"). To improve its competitiveness, the industry underwent major restructuring after 2000. Where it once had been a relatively diversified producer, the industry as a whole adopted a leaner, low-cost business model based on high-volume production that could take advantage of Haiti's low-skill labor pool. Haiti was able to rebuild the industry based on this strategy and can compete at the low end of the U.S. apparel market based on its low wages, quality products, and proximity to the United States, consistent with Haiti's stage of development.

For the most part, Haiti's production is still limited mostly to simple knits and some woven products. The mix is shifting, however, toward greater production of more complicated woven goods (e.g. khaki pants), which rose from 12.6% of apparel exports to the United States in 2007 to 18.6% in 2009. Knits (e.g., t-shirts and sweatshirts) fell from 87.4% of apparel exports to the United States, to 74.4% over the same two years. Haiti's top five apparel products account for 90% of U.S. apparel imports from the country. As may be seen in **Table 1**, for these articles, Haiti's primary competition is Central America, the Dominican Republic, and Southeast Asia (ASEAN),[33] even more so than China, with the exception of articles produced from man-made fibers. Mexico, Bangladesh, and other countries are also important competitors for some items.

Table 1. U.S. Market Share of Haitian Top Five Apparel Exports, 2009

(in percent)

Apparel Article	Haiti	CAFTA-DR[a]	ASEAN	China	Other	World
Knit cotton shirts, mens/boys	5.2	24.1	19.1	14.1	36.9	100.0
Underwear, cotton	4.6	35.3	19.0	10.7	30.4	100.0
Knit shirts, man-made fiber	1.3	32.5	25.4	11.3	29.5	100.0
Trousers, cotton, mens/boys	0.9	6.5	13.3	18.9	60.4[b]	100.0
Other, from man-made fiber	0.1	4.9	17.0	49.5	28.5	100.0

Data Source: U.S. Department of Commerce. OTEXA.

a. The Dominican Republic, Guatemala, Honduras, El Salvador, Nicaragua, and Costa Rica.

b. Mexico and Bangladesh account for 40% of U.S. imports of mens/boys cotton trousers.

Rejuvenating Haiti's apparel assembly industry has been criticized as a growth strategy for its lack of development potential and vulnerability to rapidly changing market conditions. Nonetheless, it has survived as a niche production strategy in a highly competitive industry, even diversifying its product line. Supporters of the sector argue that given Haiti's limited options for rebuilding its economy in the short term, the apparel sector offers one relatively quick response to chronically high unemployment. Apparel assembly has also allowed manufacturing to remain in Haiti that might otherwise have migrated to Asia or Central America, and the industry has recently begun to produce more sophisticated and profitable woven articles.[34] Haiti's apparel

[33] The Association of Southeast Asian Nations: Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei Darussalam, Vietnam, Lao PDR, Myanmar, and Cambodia.

[34] Dupuy, op. cit., pp. 64-65 and prepared statement by Haitian apparel representatives before the USITC and United (continued...)

industry relies entirely on foreign producers for yarns and fabrics. Fabric is sourced primarily from the United States, the Dominican Republic, and Asia, in approximately equal proportions. Apparel factories produce for a wide variety of North American firms including Hanes, Gildan, and Grupo M, a Dominican firm, who contract for many well-know U.S. brand names. Wilbes and other South Korean firms have increased their presence in Haiti, also producing for major band name retailers.

Haitian apparel production is concentrated in Port-au-Prince, where it is located largely in two free trade zones situated near airport and port facilities. In addition, in 2003, Grupo M began a mutually beneficial apparel co-production arrangement in Ouanaminthe, on the northern border with the Dominican Republic (see **Figure 1**, Map of Haiti, p. 2). The plant is located in a relatively new foreign trade zone (Compagnie Development Industriel—CODEVI). Grupo M, the only Dominican company operating a co-production plant, provides management training and guidance, and plans to turn operation of the facility over fully to Haitian managers. It has also worked with the Haitian government in providing the necessary infrastructure investment, including water and electricity, the excess of which is made available to the surrounding community. Selection and training of Haitian workers is rigorous and the jobs are highly coveted.[35] Production was unaffected by the January 2010 earthquake.

Evaluating Haiti's Competitiveness

Haiti has a competitive advantage in apparel based on its relatively low labor costs, proximity to the U.S. market, and a niche strategy based on mass-produced articles. This niche relies largely on simple assembly operations (sewing and some cutting), has few style changes over time, accommodates slightly longer lead times, and has relatively predictable demand schedules. Location of production is often not a critical decision factor for many buyers, but proximity to the U.S. market has proven to be an important benefit for Haiti. There are, however, significant productivity problems, with some firms operating barely at the margin of profitability. A survey of apparel buyers ranked Haiti as "favorable" on price and overall product quality, but pointed to the need to (1) improve training for apparel workers and middle management; (2) overcome a poor image for political stability; (3) develop better infrastructure; and (4) compensate for a lack of production in "apparel infrastructure" such as thread, linings, and fabric.

Haiti compares less favorably on costs of electricity, construction, and overall operation. While rent on industrial space is low, buildings are fully depreciated and given high construction costs and the need to rebuild, future rent costs could rise significantly, cutting into apparel firm profitability. Public investment in transport, utility, and modern customs facilities is also needed to support a more competitive apparel sector. [36]

(...continued)

States International Trade Commission. *Textiles and Apparel Effects of Special Rules for Haiti on Trade Markets and Industries.* Investigation No. TR-5003-1. November 8, 2007. pp. 2-1 thru 2-6.

[35] Discussions with Haitian and Dominican representatives in Ouanaminthe and Santo Domingo, April 20-26, 2008. From a historical perspective, this area has been an important border crossing, but also the site of significant conflict between the two countries. Communities on both sides of the border support the plant for the benefits it provides as the major income generator in the region.

[36] CARANA Corporation, *Garment Manufacturing in Haiti*, pp. 11-14, 41-42 and Nathan Associates Inc., *Bringing HOPE to Haiti's Apparel Industry: Improving Competitiveness Through Value-Chain Analysis*, September 2009, p. 5.

There are some key challenges to Haitian apparel competitiveness. One is producer concerns over losing a major cost advantage because of the large 2009 minimum wage increase. Apparel managers note that even though fully trained workers already earn more than the new minimum wage, raising the minimum wage can reduce the worker production incentives. Second, to remain competitive, firms will need investment to move toward higher value-added "full package" production, an increasingly standard requirement of U.S. buyers. Full package production involves a wide range of skills that include design, sourcing materials, organizing logistics, manufacturing the entire finished product, packaging, and delivering the final good to the retailer. Full packaging requires advanced financial, managerial, sewing, and other operational capabilities not yet widely available in Haiti.[37]

Third, few believe that investors are willing to make large capital commitments necessary to construct fabric mills in Haiti. Many view Haiti as politically and socially unstable and unattractive because of high construction, capital, and utility costs. Still, the key to Haiti's long-term apparel production development is moving up the value-added chain toward full package operations. This process can also be done incrementally, as managerial and worker skills improve allowing for additional work in printing, finishing, washing, and other stages of apparel production. The United States Agency for International Development (USAID) has let a long-term contract to help Haiti apparel producers develop these skills, and includes funding construction training centers to develop the managerial expertise and other skills necessary to move toward full package production.[38]

Effects and Implications of the 2010 Earthquake

The earthquake that rocked Haiti on January 12, 2010 did untold damage to the country, including a significant loss of life and property. The world has responded with an unprecedented humanitarian relief effort. While Haiti grapples with stabilizing a catastrophic situation, the apparel sector is also struggling to regain its previous production capacity as soon as possible. The apparel world moves quickly, and the greatest fear is that U.S. buyers will abandon Haiti for other production sites just as the apparel industry was making strides in redevelopment. Although buyers are reportedly willing to stay with Haiti, the sentiment could shift quickly if production is unable to return to levels adequate to meet the next round of orders.[39]

Haitian industry estimates as of February 2010 indicate that earthquake damage to firms was uneven and not as severe as it might have been. Of the 28 factories operating in 2010, the earthquake completely destroyed one, killing at least 500 people, and seriously damaged four or five others. A number of other factory buildings were damaged to the extent that operations will have to be moved. In general, the industry is working hard to bring production back on line, and among those factories that were not severely damaged, industry representatives suggest that production could return to near full capacity by sometime in March 2010. As of the first week of February 2010, 75%-80% of work force had returned. According to the ILO, as of February 25, 2010, 100% of the factories had returned to production, but not necessarily at full capacity. Many were still in need of cleaning, repair, renovation, and equipment.[40]

[37] CARANA Corporation, ibid, pp. 8 and 16, and Nathan Associates Inc., ibid., pp. 5, 36, and 50.

[38] CARANA Corporation, ibid, pp. 8 and 16, and Nathan Associates Inc., ibid., p. 5.

[39] Correspondence with representatives and consultants to Haiti's apparel firms.

[40] United Nations. International Labor Organization, *Update Better Work Haiti Crisis Response*, February 25, 2010.

Early estimates of rebuilding costs for the industry begin at $25 million to refurbish damaged buildings, replace machinery, and train new employees. Others suggest that to the extent that the Haitian apparel firms elect to rebuild at new and higher standards, which would be in line with the broad strategic vision for the sector's long-term development, perhaps twice as much investment capital would be needed. As noted above, construction costs are high in Haiti because most materials must be imported. A key to successful reconstruction will be the availability of affordable financing. The need for immediate and swift reconstruction raises a host of policy questions regarding the use of international aid for providing affordable financing such as grants, subsidized loans, loan guarantees, or other incentives that would entice private investors to take on the risk of rebuilding in Haiti.[41] One important factor for the U.S. Congress may be to modify the tariff preferences and rules of origin in the HOPE Act, as amended, to support further Haitian exports of apparel goods to the U.S. market.

The Haiti HOPE Act

Congress first provided trade preferences to the Caribbean region in the Caribbean Basin Economic Recovery Act (CBERA) of 1983—often referred to as the Caribbean Basin Initiative. The preferences did not, however, cover textile or apparel goods.[42] In 2000, Congress passed the Caribbean Basin Trade Partnership Act (CBTPA), which provided additional incentives on a temporary basis to select U.S. imports of textile and apparel articles assembled or knit-to-shape by firms in designated beneficiary countries. In general, to qualify for the tariff preferences, the articles had to be made from inputs produced in the United States or the region. The HOPE Act, as amended, builds on this precedent, providing additional benefits exclusively for Haitian apparel exports as a way to support growth and development in Haiti.

The HOPE Act, as amended, offers duty-free treatment for U.S. apparel imports from Haiti under rules of origin that allow for more flexible sourcing of materials than those offered to Caribbean countries under the CBTPA. The critical difference is that under the CBTPA, apparel goods receive duty-free treatment if assembled or knit-to-shape from *U.S. yarns and fabrics*.[43] Under the HOPE Act, duty-free treatment is extended to apparel articles if wholly assembled or knit-to-shape in Haiti from *materials (yarns, fabric, and components) sourced from any country* provided a minimum portion of the materials is produced by a country that is party to a U.S. unilateral preferential trade arrangement or a free trade agreement (FTA). Other special rules allow Haiti apparel exports exclusively to contain limited amounts of lower-cost inputs from anywhere in the world and still enter the United States free of duty. Because the United States is the dominant market for Haitian apparel, the economic benefit conveyed from the preferences is potentially significant for investment, output, and employment in that sector.[44]

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[41] Discussions and correspondence with representative of and consultants to the Haitian apparel sector.

[42] In 1986, President Reagan, by Executive Order, authorized a Special Access Program (SAP) for eligible Caribbean countries that allowed a guaranteed annual amount of apparel imports that was subject to duties only on the amount of value added abroad.

[43] Knit apparel may also use fabric made in a CBTPA beneficiary country. Other rules and exceptions exist. United States International Trade Commission. *Textiles and Apparel Effects of Special Rules for Haiti on Trade Markets and Industries*. Investigation No. TR-5003-1. November 8, 2007. pp. 1-5.

[44] Some research suggests the preference margins can create an important competitive advantage, see Brenton and Hoppe, *Clothing and Export Diversification: Still a Route to Growth for Low-Income Countries?*, pp. 6,7, and 14.

HOPE I

In December 2006, the 109th Congress passed the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2006 (HOPE I) as Title V of the Tax Relief and Health Care Act of 2006 (H.R. 6111/P.L. 109-432). Now referred to as HOPE I, the act provided special rules for the duty-free treatment of select apparel imports from Haiti made from third-country yarns and fabrics, provided Haiti met rules of origin and eligibility criteria. To be eligible, Haiti had to make progress toward establishing a market economy, the rule of law, the elimination of barriers to U.S. trade and investment, policies to reduce poverty, a system to combat corruption, and protection of internationally recognized worker rights.

The act required that all eligible exports be shipped directly from Haiti. It also established an overall cap on total qualified apparel imports equal to 1%-2% of total U.S. apparel imports. It included a short supply rule that allowed duty-free treatment of goods made from fabrics found to be in "short supply," as defined in all other preference arrangements and FTAs of the United States, and gives preferences to wire harness automotive imports.

At the heart of HOPE I were two new rules of origin. First, quotas were established for the duty-free treatment of apparel articles made from inputs that meet the 50% to 60% value-added content requirement from countries that are a party to a U.S. FTA or are beneficiary countries under a unilateral preference arrangement. There are no restrictions on the source of the remaining inputs. Second, additional quotas (50 million square meter equivalents–SMEs) were established for duty-free treatment of woven apparel that did not have to meet the 50%-60% value-added rule (allowing all inputs for these articles to be sourced from anywhere in the world).

Despite these new trade rules favoring Haitian apparel producers, HOPE I soon came under criticism for being ineffective. In 2007, the first year of operation, only 3% of U.S. imports of Haitian apparel entered under HOPE I, the rest still entering duty free under the CBTPA.[45] There were five major criticisms of HOPE I.[46]

- The three-year program was too short to attract new investment.
- The 50% value added rule was too high, greatly limiting its use.
- The value-added rule for woven articles was too small and did not include knit articles, which make up 80% of Haitian apparel exports.
- The requirement for direct shipping from Haiti was cumbersome and costly since apparel finishing had to be done in the Dominican Republic, with the articles shipped back to Haiti for export to the United States.
- The overall cap on imports was too small.

In addition, some U.S. textile producers objected to the preferences, contending that because they permitted use of third-party fabrics and other inputs, they were effectively displacing textile jobs in the United States and the Caribbean with those in Asia. U.S. producers also argued that the rules of origin were vague and difficult to enforce, and that the tariff preferences could result in

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[45] USITC, *Textiles and Apparel: Effects of Special Rules for Haiti on Trade Markets and Industries*, pp. 2-11 and 3-1.

[46] Communications with Haitian and Dominican industry representatives, also summarized in USITC testimony and USITC, *Textiles and Apparel: Effects of Special Rules for Haiti on Trade Markets and Industries*, pp. 3-9 thru 3-10.

diverting apparel production to Haiti from countries in the region that had apparel trade preferences in other agreements with the United States.[47]

HOPE II

Because early assessments of the effectiveness of HOPE I were critical of its progress in stimulating foreign investment in the apparel sector, and given that Haiti's economic and social conditions were deteriorating rapidly in early 2008, the 110th Congress amended the HOPE Act with passage of the Hemispheric Opportunity through Partnership Encouragement Act of 2008 as part of Title XV of the Food, Conservation, and Energy Act of 2008 (H.R. 6124/P.L. 110-246)—the "Farm Bill." It became known as HOPE II, and both Houses of Congress agreed quickly on bill language without formal hearings, expediting the legislative process, but to the chagrin of some Members.

Tariff Preferences and Rules of Origin

As with HOPE I, duty-free treatment is provided to apparel articles that are wholly assembled or knit-to-shape in Haiti. The specific rules of origin determine the amount of third party inputs that can be used in the manufacturing process and still receive duty-free treatment. Congress made three broad design changes to the HOPE Act.

- It extend all tariff preferences from a period of 3 to 10 years ending September 30, 2018.
- It allowed direct shipment of final goods from either Haiti or the Dominican Republic.
- It clarified the quantitative limitation (cap) rules to ensure that (1) articles subject to a specific cap do not count toward the overall value-added cap; (2) articles subject to one cap do not count toward another cap; and (3) HOPE benefits are understood to be extended in addition to any other benefits conveyed under the Caribbean Basin Initiative.

Amended rules of origin allow for more liberal application of duty-free treatment for imports of Haitian apparel *regardless of the source of inputs* (yarns, fabrics, components). Three of the more effective changes stand out.

- An increase in the annual cap for select woven apparel imports without regard to source of inputs to 70 million square meter equivalents (SMEs);
- An addition of a new duty-free rule for knit apparel without regard to source of inputs capped annually at 70 million SMEs, with some important exclusions such as t-shirts.
- The addition of a new uncapped "3 for 1" earned import allowance (EIA). It allows producers to claim a credit for the export of apparel articles made from qualifying inputs that can be used in exchange for exporting articles duty-free

[47] United States International Trade Commission. *Textiles and Apparel Effects of Special Rules for Haiti on Trade Markets and Industries.* Investigation No. TR-5003-1. November 8, 2007. pp. 31-34 and testimony submitted jointly by the American Manufacturing Trade Action Coalition and the National Council of Textile Organizations.

> made from non-qualifying inputs in a 3 for 1 ratio. Qualifying woven fabric must be wholly formed in the United States from yarns wholly formed in the United States. Qualifying knit fabric and knit-to-shape components must be wholly formed or knit-to-shape in the United States or any country or combination thereof that is a party to a U.S. free trade agreement or a beneficiary country under a unilateral preference arrangement, from yarns wholly formed in the United States.

HOPE II also maintained the value-added rule, but froze the overall cap on eligible apparel articles at 1.25% of total U.S. apparel imports. The cap expires in 2012. A new uncapped duty-free rule for brassieres, selected women's and girls' sleepwear, luggage, and handbags was added and the statute clarifies that the "short supply" rule, or benefits given for the use of non-U.S. fabric and yarns not available in commercial quantities, is uncapped and expanded to include all fabric and yarns in short supply lists in other U.S. preference arrangements and FTAs.

Labor Provisions

Haiti is eligible to receive preferential treatment as long as the President of the United States determines and certifies that Haiti has established or is making continual progress toward establishing protection for internationally recognized worker rights. The statute defines these as including (1) the right of association; (2) the right to organize and bargain collectively; (3) a prohibition on the use of any form of forced or compulsory labor; and (4) a minimum age for the employment of children and acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.

HOPE II also amended the eligibility requirements by requiring Haiti to create a new independent Labor Ombudsman's Office and to establish the Technical Assistance Improvement and Compliance Needs Assessment and Remediation (TAICNAR) Program within 16 months of enactment of the legislation. The Labor Ombudsman is to be appointed by the President of Haiti and report directly to him. The office's major functions include (1) maintaining a registry of apparel producers who may seek to use the trade preferences; (2) coordinating with government officials to create a system to ensure participation by apparel firms; (3) overseeing the TAICNAR program; and (4) receiving and directing appropriate comments to the Haitian Department of Labor and the United Nations International Labor Organization (ILO) regarding comments and complaints directed at firms participating in the program.[48]

The TAICNAR program creates an independent factory monitoring system focused primarily on assisting factories in improving their working conditions and labor-management relations. It is based on the Better Factories Cambodia project that was negotiated as part of the terms of the 1999 U.S.-Cambodia Bilateral Textile Agreement.[49] The ILO has since developed a Better Work Global Program in conjunction with the International Finance Corporation of the World Bank to expand use of this model. The TAICNAR program is one of these, referred to by the ILO as Better Work Haiti. The ILO is given the lead because, as with the Cambodia project, Haiti lacks the resources and institutional capacity to monitor and enforce compliance with labor standards. Developing this capacity is also a goal of the TAICNAR program.

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[48] President Obama certified on October 16, 2009 that Haiti had met all the statutory requirements.

[49] Sandra Polaski, "Harnessing Global Forces to Create Decent Work in Cambodia," *International Institute of Labor Studies*, forthcoming.

In the Better Work approach, access to the U.S. apparel market is given in exchange for sustained and verifiable improvement in factory labor conditions. The TAICNAR program employs a similar incentive system and operational structure in that Haiti's duty-free access depends in part on firms complying with core labor standards and submitting to ILO monitoring at the firm level. Although duty-free access can eventually be denied if conditions do not improve, the thrust of the program is to reinforce a positive response to improving labor conditions rather than imposing a punitive system to address noncompliance. Hence, there is emphasis on providing assistance for remediating problems. In addition, for the program to move forward, government and private sector actors in Haiti had to agree to this arrangement that empowers the ILO with operational authority. Haiti stakeholders acquiesced not only to take advantage of the trade preferences, but also to demonstrate their commitment to transparency in an admittedly difficult process of improving working conditions to levels now required of global apparel production.

HOPE II requires that the TAICNAR program assess registered apparel producers compliance with (1) core labor standards;[50] (2) labor laws in Haiti that relate directly to core labor standards; and (3) a provision that acceptable conditions of work are maintained with respect to minimum wages, hours of work, and occupational health and safety. The ILO has the authority to conduct unannounced site visits to manufacturing facilities and confidential interviews with workers and management, provide the results of assessments to workers and management, and require actions to remediate deficiencies. The ILO must produce publicly available biennial reports on the program and biannual reports evaluating the progress of each factory in meeting these goals. Congress authorized and appropriated $10 million to the U.S. Department of Labor to finance the TAICNAR program.

Although the ILO and some independent analyses have praised the success of the Better Work approach,[51] in Haiti it is too new to evaluate. The ILO representative arrived in June 2009 and has only completed the first round of firm site visits. The earthquake has also interrupted the ILO evaluation process. Review of the labor code has found it acceptable, but as was expected by some, it has been poorly enforced and many firms will be required to improve their practices and factory conditions to comply with the TAICNAR standards. In addition, enhancing Haiti's capacity to do these type of inspections and enforce labor codes is another major challenge.[52]

Other issues have come to light with respect to the TAINCAR program. First, the relationship between the autonomous nature of the ILO's representative and the government of Haiti is somewhat ambiguous. Although the Haiti Labor Ombudsman views its office as having overall authority, the ILO does operate independently. Despite the agreement to collaborate, this relationship has raised questions in the minds of various stakeholders as to the ultimate authority on labor matters, should disagreements arise. In a related issue, another debate has surfaced as to the implication of the core labor standards listed in the HOPE II legislation. They are the same as those listed in the ILO Declaration on Fundamental Principles and Rights to Work, to which all members are obligated to uphold. The statute, however, does not reference the ILO. Without such a reference, and/or language limiting this understanding specifically to the ILO Declaration and

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[50] Core labor standards are defined in the statute as: (1) freedom of association; (2) the effective recognition of the right to bargain collectively; (3) the elimination of all forms of compulsory or forced labor; (4) the effective abolition of child labor and a prohibition on the worst forms of child labor; and (5) the elimination of discrimination in respect to employment and occupation.

[51] Sandra Polaski, "Harnessing Global Forces to Create Decent Work in Cambodia," op. cit.

[52] Author's interviews in Port-au-Prince, November 5-11, 2009 and United Nations. International Labour Organization. *CEACR: Individual Observation Concerning Labour Inspection Convention, 1947 (no 81).* 2009.

the eight fundamental conventions that back the Declaration (as is done in the case of the Labor Chapters of recent U.S. free trade agreements), some have questioned whether a more expansive application of other ILO conventions and jurisprudence could be applied in Haiti.

Evaluating HOPE II

The Haitian apparel industry benefits from a comparative advantage that rests on low-wage production and proximity to the U.S. market, augmented by flexible trade preferences created by the U.S. Congress in HOPE II. Because the United States is the primary market for Haitian apparel exports, these "uniquely" generous trade preferences based largely on duty-free treatment for apparel articles made with third-country inputs, especially fabric, are expected to lead to increased foreign investment in apparel manufacturing. Job growth and production increases in the apparel industry since HOPE I was established are early indicators that the strategy may have been taking hold before the earthquake.

Table 2. U.S. Imports of Apparel from Haiti by Preference Program and Rule

(in $ millions)

Preference Program	2007	2008	2009
Total	420.5	407.7	511.9
CBTPA	406.8	332.8	374.0
HOPE Act:	13.7	74.8	137.9
Value-Added Rule	12.2	47.9	67.3
Woven Apparel Rule	1.5	27.0	63.9
Knit Apparel Rule	0.0	0.1	6.7
Other Rules[a]	0.0	0.0	0.0
Percent HOPE Act	3.3%	18.3%	26.9%

Data Source: U.S. Department of Commerce. Office of Textile and Apparel (OTEXA).

a. Includes dollar value of apparel imported under special rules for brassieres, sleepwear, headgear, and apparel made from fabric or yarn not available in commercial quantity.

As seen in **Table 2**, data from the U.S. Department of Commerce, Office of Textile and Apparel (OTEXA) indicate that Haitian apparel producers are increasing the amount of apparel exports sent to the United States under the HOPE II preferences. From 2007 to 2009, as measured by dollar value, the proportion of apparel entering under HOPE II grew from 3.3% to 26.9% of total apparel entering duty free under all preference programs (CBTPA and HOPE Act). Although there may be some switching of exports entering the U.S. market from CBTPA to HOPE II, OTEXA data reveal that in 2009 there has been a 137% jump in the use of the woven apparel rule and a 41% increase in the use of the value-added rule, likely in response to HOPE II. By 2009, a small portion of apparel began to enter under the knit apparel rule as well, but there has been no use of other special import rules provided to Haitian apparel exports.

In addition, OTEXA data (not shown) reflect that the statutory caps on the amount of apparel allowed to enter duty free are still far from being exceeded. For example, in 2009 Haiti filled 5.2% of its overall apparel quota, 2.1% of the knit apparel cap, and 22.8% of the woven cap. The Haitian government and business sector would like to see HOPE II amended to enhance these incentives as one way to encourage continued interest and investment in Haiti as a long-term producer of apparel. The debate has already found its way to the U.S. Congress and legislation (S. 2978) has been introduced that would extend CBTPA and the value-added rule (discussed below). Haitian representatives would like to see an even more comprehensive approach to amending HOPE II.

Because the Haitian apparel sector is dominated by contractual work for apparel assembly, it is highly vulnerable to the vicissitudes of global competition as well as non-business factors such as natural disasters. As discussed above, it is widely recognized that for apparel to become a more meaningful part of Haiti's long-term development, factories must move beyond relatively low value-added work to "full package" production. This means developing the skills and technology necessary to source materials, design and cut component parts, take on processing tasks such as dyeing and finishing, sewing, packaging, tagging, and shipping a finished product to a major purchaser. Some firms have already begun to make the transition, but it is possible that HOPE II preferences can do more to facilitate development.

Tariff Preferences[53]

The design of the tariff preferences play a large role in how effective they may be in helping Haiti develop a more sophisticated apparel industry. The core benefit of the tariff preferences is the ability to export duty-free to the United States articles made from lower-cost third-country materials. HOPE II, however, also takes into consideration its effect on U.S. textile firms that produce the fiber, yarn, and fabric widely used in Caribbean textile production. To some extent, helping Haiti's apparel exports and preserving U.S. fiber, yarn, and fabric production are at once both complementary and competing goals, depending on the product, business relationship, and preference rule.

Value-Added Rule

To receive duty-free treatment, currently 55% of the value of the exported product must be made from inputs and processes from Haiti, the United States, or a country in an FTA or unilateral preferences arrangement with the United States. Third-country inputs currently may therefore not exceed 45% of the value of the apparel article. This value-added content requirement rises next year to 60%. Yarn and fabric constitute the largest cost of apparel, typically 60% or more of the total product cost, and nearly all the material cost. Therefore, under this rule, the opportunity for Haitian producers to use lower-cost third country fabric is limited because it's use would exceed the 45% threshold. In other words, at this time, most Haitian garment producers do not have the value to add to take full advantage of this rule. Haiti would like to see the regional content threshold reduced to a level that would allow them to take fuller advantage of the rule, although this could generate a cautious response from U.S. yarn and fabric producers.

Woven Rule

HOPE II expanded the cap on Haitian woven apparel that may receive duty-free treatment regardless of source of inputs. It is an attractive incentive, easy to use, and for many producers,

[53] This discussion reflects industry data and sources consulted in the United States, in Port-au-Prince during a visit November 5-11, 2009, and in discussions with Haitian business representatives and experts after the earthquake.

both foreign and Haitian, small and large, a primary reason for locating and investing in Haiti. Production of woven articles is expanding and because woven articles are more labor intensive than knit articles, they provide a greater employment impact than knits. Production has responded to the incentive, with exports of woven articles to the United States expanding by 79% from 2007 to 2009. In fact, although estimates vary, according to some producers, the 70 million SME cap could be exceeded sometime in 2011 or 2012, although the earthquake may change this time frame. Haitian producers encourage increasing this cap. The tradeoff of this rule is that it emphasizes contract work for simple assembly operations and discourages use of U.S. yarns and fabrics.

Knit Rule

The 70 million SME knit rule, added in HOPE II, functions somewhat differently than the woven cap. Because the large volume of t-shirts is excluded, most estimates indicate that companies producing knits in Haiti are unlikely to exceed the quota in the near future. Duty-free treatment of Haitian t-shirts is also supported by CBTPA, which allows for limited but generous duty-free entry of qualified knit t-shirts (see **Table 2**). The link between HOPE II and CBTPA is important. First, if CBTPA were to expire and HOPE II were to accommodate duty-free treatment of knit t-shirts, the knit cap would be exceeded quickly, so HOPE II legislation operates in conjunction with the tariff preference provision in CBTPA. Second, the CBTPA statute supports investment and production in place in the Dominican Republic, which makes the fabric for t-shirts from U.S. yarns that are then sent to Haiti for cutting (in some cases) and assembly. Effectively, HOPE II brings Haiti assembly into an already existing integrated U.S.-Caribbean production process supported by CBTPA. Knit exports to the United States have grown only by 3% from 2007 to 2009, but these products still represent 80% of apparel exports. If CBTPA is extended, the knit cap is unlikely to be exceeded.

3-for-1 Earned Import Credit

This rule potentially benefits mostly those factories that are able to produce large volumes of articles, in this case mostly t-shirts, that use fabric from yarn made in the United States. Potentially, some contractors in the Dominican Republic and Haiti are able to make large runs of cotton t-shirts exported duty-free to the United States under CBTPA (supporting U.S. yarn manufacturers). These same firms then use the earned import credits to produce other articles (mostly t-shirts) assembled from fabric not made from U.S. yarns (cotton or synthetic fabric from Asia or elsewhere), which enter duty-free under HOPE II. The rule has been criticized by Haitian industry representatives as being too complicated and difficult to use. To date it has not been used, largely because apparel articles made from third country inputs enter duty free under the knit and woven caps. It is unlikely to be used significantly until such a time as these caps are exceeded, but those Haitian producers who might be able to take advantage of the rule in the future support its continuation and possible expansion. Because it also supports U.S. fabric producers, expanding this rule may not be highly controversial.

Other Options for Amending HOPE II

A number of other options have been mentioned for amending the HOPE II Act. These include extending the preferences beyond the current termination date of September 30, 2018, expanding coverage to a broad array of apparel and/or non-apparel products, and providing direct incentives for investment in Haiti.

Outlook

In the aftermath of the January 2010 earthquake, the apparel sector faces a number of problems in returning to full production, including damaged factories, a devastated work force, and interrupted finance and logistical capabilities.[54] The main challenge to the industry in the short run is that buyers could turn elsewhere to carry on what was once Haitian production. One option Congress may consider is to further liberalize and simplify rules governing preferential treatment of Haitian apparel exports in HOPE II to provide additional incentives for buyers to exercise the patience needed to consider rebuilding in Haiti. This goal could be accomplished by enhancing any of the major preferences in the legislation.

First, the 55% value-added rule could be lowered. Reducing the 55% threshold would presumably allow more firms to take advantage of the preference. Second, there is a capped (70 million square meter equivalents—SMEs) provision for both knit and woven articles that allows duty-free treatment for apparel made from third-country inputs with no value-added requirement. The rule is attractive for many apparel producers of varying size and capabilities in Haiti and the caps could be increased, exclusions reduced, or either eliminated. Third, Congress could reduce the 3-for-1 earned import allowance rule to a 2-for-1, or 1-for-1 rule.

Any of these and perhaps other solutions that either simplify the rules of origin or expand use of tariff preferences could help increase Haitian apparel exports, and perhaps retain or expand foreign investment in the sector, which is vital for its long-term success. Other options might include a more comprehensive extension of tariff preferences to other manufactured goods or a broader elimination of tariffs across the board. The tradeoff would be the possible reduction in the use of U.S.-made yarns and fabrics in Haiti apparel production. Although Haiti is not a large producer by worldwide standards, U.S. firms may wish to minimize any possible negative effects on their industry.

[54] Doreen Hemlock, "Earthquake Threatens Haiti's Garment Sector," *South Florida Sun-Sentinel*, January 20, 2010, p. 1D and Simon Romero, "Economy in Shock Struggles to Restart," *The New York Times*, January 22, 2010, p. A10.

Appendix. Haiti: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP Growth (%)	0.9	-1.0	-0.3	0.4	-3.5	1.8	2.3	3.4	1.3
Per Capita GDP Growth (%)	-0.8	-2.7	-1.8	-1.2	-5.0	0.2	0.7	1.7	-0.4
Inflation Rate (%)	14.1	14.2	9.9	39.3	22.8	15.1	13.2	8.4	15.5
Real Interest Rate (%)	6.1	20.5	10.7	-9.7	13.9	12.3	19.5	24.5	16.9
Average Real Wage (% change)	-11.9	-11.6	-8.9	33.5	-14.4	-13.2	-12.0	-7.6	
Real Minimum Wage (index)	100.0	88.4	80.5	107.5	91.7	79.6	70.0	64.8	56.2
Gross Fixed Capital Formation (% GDP)	27.3	27.3	28.0	28.8	28.9	28.8	28.8	28.6	28.7
Current Account Balance (% GDP)	-3.0	-3.8	-2.8	-1.6	-1.5	0.9	-0.4	-0.2	-4.2
Current Acct. Bal. – w/out grants (%)							-8.2	-6.6	-11.0
Net Foreign Direct Investment ($ mil)	13.0	4.0	6.0	14.0	6.0	26.0	160.0	75.0	30.0
Terms of trade (index)	100.0	101.2	100.2	98.7	96.0	92.4	88.9	86.4	62.4

Source: United Nations Economic Commission on Latin America and the Caribbean (ECLAC). *Economic Survey of Latin America and the Caribbean 2008-2009*, July 2009, and International Monetary Fund. *Haiti: Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility*, August 2009.

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