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Dominica: Third and Fourth Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Dominica

In the context of the third and fourth reviews under the three-year arrangement under the Poverty Reduction and Growth Facility with Dominica, the following documents have been released and are included in this package:

- the staff report for the third and fourth reviews under the three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on December 3, 2004, with the officials of Dominica on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 18, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the views of the Executive Board as expressed during its March 7, 2005 discussion of the staff report that completed the review.

- a statement by the Executive Director for Dominica.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Dominica*
Supplement Memorandum of Economic Policies by the authorities of Dominica*
Technical Memorandum of Understanding

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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DOMINICA

Third and Fourth Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Ratna Sahay and Matthew Fisher

February 17, 2005

- **Arrangement**. A three-year Poverty Reduction and Growth Facility (PRGF) arrangement for SDR 7.7 million (94 percent of quota) was approved by the Executive Board on December 29, 2003. The first two program reviews were completed by the Executive Board on March 24, 2004 and August 4, 2004. To date, SDR 3.0 million has been disbursed. The next two reviews were to be based on June and December 2004 targets, respectively. Availability of information on outcomes with respect to both sets of targets enables consideration now of the third and fourth reviews of the program, completion of which will make available an additional SDR 1.2 million.

- **Developments**. The economic recovery is gaining ground, despite an earthquake that struck late in 2004. The economy grew by an estimated 2 percent in 2004, after having contracted by 10 percent during 2001−03. The debt restructuring has progressed far and the authorities have closed the exchange offer. Macroeconomic performance remains strong, with all quantitative performance criteria but one observed. Progress at structural reforms have been somewhat slower than envisaged but with some recent steps forward, remains satisfactory.

- **Issues**. In their attached letter of intent, the authorities request that the quantitative program for the current fiscal year be kept as approved during the second review. The authorities also elaborate on their structural reform agenda for 2005, which focuses on measures to improve the fiscal framework and public finances, and to strengthen social security and the financial sector.

- **Discussions**. These took place in Roseau during October 18–29, 2004, and Washington during December 2−3, 2004. The mission met with Prime Minister Skerrit, the Cabinet, Program Coordinator Lestrade, other senior officials and private sector representatives. The staff team consisted of S. Panth (Head), P. Njoroge, P. Dyczewski (all WHD), G. Fernandez (MFD), S. Seshadri (PDR) and M. Syed (FAD). The mission partly overlapped with a World Bank team also in Roseau, assisting the authorities in formulating their growth strategy. Mr. Faircloth (OED) participated in some of the policy discussions, as did representatives from the ECCB and the CDB.

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EXECUTIVE SUMMARY

Program performance has remained strong. All but one quantitative performance criteria (PC) for June−December, 2004 were met. Arrears associated with the missed PC have been cleared. Three of the four structural benchmarks have now been implemented and progress with the final one remains satisfactory. The conduct of fiscal policy has been prudent, with large savings realized above programmed amounts on account of a stronger-than-expected revenue performance.

The economic recovery is gathering strength, despite an earthquake that struck Dominica in late 2004. Following a decline of almost 10 percent during 2001–03, real GDP is estimated to have increased by 2 percent in 2004. Strong tourism receipts are helping bolster the external position, and financial intermediation is on the rebound. Annual inflation declined to 2 percent in November 2004.

The debt exchange offer has closed. The authorities had kept the offer open past the formal deadline of June 11 for tendering claims but they have decided that as of September 30, 2004, they no longer felt bound by its terms. Thus far, agreements (in-principle) have been reached to restructure about 70 percent of the eligible debt. For nonparticipating creditors, interest accrued until June 11 has been deposited into escrow accounts. The authorities plan to continue making payments for nonparticipating creditors into such accounts, but under restructured terms.

The authorities are maintaining their fiscal policy stance for 2004/05. While continuing to abide by the quantitative targets as approved by the Executive Board during the second review, they intend to use revenues in excess of programmed amounts to finance some of the earthquake-related reconstruction. A program adjustor is also being introduced to take into account the potential incurrence of unbudgeted expenses to set up a regional court. The authorities intend to stick to the approved budget in other respects.

The authorities have fleshed out the structural reform agenda for 2005. Efforts will focus on improving the fiscal framework and public finances, and strengthening social security and the financial sector. Specific measures include improving the regulation and oversight of nonbank financial institutions, institutionalizing fiscal discipline through legislative amendments, and carrying out a comprehensive review of the pension system.

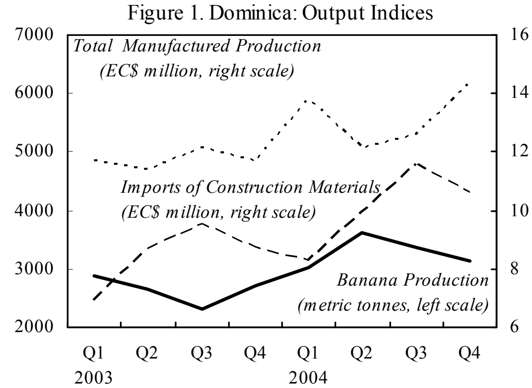
I. Background

1. **Fund financial support of Dominica is being provided in the context of a two-stage strategy to address severe macroeconomic imbalances**. The first stage focused on achieving macroeconomic stability through a large fiscal adjustment and collaborative restructuring of the unsustainable debt. The second stage envisages implementation of strong structural reforms to establish the basis for sustainable growth and reduce unemployment-related poverty.

2. **A degree of macroeconomic stability has been achieved**. In particular:

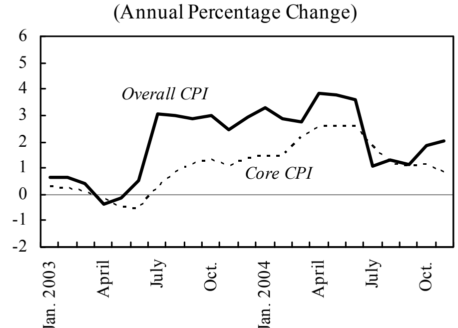
- ***Economic growth has resumed***. Following a decline of almost 10 percent during 2001–03, real GDP is estimated to have increased by upwards of 2 percent during 2004 due to the strong performance of agriculture, manufacturing and construction, and despite an earthquake, which struck Dominica in November 2004.

Figure 1. Dominica: Output Indices



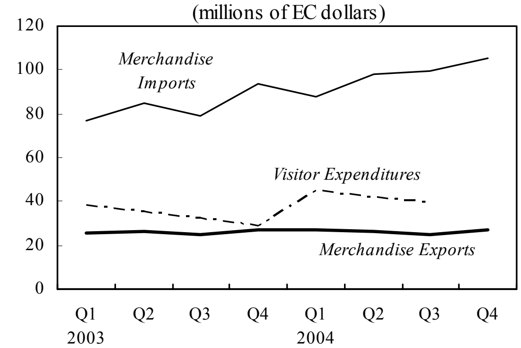
- ***Inflation has declined***. Despite a recent uptick caused by the pass-through of higher energy prices to the consumer basket, headline inflation (year-on-year) fell to 2 percent in November 2004, from 2.9 percent at end-2003.

Figure 2. Dominica: Inflation
(Annual Percentage Change)



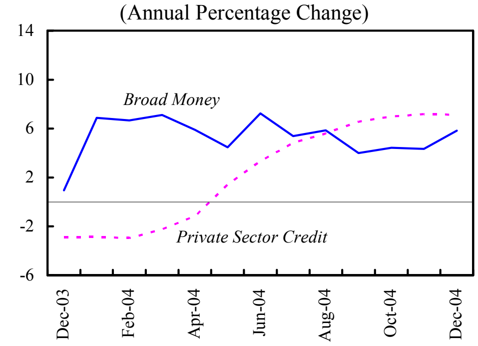
- ***The external position is reflecting the economic recovery and the improved global environment.*** [1] Import growth has been robust on account of the economic recovery but the impact on the current account has been partially offset by increased tourism receipts.

Figure 3. Dominica: External Indicators
(millions of EC dollars)



[1] The determinants of growth will be a particular focus of the upcoming Article IV consultations.

Figure 4. Dominica - Monetary Developments
(Annual Percentage Change)



- ***Financial intermediation is on the rebound***. Credit to the private sector, which had been contracting since early 2001, is growing again. The new credit is being channeled to private construction, trade and professional services, which augurs well for the continued strength of economic activity.

3. **Performance under the program has remained strong**. With the exception of one performance criterion (PC), all quantitative PCs for June−December 2004 were met, many with large margins (Table 1). There were inadvertent delays in making some external debt service payments, leading to the non-observance of the arrears performance criterion. However, the authorities corrected the errors immediately upon discovery, and strengthened their monitoring system to prevent recurrences. Although some delays have been encountered, overall progress with structural benchmarks is satisfactory.

Dominica: Recent Fiscal Performance

	2003/04			2004/05 H1		
	Prog.	Actual	Diff.	Prog.	Actual	Diff.
	(in percent of period GDP)					
Primary balance 1/	**1.7**	**5.6**	**4.0**	**0.8**	**3.8**	**3.0**
Revenues (excl. grants)	**29.5**	**31.3**	**1.8**	**28.5**	**31.8**	**3.3**
Non-Interest Expenditures and Other	**-27.9**	**-25.7**	**2.2**	**-27.7**	**-28.0**	**-0.3**
Non-interest current expenditures	-26.8	-25.5	1.3	-24.3	-24.4	-0.1
Investment (net of grants) and other 2/	-1.1	-0.2	0.9	-3.5	-3.7	-0.2
Memorandum items:						
Grants	7.4	8.9	1.5	8.8	5.7	-3.1
Non grant-financed investment (ratio)	31.6	29.6		27.3	40.7	

1/ Measured from below the line.
2/ Includes net lending and statistical discrepancy.

4. **The conduct of fiscal policy, a corner-stone of the program, has remained prudent, with large savings realized above programmed amounts**. Revenue performance has outpaced projections. To some extent, this is transitory, reflecting the collection of arrears and windfall gains from the unclaimed deposits of regional migrants. Tax buoyancy has, however, also been better than expected. As regards current expenditures, the authorities have kept vacated positions in the civil service unfilled, enabling the realization of savings in the wage bill ahead of schedule. Other current outlays, such as transfer payments have, however, offset some of these savings. And, while total capital expenditure has remained restrained, in significant part due to shortfalls in grants, the domestically-financed component has picked up this fiscal year, including on account of the recent earthquake.

5. **The authorities remain committed to the structural reform agenda**. Despite sharp increases in international prices in recent months, domestic petroleum prices continue to be adjusted according to the agreed formula. As regards structural benchmarks, the review of statutory tax exemptions was carried out in June and cabinet approval was obtained, ahead of schedule, of key VAT parameters (Table 2). In contrast, the legislation on the retirement of public employees was initially delayed because of a lack of consensus within the government

on how to treat different professional groups. This issue was finally resolved in the new year and the legislation was submitted to, and approved by, parliament in January 2005.[2] The reform of the electricity sector is also taking longer than anticipated. Following the visit of a World Bank technical team in December 2004, cabinet reconsidered the timeframe to allow for more public consultations—the measures are now expected to be implemented by mid-2005.

6. **Although the debt exchange offer launched in April 2004 is now closed, progress continues to be made in debt restructuring**. After keeping the offer informally open past its official deadline, the authorities decided on its closure with effect from September 30, 2004. Prior to that date, a number of private creditors, including holders of one of the two large external bonds, had tendered their claims into the offer and new instruments are in the process of being issued. The holders of the other major bond have not yet agreed to a restructuring. Separate agreements have been reached with most official bilateral creditors, and final deals are in the process of being concluded with most domestic creditors, in many cases under terms tailored to their specific circumstances (see paragraphs 19–20). Altogether, as of late January 2005, agreements, at least in principle, had been reached with creditors on about 70 percent of the debt subject to restructuring.[3]

7. **There is increasing speculation about the timing of elections**. Elections are required by mid-2005 under the constitution but can be called earlier by the ruling coalition, which holds a slim parliamentary majority. Campaigning has started in earnest by all sides, even without a formal date set yet for the elections.

II. Policy Discussions

8. **Dominica has made significant progress at macroeconomic adjustment; the imperative now is to consolidate these gains and implement the second leg of the two-stage strategy**. With resolute implementation of the program, the fiscal position has strengthened considerably, external balances are improving, and economic growth has resumed. Further efforts to bring macroeconomic balances into order are, however, still necessary—debt restructuring, in particular, remains to be completed. At the same time, some of the root causes of the crisis—weaknesses in the structure and execution of the budget—need to be addressed to help prevent recurrences of past problems; and

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[2] The authorities have increased both the age of mandatory retirement (from 55 to 60) and the age of eligibility for early retirement with full benefits (from 50 to 55). The fiscal savings will depend on the options exercised in practice.

[3] In-principle agreements indicate confirmation to the Dominican authorities from creditors of their willingness to restructure the debt. In some cases, precise terms remain to be worked out and the final legal documents are in the process of being drafted. Following signatures by both parties, payments can then proceed under the restructured terms (for official creditors) or new bonds can be issued (to creditors participating in the exchange offer). The authorities are also working out the details of jurisdictional filing requirements to issue the new bonds.

macroeconomic vulnerabilities in social security and the financial system need to be tackled (Figure 5). The discussions focused on these challenges and on the growth agenda.

A. Macroeconomic Framework and Fiscal Adjustment

9. **There was consensus that the outlook for 2004–05 was turning out better than had been anticipated**. Real economic growth is likely to have exceeded 2 percent during 2004, compared with 1 percent under the program. Despite the lingering and as yet uncertain impact of the earthquake on growth, a pick-up in investment, including the start of construction of the Windsor Park stadium with Chinese assistance should provide a temporary boost to economic activity during 2005. Taking into account also other available information, including the relatively strong revenue performance in December as providing some indication of the resumption of activity following the earthquake, growth for 2005 is now tentatively projected at about 2½ percent, a little higher than the estimated long-term trend growth rate of 2 percent. There was agreement that on balance, the 2005 inflation target, of about 1½ percent, remained appropriate despite the recent small uptick in prices.

10. **The mission inquired about the authorities' plans regarding the primary surplus target for FY 2004/05**. Revenues were likely to continue to turn out higher than envisaged, although the current margin of performance should be expected to erode. While there may be limited scope for continued collection of one-off items and a further stepping-up of enforcement, the observed buoyancy should persist, raising revenues for the year by about 2 percent of annual GDP over the budgeted amount. If line items are held to budgeted levels, the primary surplus should, therefore, be double the 2 percent of GDP targeted under the program. On the other hand, repairing the damage to public infrastructure resulting from the earthquake, estimated at 7 percent of GDP, will require substantial resources, and expenses could arise on account of the Caribbean Court of Justice (CCJ), which had not been budgeted for this year.[4]

11. **The authorities remained resolute in their determination to see the fiscal adjustment and debt restructuring efforts through to fruition**. They noted that Dominica had come too far along the path toward its medium-term objectives to relax the fiscal effort at this stage, even with the recent earthquake. They considered it important to further demonstrate to their creditors that Dominica was intent on upholding its part of the bargain in what the authorities hoped would remain a collaborative effort to bring about macroeconomic

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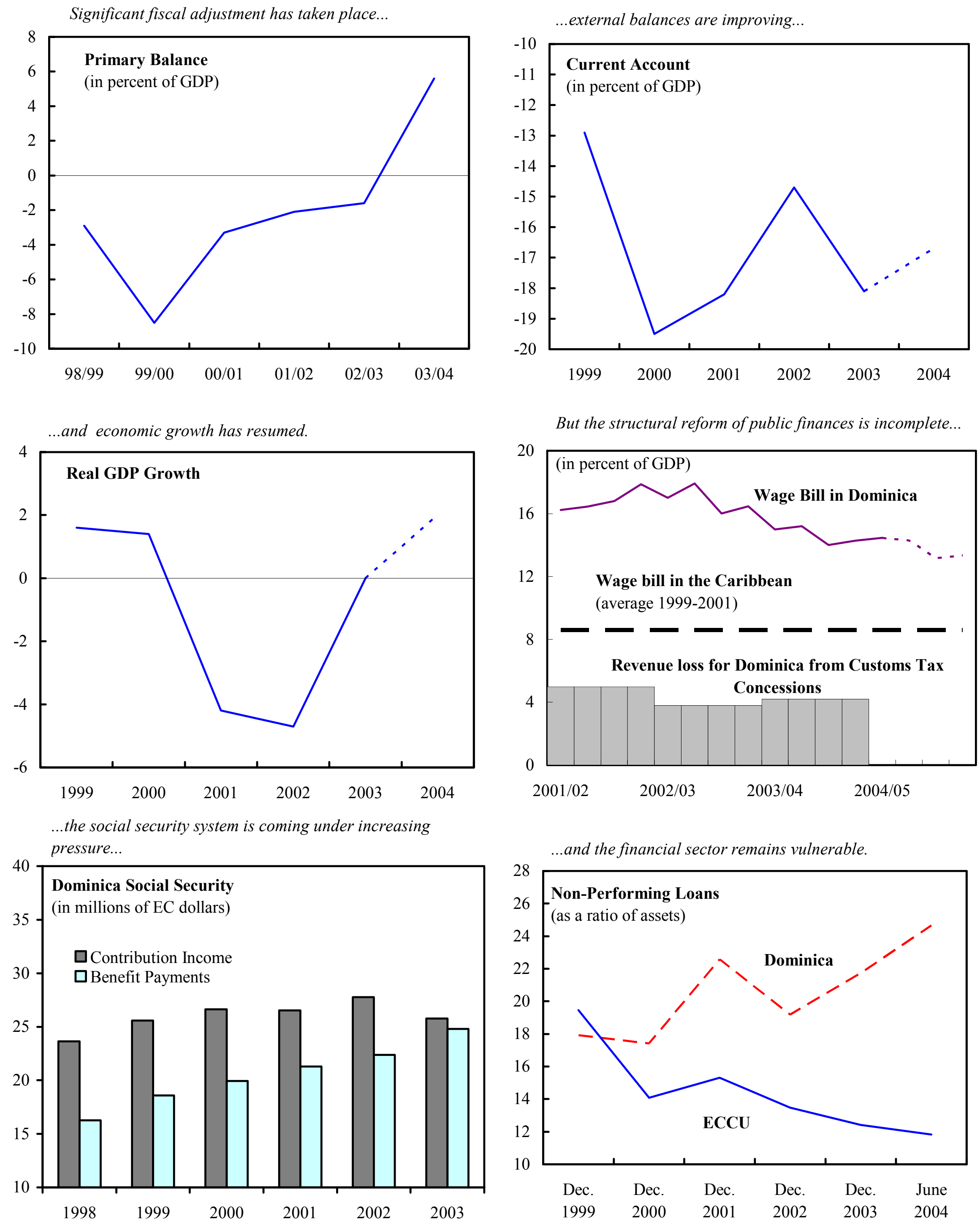
[4] Dominica, along with other members of CARICOM, has obtained loans from the Caribbean Development Bank (CDB) to finance the establishment of the CCJ, which for Dominica would eventually serve as the highest court of appeal. The proceeds of the loan disbursed in July 2004 (amounting to 0.8 percent of GDP) remain in an escrow account, pending the court's establishment. The disbursement will be recorded as expenditure once the proceeds are transferred to the CCJ.

Figure 5. Dominica: Economic Developments Under the Program and Challenges



Sources: Dominican Authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

sustainability through fiscal adjustment and debt restructuring. The authorities were also aware that with the restructuring terms for some creditors yielding less savings than had originally been hoped for, there was some chance that greater fiscal consolidation may be required over the medium term than had been envisaged.

12. **Accordingly, there was consensus to continue to aim for the achievement of the programmed primary balance for this year**. Toward that end, the authorities settled on leaving the quantitative targets for this budget year as approved by the Executive Board in August, with revenues in excess of programmed amounts to be used for the most pressing repair and reconstruction needs following from the earthquake. Other earthquake-related projects would be put off until they could be comprehensively reassessed within the public sector investment program (PSIP). This assessment will take into account prospects for additional grant financing (which has thus far been limited) and also focus on issues of absorptive capacity. Such an updating of the PSIP is to be undertaken over the coming months in conjunction with the preparation of next year's government budget. The authorities intend to stick to the approved budget in other respects and reallocate expenditures across categories as necessary to meet any other emerging requirements. In this respect, there was recognition that continued improvement in public expenditure management remained a key priority (see paragraph 18).

13. **The program modalities reflect these understandings**. Consistent with the authorities' intentions, the existing indicative targets for March 2005 are being retained and those for June 2005 are being converted into performance criteria. An adjustor to take into account the possible need to finance the Caribbean Court of Justice is also being introduced. The earthquake-related reconstruction as well as the assistance from China and the associated expenditures will be recorded in the ex-post fiscal accounts. Given the delays encountered because of the earthquake, the authorities are also requesting a rephasing of the program, with the next review to be based on performance through June 2005 and on reaching understandings on the budget for 2005/06. Pending the preparation of the budget, indicative targets are being established for September 2005, which continue to be predicated on achieving an annual primary surplus of 3 percent of GDP, in line with the original medium-term program objective.

14. **A comprehensive reassessment of the medium-term fiscal program should, however, be carried out once there is clarity about the final outcome of the debt strategy**. The mission and the authorities concurred that the desirability of continued revenue overperformance and the overall expenditure envelope, including the capital investment program, should be assessed on the basis of longer-run objectives. The authorities hoped to undertake such a reassessment at the time of the next program review. The mission noted that the Article IV discussions, scheduled for later this spring, would also provide an opportunity to step back and take a comprehensive new look at the medium-term strategy, keeping in mind both the outcome of the debt restructuring and the growth strategy. On the latter, a particularly germane issue for consideration, given Dominica's geographic location and volcanic topography, is how to safeguard against the economic impact of natural disasters.

B. Structural Reform

15. **The priority for structural reform during 2005 is to buttress the gains made in macroeconomic stabilization while laying the foundation for higher growth**. Key in these respects are the needs to: (i) improve the fiscal framework; (ii) strengthen social security and the financial sector; and (iii) articulate the growth agenda. The first two items are critical to address weaknesses in the current system that were either contributory factors to the economic crisis, or vulnerabilities that could potentially result in large budgetary costs in future. As regards the growth agenda, putting in place a coherent comprehensive strategy is indispensable to permanently ratcheting the growth path upwards. Given the electoral cycle, the discussions focused on laying out the broad elements of the structural reform agenda. Specific elements of the structural conditionality for the rest of the program period would need to be finalized by the post-election government, drawing on the policies described in the attached MEP.[5]

The Fiscal Framework and Reform of Public Finances

16. **There was recognition that fiscal discipline should be institutionalized over the long run**. In this regard, the authorities remain committed to putting in place, with broad political consensus, legal guidelines providing numerical targets and procedures to follow in the design of the budget, including key transparency and accountability principles. The mission underscored the value of these guidelines in helping keep debt accumulation under control. The authorities have reconsidered the need to introduce a stand-alone fiscal responsibilities law but propose to prepare for discussion by cabinet and the general public amendments to the existing Finance Administration Act, which will lay out the broad targets and procedures to be followed.

17. **Dominica is proceeding with the reform of the tax system**. Key in this respect is the introduction of the VAT to replace existing cascading taxes and improve efficiency. A draft VAT law has been prepared and was discussed by cabinet at end-2004. The staff suggested that some elements of the law could be strengthened. In particular, some of the provisions on zero rating and exemptions and the use of multiple rates, were undesirable. The authorities were concerned that education of the public about the VAT was lagging behind, the business community remained wary and more resources may be needed by the revenue administration department. The mission indicated that the passage of a good VAT law was a key step in alerting the public about the new tax. As regards resources, some of the fiscal savings could be used to implement this important plank of the revenue reform effort. The authorities, nevertheless, considered it necessary to proceed carefully with the introduction of

[5] The four pillars of the authorities' strategy, laid out in the MEP are: (i) collaborative debt restructuring; (ii) fiscal reform; (iii) budgetary reform and financial sector strengthening; and (iv) structural reforms to create an enabling environment for growth.

the tax, so as to better ensure its success. Accordingly, they no longer intend to introduce the tax at the start of the next fiscal year but remain committed to doing so during the course of FY 2005/06. They also emphasized their intention to continue working with CARTAC to identify and address potential roadblocks, and to formulate a revised detailed timetable.

18. **Other steps are being taken to strengthen public finances**. The authorities aim to follow up on the June study on tax exemptions by identifying and repealing specific legal provisions, while continuing to hold the line on the granting of discretionary exemptions. They are also improving the administrative procedures for granting tax exemptions, and are making the process more transparent. Improved public expenditure management is another continuing element of the fiscal reform agenda (see Box 1).

Social Security and the Financial Sector

19. **Reform of the social security system is part of the effort to strengthen the government's financial position**. The authorities are keenly aware that fiscal adjustment at the central government level is insufficient if large imbalances elsewhere are left untended. Even prior to the debt restructuring, the social security system was already coming under strain from demographic pressures (see Box 2). The government and DSS are considering a complex restructuring of their mutual obligations, which could involve not only the government's debt but also arrears and contributions to the budget by DSS to meet retirees' healthcare costs. Regardless of the final terms, any intra-governmental agreement will not alter the obligations of the state as a whole until a fundamental reform of the social security system is carried out. Toward this end, the authorities intend to conduct, with external assistance, a comprehensive pension system review during 2005.

20. **Financial sector policies aim to safeguard the budget against potential vulnerabilities**. For commercial banks, the nonperforming loan ratio provisionally stood at 24 percent at end-June 2004, significantly above the 10 percent prudential benchmark established by the ECCB. The Dominican authorities consider it important to try to prevent the state from having to step in to bail out the banking sector in the future. Hence, they are providing special terms to banks for the debt restructuring, keeping also in mind the limited potential for collecting on nonperforming loans and the consequences for bank capital (which, as currently measured, exceed prudential requirements; not least because government assets are assigned zero risk)[6]. The reductions in net present value are still sizeable, however, and the financial sector would be left weaker following the restructuring. The ECCB is following through on the FSAP recommendations regarding the preparation of prudential

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[6] As of end-January, 2005 agreements had been signed with three of the four commercial banks. Each agreement is unique and depends on the bank's exposure and range of instruments held.

Box 1. Dominica: Public Expenditure Management

Fiscal policy cannot function as an effective demand management tool without flexible and responsive budget execution. This requires at least two basic inputs: *(i) a comprehensive and timely monitoring system*, which provides early warnings about expenditure pressures and shortfalls in financing, and *(ii) an effective cash management system*, which ensures that spending requests are consistent with available resources.

Since late 2002, a number of external partners have been assisting in the establishment of an effective Public Expenditure Management (PEM) system in Dominica. These projects identified some basic weaknesses:

- *Poor accounting system*—The General Ledger did not cover all government bank accounts, there was no regulation of existing accounts and no clear policy regarding the opening or managing of government bank accounts. In addition, the financial information system did not cover all of the government's cash transactions, and there was no systematic reconciliation with bank accounts.
- *Inadequate reporting and monitoring of commitments and lack of timely information on some capital expenditure*—Local purchase orders were not always used and contracts were often unreported. As a result, the ministry of finance could not fully identify commitments entered into by the spending ministries. Expenditures made directly by donors to contractors for externally financed projects further complicated the task of monitoring.
- *Weak institutional arrangements*—The lines of responsibility between various officials and departments in the ministry of finance needed clarification. And, the internal control system needed to be further strengthened to ensure that line ministries complied with matters of fiscal discipline introduced by the ministry of finance. In addition, legislative oversight was limited since there were no formal requirements to report overspending to Parliament.

Steps have recently been taken to address some of these concerns, but continued progress will require additional external technical assistance. Progress is being made, in particular, in reconciling government bank accounts and a number of measures have been taken to improve coverage, reporting and monitoring of public expenditures (see MEP paragraph 14). Cash and commitment limits are now regularly issued to line ministries, and there is evidence of increased discipline and expenditure control. However, more remains to be done to firmly establish a system capable of effective financial management.

guidelines on capital adequacy and corporate governance, and risk-based supervision. This should help prevent, over the long run, a further worsening of the position of commercial banks.

21. **The Dominican authorities, for their part, are stepping up efforts to strengthen the oversight of nonbank financial institutions.** Improved oversight of credit unions, where progress was slow last year, is of particular concern as Dominica has the only systemically important credit union in the Eastern Caribbean Currency Union. Measures to strengthen the supervision of these financial institutions are, therefore, being included as structural conditionality (MEP Table 2).

Box 2. Dominica: Social Security

Dominica Social Security (DSS) has been generating cash surpluses but faces a looming actuarial deficit. The restructuring of the government's obligations could significantly add to this problem.

Prior to the debt restructuring, the reserves of DSS were already projected to start declining. Because it is a relatively young system, expenditures have remained below contribution income until recently. Nevertheless, while the latter has been broadly flat, benefit payments have been increasing steadily. As a result, total expenditures are estimated to have exceeded contribution income for the first time already in 2003 and, in the absence of reform, are expected to continue to do so for the foreseeable future. Going forward, DSS will, therefore, have to rely increasingly on the income from its assets (generated from previous surpluses) to meet its expenditures. However, the longevity of Dominicans, the outward migration of the working age population, and the current structure of contribution and benefits implies that eventually total expenditures will exceed even the sum of contribution payments and investment income. This will require dipping into reserves to meet benefit payments, resulting eventually in asset depletion.

Under projections made in 2003, the reserves of DSS were expected to begin decreasing between 2010 and 2017, with their complete depletion expected between 2017 and 2024. The precise dates depend on assumptions regarding fertility, mortality, migration and real GDP growth. The intermediate projections, for example, assumed some decrease in fertility and improved mortality; some reduction in net outward migration; medium-term GDP growth of 2.5 percent per annum; and inflation of 3 percent. These scenarios were created assuming unchanged benefits and contributions, and that the government would continue meeting its obligations under the then-existing terms.

The restructuring of the government's debt would significantly bring forward the dates at which cash flows turn negative and assets deplete. The DSS's reserves are mostly concentrated in government debt instruments—including arrears, DSS's claims on the government amounted to about 17 percent of GDP in mid-2004. In the absence of countervailing steps, the debt restructuring would reduce the income of DSS.

Growth Strategy and the PRSP Process

22. **Work is proceeding on the Growth and Social Protection Strategy Paper (GSPSP)**.[7] To date, the focus has been on tourism and agriculture as the key sources of growth. Substantial donor resources have already been committed for most of the initiatives in tourism and a few nontraditional agricultural export products are emerging as potential growth nodes. However, there is a need to strengthen overall policy coordination across government agencies. The mission emphasized, and the authorities concurred, on the importance of ensuring that the sectoral strategies were adequately prioritized and that the

[7] The GSPSP is Dominica's full PRSP.

public sector investment program reflected the articulated priorities. There was also consensus that it was important for the sectoral strategies to fit within a consistent and coherent macroeconomic framework. Following consultations with key stakeholders, the authorities hope to finalize the GSPSP in time for the formulation of the 2005/06 budget.

C. Debt Restructuring, Program Financing and Fund Support

23. **With no additional creditor participation in several months, the authorities decided to close the debt exchange offer**. While they had earlier remained willing to abide by the terms of the offer past its formal deadline of June 11 for tendering claims, they have decided that they no longer feel bound to this position. Letters have been sent out to nonparticipating creditors informing them of the closure of the offer. For such creditors, interest accrued up to June 11, 2004 under the original terms has been deposited into an escrow account at the ECCB. Thereafter, the authorities are treating the outstanding principal amounts as if they had been converted into the intermediate bond envisaged under the exchange offer and, as payments fall due, are making payments into the escrow accounts under restructured terms.[8] In January 2005, parliament passed legislation to stop earmarking of revenues to service debt held by some creditors that have thus far chosen not to restructure their exposure. The authorities consider this to be an important step in restoring debt sustainability over the medium term. With this change, debt service payments would be consistent with the assumptions underlying the authorities' budget (and hence the program) for this year, which was predicated on full creditor participation in the restructuring effort.

24. **Indicating that the decision to close the exchange offer was a difficult one, the authorities explained that they remain committed to working with creditors on finding a solution to their debt problems**. They emphasized the collaborative nature of the pre-emptive restructuring of their unsustainable debt, and were pleased with the support shown by the large majority of creditors who had agreed to participate in the effort. Thus far, creditors holding about 30 percent of the eligible debt had, however, decided to remain outside the process. The authorities hoped that more creditors will be encouraged by recent developments to join in their debt restructuring effort. Toward this end, they would actively seek to maintain dialogue and continue to share with creditors any relevant nonconfidential information that would be helpful in reaching mutually acceptable solutions.

25. **The shift to making payments to creditors under restructured terms, in line with budget assumptions, ensures that the program remains financed for now but it also creates risks**. Following the closure of the exchange offer and the unilateral switch to making payments under restructured terms, Dominica is vulnerable to legal action by its

[8] See IMF Country Report No. 04/286 for a description of the different bonds. In one particular case of debt under dispute, the authorities are making fixed monthly payments into the escrow accounts.

creditors for having ceased to abide by the terms of the original contracts.[9] Until new agreements are reached and these arrears are eliminated, there is a risk to Fund resources, as there is some uncertainty about the future debt service costs for Dominica and thereby, its capacity to repay the Fund. There are also risks to the overall financing package posed by rescheduling agreements that depart from the principle of inter-creditor equity.

26. **In the presence of arrears to private parties, the Fund's policy on lending into arrears allows continued disbursements if certain conditions are met**. These are: (i) prompt Fund support is considered essential for the successful implementation of the member's adjustment program; (ii) the member is pursuing appropriate policies, and, (iii) it is continuing to make a good faith effort to reach a collaborative settlement with creditors. In such cases, all disbursements are subject to financing reviews by the Board. The authorities' request to complete this review would be governed by this policy.[10]

III. Staff Appraisal

27. **Dominica continues to make remarkable progress at fiscal consolidation**. Having already accelerated the achievement of the medium-term primary surplus target once, the authorities' resolve to stick with the fiscal targets for this year under difficult circumstances is a powerful testament to their continuing commitment to the program objectives. In taking this decision, they recognize that while the hard-won achievements to-date have brought Dominica much of the way toward medium-term sustainability, the task is not yet complete. Thus, while the authorities are to be commended for the resolute implementation of the fiscal program, they are also strongly encouraged to stay the course.

28. **Budgetary reform remains crucial to realizing the fiscal objectives**. If the higher-than-anticipated revenues are to go fully to finance earthquake-related expenditures, vigilance is required in ensuring that the budgetary ceilings for other current and nongrant-financed capital expenditures are respected. In this regard, strengthened public expenditure management is an integral element of the program, and the steps that are being taken to improve cash management are welcome.

29. **The efforts to reform the tax system and strengthen social security are necessary to place Dominica's public finances over the long term on a firmer footing**. The authorities have emphasized their continued commitment to implementing the VAT. The staff concurs that it is preferable to identify early and satisfactorily address potential

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[9] Payments were already not current on debt under dispute, which are carved out of the program performance criterion on external arrears, as are debt service payments to official bilateral creditors pending final agreement on the new terms.

[10] Accordingly, the performance criterion on external arrears is being modified to exclude debt to the private sector that has been, or is eligible to have been, tendered into the debt exchange offer that was closed.

obstacles to the tax than to risk its eventual success through undue haste in its introduction. The business community should, nevertheless, continue to work actively with the authorities to help prepare for the introduction of the tax and refrain from calling for tax exemptions. Such exemptions, of questionable value in attracting new inflows, can harm the investment climate by perpetuating weak public finances. As regards social security, the initiation of steps to assess the sustainability of public finances from a broader, general-government, level, is timely and the staff welcomes the commitment to undertake a comprehensive review of the pension system this year.

30. **The debt restructuring remains to be completed, posing risks to the program**. Dominica has followed international best practice in seeking to pre-emptively restructure its debt, and for the most part, the international community has responded very favorably, as evidenced by the strong participation of creditors in the authorities' undertaking. All creditors are, however, not yet on board. The arrears that have now started accumulating and the uncertainty this introduces to the program represent risks to Fund resources. However, continued Fund support remains essential for the successful implementation of Dominica's adjustment program. Furthermore, Dominica is pursuing appropriate macroeconomic policies, and the authorities have stressed that they will continue to make good faith efforts to reach collaborative settlements with creditors. In the last respect, a key indication of their intention is the commitment to continue making payments into escrow accounts for nonparticipating creditors, and to maintain open the lines of communication with them.

31. **The authorities should ensure that their commitments under the structural reform agenda continue to translate into actions**. While the agenda will need to be given greater specificity by the post-election government, the policies outlined in the attached MEP would remain vital to securing Dominica's future, regardless of the particular identity of the government in office. The very binding capacity constraints, arising in significant part from the inherent diseconomies of scale involved in a small island economy, will also require the judicious selection of measures to those that are likely to make the greatest impact and are critical to the successful achievement of the program objectives. The authorities need to marshal their limited resources to implement the reforms, many of which will require introducing or amending legislation, an area where constraints have been particularly binding of late. The authorities are encouraged to continue to address these bottlenecks. At the same time, it also has to be recognized that the timely delivery of technical assistance by the international community remains critical to making sufficient progress in all the areas identified for action.

32. **The staff supports completion of the program reviews**. The authorities' commendable implementation of the program is beginning to yield visible results. Growth is up, revenue collections are buoyant, and financial intermediation is on the rebound. While significant risks to the program remain on account of the unfinished debt restructuring, they are balanced by the authorities' continued commitment to the financial program and their good faith efforts to reach agreement with their creditors. Furthermore, financing assurances reviews will provide opportunities to bring developments at an early stage to the attention of

the Executive Board and consider whether adequate safeguards remain in place for the continued use of Fund resources. On these grounds, and the corrective actions that have been taken, the authorities' request for a waiver of the performance criterion on external arrears, the completion of the third and fourth reviews, and the release of the fourth, fifth, and sixth loans under the arrangement, are worthy of support.

Table 1. Dominica: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	Mar. 31, 2004 1/			Jun. 30, 2004 1/			Sept. 30, 2004 2/				Dec. 31, 2004 2/			
	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Program PC	Adjusted PC	Actual	Margin (+)/ Excess (-)	Program PC	Adjusted PC	Prov. Actual	Margin (+)/ Excess (-)
I. Performance Criteria														
(In millions of Eastern Caribbean dollars)														
Central government primary balance 3/	-4.1	28.1	32.2	2.0	40.1	38.1	-3.0	-3.0	0.1	3.1	3.0	3.0	14.0	11.0
Central government wage bill	83.2	77.9	5.3	108.6	104.2	4.4	27.0	27.0	25.3	1.7	54.0	54.0	51.5	2.5
Banking system net credit to central government 4/	3.0	-31.6	34.6	3.0	-41.4	44.4	3.0	6.7	4.0	2.7	3.0	6.0	-2.2	8.2
Net changes in central government arrears to private domestic parties 5/	15.0	-3.4	18.4	15.0	-7.2	22.2	15.0	15.0	3.2	11.9	15.0	15.0	4.4	10.6
(In millions of U.S. dollars)														
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year 3/	31.5	23.9	7.6	32.5	27.6	4.9	4.0	4.0	2.9	1.1	6.0	6.0	3.4	2.6
Net changes in the outstanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 5/	0.0	0.0	0.0	0.0	Met	...	0.0	0.0	Met	...	0.0	0.0	Met	...
Net changes in external payments arrears of the central government 5/ 6/	0.0	-0.7	0.7	0.0	Met	...	0.0	0.0	Not met	...	0.0	0.0	Not met	...
II. Indicative Targets														
(In millions of Eastern Caribbean dollars)														
Central government overall balance 3/	-37.6	-6.2	31.4	-38.0	-1.6	36.4	-16.7	-16.7	-13.5	3.2	-19.6	-19.6	-8.2	11.4
Central government revenues	148.5	157.7	9.2	197.4	221.6	24.2	48.7	48.7	55.3	6.6	103.6	103.6	116.4	12.8
Central government primary savings	0.0	27.0	27.0	10.6	41.4	30.8	4.1	4.1	12.5	8.4	15.2	15.2	27.6	12.4

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Cumulative amounts from June 30, 2003.
2/ Cumulative amounts from June 30, 2004.
3/ Up to June 2004, limits will be adjusted downward (upwards) to the extent that project financing falls short of (exceeds) programmed amounts. Upward adjustments will not exceed US$7.7 million by end-June 2004.
4/ Up to June 2004, limits on banking system net credit to the central government will be adjusted upward to the extent that there are shortfalls in external nonproject financing that are outside the control of the authorities. These upward adjustments will not exceed US$7.7 million by end-June 2004. Limits on banking system net credit to the central government will be adjusted downward to the extent that external nonproject financing exceeds programmed amounts. Beginning September 2004, limits on banking system net credit to the central government will be adjusted upward (downward) to the extent that cash interest payments of the central government are higher (lower) than in the baseline projection.
5/ These performance criteria will be monitored on a continuous basis.
6/ External arrears that were known at the time of the Executive Board discussion on August 4, 2004, were waived.

Table 2. Dominica: Structural Performance Criteria and Structural Benchmarks for the PRGF Arrangement through December 2004

	Expected Completion Date	Category	Status
Tax policy Significant reduction of discretionary tax exemptions.	Mid-December 2003	Prior Action for the Arrangement	Done
Civil service reform Study outlining the process for reduction in the wage bill for FY 2004/05 by 5 percent through retrenchment.	End-March 2004	Benchmark	Done
Tax policy and administration Conduct a review of all statutory tax exemptions with a view to assessing their effectiveness and justification, and to prevent abuses.	End-June 2004	Benchmark	Done
Pension reform Submit legislation to Parliament proposing a phased increase in the retirement age for public employees to 60 years.	End-June 2004	Benchmark	Done
Budget Approval Approval of FY 2004/05 budget, consistent with the program.	Early-July 2004	Prior Action 2nd Review	Done
Tax policy Announcement in the budget for FY 2004/05 the adoption of the VAT by mid-2005. Cabinet approval of key parameters such as the base, the rate, registration threshold, filing frequency, and refund system.	End-September 2004	Benchmark	Done
Institutional strengthening Improve the regulatory framework for electricity supply, following the recommendations of technical assistance mission.	End-September 2004	Benchmark	Pending

Sources: Dominican authorities and Fund staff estimates and projections.

Table 3. Dominica: Selected Economic and Financial Indicators

	2001	2002	2003	Prog. 1/ 2004	Est. 2004	Proj. 2005
(Annual percent change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	-4.2	-4.7	0.0	1.0	2.0	2.5
GDP deflator (factor cost)	1.2	-0.4	1.7	1.5	1.6	1.5
Nominal GDP (at factor cost)	-3.0	-5.1	1.7	2.6	3.7	4.1
Nominal GDP at market prices	-2.7	-3.7	2.4	3.2	4.1	3.9
Consumer prices (end of period) 2/	1.9	0.5	2.9	1.5	2.0	1.5
Money and credit						
Net foreign assets of the banking system 3/	6.6	19.9	17.3	-2.5	8.1	4.1
Net domestic assets of the banking system 3/	0.9	-11.3	-16.4	5.7	-2.2	1.5
Of which						
Net credit to the nonfinancial public sector 3/	5.6	-7.0	-4.1	4.7	-5.2	0.0
Credit to the private sector 3/	-3.1	-1.3	-2.3	2.4	5.4	3.8
Liabilities to the private sector (M2)	7.4	8.5	1.0	3.2	5.8	5.6
Balance of payments						
Merchandise exports, f.o.b.	-18.9	-3.7	-7.2	5.1	3.4	10.1
Merchandise imports, f.o.b.	-11.6	-12.1	10.0	4.3	11.0	6.3
Real effective exchange rate						
(end-of-period; depreciation -) 2/	3.7	-6.3	-6.7	…	-5.3	…
(In millions of U.S. dollars)						
Merchandise exports, f.o.b.	44.4	42.8	39.7	41.7	41.0	45.2
Merchandise imports, f.o.b.	115.3	101.4	111.5	116.3	123.8	131.6
Current account balance	-47.6	-37.0	-46.6	-41.4	-44.8	-42.4
Capital account balance 4/	49.1	49.2	43.0	20.6	19.1	32.7
Overall balance	1.5	12.1	1.4	-20.6	-25.7	-9.7
(In percent of GDP, unless otherwise specified)						
Central government 5/						
Savings	-3.0	-0.6	8.7	7.0	8.4	8.1
Of which						
Primary	2.4	5.1	14.7	13.8	14.7	14.0
Grants	1.7	4.5	8.9	8.8	8.1	6.2
Capital expenditure and net lending	5.7	5.1	10.1	11.8	12.3	11.0
Primary balance	-2.1	-1.6	5.6	2.0	2.0	3.0
Overall balance	-8.6	-5.4	-1.3	-4.3	-3.5	-2.5
External sector						
Current account balance	-18.2	-14.7	-18.1	-15.5	-16.7	-15.2
External public debt service 6/	10.8	12.3	18.5	22.8	19.5	...
Amortization	4.5	4.9	12.1	15.0	13.2	...
Interest	6.4	7.5	6.4	7.7	6.3	...
Memorandum items:						
Nominal GDP at market prices (EC$ millions)						
Calendar year	706.8	680.5	697.1	719.4	725.7	754.2
Net international reserves						
(U.S. dollars millions; end-of-period) 7/	30.4	42.5	44.0	47.7	33.6	34.0

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/286, 2nd PRGF Review (August 2004).
2/ Figure for 2004 is for November 2004.
3/ Change relative to the stock of M2 at the beginning of the period. From 2003, transactions with the IMF are included as transactions of the monetary authorities.
4/ Including errors and omissions.
5/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.
6/ On a due basis (i.e. before restructuring). In percent of exports of goods and nonfactor services.
7/ Imputed reserves at the ECCB until 2002. From 2003, transactions with the IMF are included as transactions of the monetary authorities.

Table 4. Dominica: Summary Accounts of the Central Government 1/

	2000/01	2001/02	2002/03	2003/2004 Prog. 2/	2003/2004 Est.	2004/2005 Prog. 2/	2004/2005 Proj.	2005/2006 Prog. 2/	2005/2006 Proj.
(In millions of Eastern Caribbean dollars)									
Total revenue and grants	**271.5**	**209.7**	**224.1**	**262.0**	**285.9**	**278.7**	**291.3**	**278.4**	**287.0**
Current revenue	200.5	197.1	191.9	207.5	221.8	211.1	229.2	217.6	237.2
Capital revenue	3.0	0.9	1.3	2.3	1.0	3.0	2.5	2.6	2.6
Grants	68.0	11.8	30.9	52.2	63.2	64.6	59.6	58.2	47.3
Total expenditure 3/	**350.3**	**269.3**	**261.3**	**291.9**	**295.2**	**310.3**	**317.5**	**303.8**	**306.4**
Current expenditure	230.1	229.7	226.6	231.6	223.1	224.1	226.7	224.4	222.2
Wages and salaries	116.2	116.5	116.1	108.6	104.2	102.7	102.7	99.7	99.7
Interest	36.0	36.9	37.6	41.7	41.7	46.4	43.8	48.2	42.4
Others	77.9	76.3	72.8	81.3	77.2	75.1	80.1	76.5	80.1
Capital expenditure and net lending	120.2	39.6	34.7	60.2	72.1	86.2	90.9	79.4	84.2
Overall balance	**-78.8**	**-59.5**	**-37.2**	**-29.9**	**-9.3**	**-31.6**	**-26.3**	**-25.4**	**-19.3**
Statistical discrepancy 4/	18.7	8.2	-11.5	0.0	7.7	0.0	-2.7	0.0	0.0
Financing	**60.1**	**51.3**	**48.7**	**29.9**	**1.6**	**31.6**	**29.0**	**25.4**	**19.3**
Net foreign financing	42.7	25.6	44.9	40.6	47.3	23.5	16.9	24.0	12.5
Disbursements	...	31.9	47.7	75.9	78.4	20.6	20.9	21.2	11.5
Amortization	...	6.3	6.5	37.2	37.2	44.7	43.2	18.2	20.2
Other including rescheduling	...	0.0	3.8	1.9	6.1	47.5	39.2	21.0	21.2
Net domestic financing	17.4	25.7	3.8	-10.7	-45.7	8.1	12.1	1.4	6.8
Bank	11.2	16.3	-6.9	-8.0	-41.4	-4.9	-0.2	-11.5	-2.9
Nonbank	6.2	9.5	10.7	-2.0	-8.8	0.6	1.6	0.6	0.0
Other including rescheduling	0.0	0.0	0.0	-0.7	4.6	12.4	10.7	12.3	9.7
Gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
(In percent of GDP)									
Total revenue and grants	**37.6**	**30.2**	**32.7**	**36.9**	**40.2**	**38.0**	**39.4**	**36.7**	**37.4**
Current revenue	27.8	28.4	28.0	29.2	31.2	28.8	31.0	28.7	30.9
Capital revenue	0.4	0.1	0.2	0.3	0.1	0.4	0.3	0.3	0.3
Grants	9.4	1.7	4.5	7.4	8.9	8.8	8.1	7.7	6.2
Total expenditure 3/	**48.5**	**38.8**	**38.2**	**41.1**	**41.5**	**42.3**	**42.9**	**40.0**	**39.9**
Current expenditure	31.9	33.1	33.1	32.6	31.4	30.6	30.6	29.6	28.9
Wages and salaries	16.1	16.8	17.0	15.3	14.7	14.0	13.9	13.1	13.0
Interest	5.0	5.3	5.5	5.9	5.9	6.3	5.9	6.4	5.5
Others	10.8	11.0	10.6	11.5	10.8	10.2	10.8	10.1	10.4
Capital expenditure and net lending	16.6	5.7	5.1	8.5	10.1	11.8	12.3	10.5	11.0
Overall balance	**-10.9**	**-8.6**	**-5.4**	**-4.2**	**-1.3**	**-4.3**	**-3.5**	**-3.4**	**-2.5**
Statistical discrepancy 4/	2.6	1.2	-1.7	0.0	1.1	0.0	-0.4	0.0	0.0
Financing	**8.3**	**7.4**	**7.1**	**4.2**	**0.2**	**4.3**	**3.9**	**3.4**	**2.5**
Net foreign financing	5.9	3.7	6.6	5.7	6.6	3.2	2.3	3.2	1.6
Disbursements	...	4.6	7.0	10.7	11.0	2.8	2.8	2.8	1.5
Amortization	...	0.9	1.0	5.2	5.2	6.1	5.8	2.4	2.6
Other including rescheduling	...	0.0	0.6	0.3	0.9	6.5	5.3	2.8	2.8
Net domestic financing	2.4	3.7	0.6	-1.5	-6.4	1.1	1.6	0.2	0.9
Bank	1.5	2.3	-1.0	-1.1	-5.8	-0.7	0.0	-1.5	-0.4
Nonbank	0.9	1.4	1.6	-0.3	-1.2	0.1	0.2	0.1	0.0
Other including rescheduling	0.0	0.0	0.0	-0.1	0.6	1.7	1.4	1.6	1.3
Gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Savings (incl. grants)	5.3	-3.0	-0.6	4.0	8.7	7.0	8.4	6.8	8.1
Primary savings (before grants)	1.3	0.7	0.6	2.8	5.8	5.0	6.6	5.8	7.8
Primary balance (incl. grants) 5/	-3.3	-2.1	-1.6	1.7	5.6	2.0	2.0	3.0	3.0
Nominal GDP at market prices (EC$ millions)	722.4	693.7	684.8	709.9	711.4	733.4	740.0	758.7	767.5

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal years beginning July 1.
2/ IMF Country Report No. 04/286.
3/ On a due basis.
4/ Difference between identified financing below-the-line and overall balance above-the-line. Projected discrepancy for FY 2004/2005 equals realized discrepancy through end-December 2004.
5/ Computed using overall deficit measured from below-the-line.

Table 5. Dominica: Summary Accounts of the Banking System

	2000	2001	2002	2003	Prog. 1/ 2004	Est. 2004	Proj. 2005
	(In millions of Eastern Caribbean dollars, end of period)						
	I. Consolidated Banking System and Monetary Authorities						
Net foreign assets	**65.2**	**96.1**	**193.8**	**289.0**	**274.6**	**333.8**	**357.7**
Net domestic assets	**405.8**	**409.8**	**355.4**	**265.5**	**297.6**	**253.0**	**261.7**
Net credit to the nonfinancial public sector	75.8	102.3	74.8	52.1	60.9	23.5	23.6
Of which							
Central government	70.3	92.3	64.2	55.9	53.3	45.6	46.6
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-84.4	-75.9	-78.8
Credit to the private sector	454.1	439.6	433.2	420.6	434.1	450.7	472.9
Other items (net) 2/	-88.3	-94.4	-106.1	-125.4	-112.9	-145.2	-155.9
Broad money 3/	**471.0**	**506.0**	**549.2**	**554.5**	**572.2**	**586.9**	**619.5**
	II. Operations of the Monetary Authorities						
Imputed net international reserves	**78.2**	**82.1**	**117.8**	**118.7**	**128.8**	**90.8**	**91.8**
Net domestic assets	**10.9**	**10.2**	**12.1**	**3.6**	**4.9**	**22.6**	**27.9**
Monetary base	**89.1**	**92.3**	**129.9**	**122.3**	**133.7**	**113.4**	**119.7**
Currency in circulation	35.4	34.6	35.5	34.2	35.3	37.6	38.9
Commercial bank reserves	53.6	57.7	94.4	88.1	98.4	75.8	80.8
	III. Commercial Banks						
Net foreign assets	**-12.9**	**14.0**	**79.0**	**170.4**	**145.8**	**243.0**	**265.9**
Net claims on ECCB	**51.2**	**58.5**	**98.2**	**85.6**	**84.2**	**73.8**	**78.8**
Net domestic assets	**397.3**	**398.9**	**336.6**	**264.3**	**306.9**	**232.5**	**235.8**
Net credit to the nonfinancial public sector	65.0	92.1	53.4	27.2	56.0	-10.4	-16.0
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-84.4	-75.9	-78.8
Credit to the private sector	454.1	439.6	433.2	420.6	434.1	450.7	472.9
Other (net)	-86.0	-95.2	-103.5	-96.7	-98.7	-132.0	-142.2
Private sector deposits 3/	**435.6**	**477.4**	**513.7**	**520.3**	**536.9**	**549.3**	**580.6**
	IV. Consolidated Banking System						
	(Annual percentage change)						
Credit to the private sector	8.2	-3.2	-1.4	-2.9	3.2	7.1	4.9
Private sector deposits	0.3	9.6	7.6	1.3	3.2	5.6	5.7
Broad money	0.6	7.4	8.5	1.0	3.2	5.8	5.6
	(Contributions to liquidity growth) 4/						
Net foreign assets	**-12.8**	**6.6**	**19.3**	**17.3**	**-2.5**	**8.1**	**4.1**
Net domestic assets	**13.4**	**0.9**	**-10.8**	**-16.4**	**5.7**	**-2.2**	**1.5**
Net credit to the nonfinancial public sector	5.7	5.6	-5.4	-4.1	4.7	-5.2	0.0
Credit to the private sector	7.3	-3.1	-1.3	-2.3	2.4	5.4	3.8
Memorandum items:							
Interest rates 5/							
Deposits (3-month time—maximum rate)	6.0	6.0	6.0	6.0	4.0	3.0	…
Lending: Minimum rate	9.5	9.5	8.5	8.0	8.5	7.5	…
Maximum rate	20.8	20.8	20.8	18.2	18.2	18.2	…

Sources: Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Program figures are as shown in IMF Country Report No. 04/286, 2nd PRGF Review (August 2004). From 2003, transactions with the IMF are included as transactions with the monetary authorities.

2/ Includes interbank float.

3/ Including deposits denominated in U.S. dollars.

4/ Change relative to broad money at the beginning of the period.

5/ Commercial banks; end-of-period rates, percent per annum.

Table 6. Dominica: Balance of Payments

	2000	2001	2002	2003	Est. 2004	Proj. 2005
	(In millions of U.S. dollars)					
Current account balance	**-52.5**	**-47.6**	**-37.0**	**-46.6**	**-44.8**	**-42.4**
Trade balance	-75.6	-70.9	-58.6	-71.8	-82.8	-86.4
Exports (f.o.b.) 1/	54.7	44.4	42.8	39.7	41.0	45.2
Imports (f.o.b.)	130.4	115.3	101.4	111.5	123.8	131.6
Services balance	37.1	25.0	25.2	27.2	37.4	47.8
Exports of services	89.7	76.7	74.7	85.0	96.2	107.2
Travel	48.2	46.3	44.2	50.8	60.3	68.7
Other	41.6	30.4	30.5	34.1	35.8	38.5
Imports of services	52.7	51.7	49.4	57.8	58.8	59.4
Net income	-32.0	-19.2	-20.1	-17.2	-16.9	-20.9
Interest payments (public sector)	-6.2	-7.7	-8.8	-8.0	-8.6	-9.0
Other income	-25.8	-11.5	-11.3	-9.3	-8.2	-11.9
Net current transfers	18.1	17.5	16.4	15.2	17.5	17.1
Private	10.6	11.5	12.0	11.0	15.4	16.9
Public	7.4	5.9	4.4	4.2	2.1	0.2
Capital and financial account	**56.2**	**41.2**	**27.3**	**22.7**	**19.1**	**32.7**
Capital account	12.3	18.0	13.3	16.2	23.5	22.6
Public capital transfers	9.6	15.3	10.5	13.3	20.6	19.6
Private capital transfers	2.7	2.7	2.7	2.9	2.9	3.0
Financial account	43.9	23.2	14.1	6.5	-4.4	10.1
Public sector	21.2	23.0	25.2	8.9	-3.4	-0.3
Budgetary flows (net)	23.9	24.6	24.4	8.9	-3.4	-0.3
Disbursements	28.4	30.0	30.1	24.0	14.7	7.8
Repayments	4.5	5.4	5.7	15.1	18.1	8.0
Nonbudgetary flows (net)	-2.7	-1.6	0.8	0.0	0.0	0.0
Private sector	22.7	0.2	-11.1	-2.3	-1.0	10.3
Direct investment	10.8	11.9	13.2	24.4	21.1	21.1
Commercial banks	19.7	-10.0	-24.0	-32.6	-26.9	-9.0
Other private flows	-7.8	-1.7	-0.3	5.9	4.8	-1.8
Errors and omissions	**-6.2**	**7.9**	**21.9**	**20.3**	**0.0**	**0.0**
Overall balance	**-2.5**	**1.5**	**12.1**	**1.4**	**-25.7**	**-9.7**
Overall financing	**2.5**	**-1.5**	**-12.1**	**-1.4**	**25.7**	**9.7**
Net international reserves	2.5	-1.5	-12.1	-1.4	10.3	-0.4
Gross reserves (increase = -)	2.5	-1.5	-15.1	-6.2	9.4	-3.5
IMF reserve liabilities (purchase = +)	0.0	0.0	3.0	4.8	0.9	3.1
Exceptional financing	0.0	0.0	0.0	0.0	15.4	10.1
	(In percent of GDP)					
Memorandum items:						
Current account balance	-19.5	-18.2	-14.7	-18.1	-16.7	-15.2
Current account balance including net capital transfers	-15.0	-11.3	-9.4	-11.8	-7.9	-7.1
External public debt 2/	53.7	64.6	77.4	87.4	...	...

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Includes stores and bunkers.
2/ Includes external financing gap.

Table 7. Dominica: Medium-Term

	2000	2001	2002	2003	Prog. 1/ 2004	Est.	Proj. 2005	Proj. 2006
	(Annual percent change)							
National income and prices								
GDP at constant (1990) prices	1.4	-4.2	-4.7	0.0	1.0	2.0	2.5	2.0
Implicit GDP deflator (factor cost)	0.6	1.2	-0.4	1.7	1.5	1.6	1.5	1.5
	(In percent of GDP, unless otherwise specified)							
Savings and investment								
Gross domestic investment	**21.0**	**16.6**	**9.6**	**14.8**	**17.8**	**19.1**	**22.1**	**22.4**
Public	12.9	10.7	5.6	7.8	11.3	11.6	13.1	13.4
Private	8.1	5.9	4.0	7.0	6.5	7.5	9.0	9.0
Gross national saving 2/	**5.5**	**5.3**	**0.2**	**3.0**	**11.4**	**11.2**	**15.0**	**16.5**
Public	1.8	1.0	-1.4	4.5	8.5	9.2	10.0	11.2
Private	3.7	4.3	1.6	-1.5	2.9	2.0	5.0	5.3
Savings-investment balance	**-15.5**	**-11.3**	**-9.4**	**-11.8**	**-6.4**	**-7.9**	**-7.1**	**-5.9**
Public Savings-Investment	-11.1	-9.7	-7.0	-3.3	-2.8	-2.4	-3.0	-2.2
Of which: Central government	-11.1	-9.7	-7.0	-3.3	-2.8	-2.4	-3.0	-2.2
Private Savings-Investment	-4.4	-1.6	-2.4	-8.5	-3.6	-5.5	-4.0	-3.7
Central government finances 3/								
Central government saving (excluding grants)	-3.7	-4.6	-4.9	-0.1	-1.4	0.7	2.3	2.8
Current revenue	27.8	28.4	28.0	31.2	28.8	31.0	30.9	30.9
Capital revenue	0.4	0.1	0.2	0.1	0.4	0.3	0.3	0.3
Current expenditure	31.9	33.1	33.1	31.4	30.6	30.6	28.9	28.4
Overall balance (after grants)	-10.9	-8.6	-5.4	-1.3	-4.3	-3.5	-2.5	-2.0
Grants	9.4	1.7	4.5	8.9	8.8	8.1	6.2	6.2
Capital spending	16.6	5.7	5.1	10.1	11.8	12.3	11.0	11.0
Primary balance	-3.3	-2.1	-1.6	5.6	2.0	2.0	3.0	3.0
Balance of payments								
Current account	-19.5	-18.2	-14.7	-18.1	-15.5	-16.7	-15.2	-14.2
Of which								
Exports of goods and services	53.7	46.3	46.6	49.1	50.0	51.0	54.6	58.3
Imports of goods and services	68.0	63.8	59.8	64.9	64.1	67.9	68.4	70.5
Current account including capital transfers	-15.5	-11.3	-9.4	-11.8	-6.4	-7.9	-7.1	-5.9
Capital and financial account 4/	20.9	15.7	10.8	8.8	7.8	7.1	11.7	11.7
Overall balance	-0.9	0.6	4.8	0.5	-7.8	-9.6	-3.5	-2.0
External public debt service 5/	7.4	10.8	12.3	18.5	22.8	19.5	...	...
Amortization	3.1	4.5	4.9	12.1	15.0	13.2	...	...
Interest	4.3	6.4	7.5	6.4	7.7	6.3	...	...
Memorandum items:								
Nonfinancial public sector debt 3/	87.4	95.4	121.9	122.0	...	...	...	...
External 6/	59.1	71.0	82.4	87.4	...	...	...	...
Domestic	28.2	24.4	39.4	34.6	...	...	...	...

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/286, 2nd PRGF Review (August 2004).
2/ Calculated using the external current account including net external capital transfers.
3/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.
4/ Including errors and omissions.
5/ On a due basis (i.e. before restructuring). In percent of exports of goods and nonfactor services.
6/ Including external financing gap.

Table 8. Dominica: Financial and External Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003	Est. 2004	Proj. 2005
Financial indicators						
Broad money (percent change, 12-month basis)	0.6	7.4	8.5	1.0	5.8	5.6
Private sector credit (percent change, 12-month basis)	8.2	-3.2	-1.4	-2.9	7.1	4.9
Unsatisfactory assets/total loans 1/	17.4	22.6	19.2	21.7	24.6	...
General and specific provisions for loan losses/unsatisfactory assets 1/	40.0	30.2	36.7	34.8	26.9	...
Specific provisions for loan losses/unsatisfactory assets 2/	33.3	26.2	32.6	30.1	30.1	...
Total capital/risk weighted assets (locally incorporated banks) 2/	30.8	35.4	34.1	29.1	29.1	...
Tier 1 capital/risk weighted assets (locally incorporated banks) 2/	27.4	34.1	32.9	29.3	29.3	...
Three-month treasury bill rate (end of period) 2/	6.4	6.4	6.0	6.3	6.3	6.3
Three-month treasury bill rate (real) 3/	5.3	4.5	5.5	3.4	4.8	4.8
External indicators						
Exports of goods and services (percent change, 12-month basis in U.S. dlrs.)	-7.9	-16.2	-3.0	6.2	10.1	11.1
Imports of goods and services (percent change, 12-month basis in U.S. dlrs.)	1.4	-8.8	-9.7	12.3	7.9	4.6
Current account balance	-19.5	-18.2	-14.7	-18.1	-16.7	-15.2
Capital and financial account balance 4/	18.6	18.8	19.5	16.9	7.1	11.7
Net official reserves (in millions of U.S. dollars, end of period) 5/	29.0	30.4	43.6	44.0	33.6	34.0
Net reserves to broad money (percent, end of period) 4/	16.6	16.2	21.4	21.4	15.5	14.8
Public sector external debt	53.7	64.6	77.4	87.4	...	...
External debt (end of period) to exports of goods and services (percent) 6/	100.8	140.8	163.2	178.6	...	...
External interest payments to exports of goods and services (percent) 6/	4.3	6.4	7.5	6.4	6.3	...
External amortization payments to exports of goods and services (percent) 6/	3.1	4.5	4.9	12.1	13.2	...
Exchange rate (per U.S. dollar, end of period)	2.7	2.7	2.7	2.7	2.7	2.7
REER appreciation (end of period; depreciation -)	4.8	3.7	-6.4	-6.7	...	...

Sources: Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Figure for 2004 is the provisional data for June 2004.
2/ Figure for 2004 is for March 2004.
3/ Treasury bill rate adjusted by end-of-period inflation.
4/ Includes errors and omissions.
5/ Imputed reserves at the ECCB until 2002. From 2003, transactions with the IMF are included as transactions of the monetary authorities.
6/ Refers to public sector debt.

Table 9. Dominica: Proposed Schedule of Disbursements Under the PRGF Arrangement

	Disbursements (in millions)		As Percent	
	US$ 1/	SDR	of Quota	Conditions
2003	**3.419**	**2.358**	**28.8**	
December 29	3.419	2.358	28.8	Board approval of PRGF; and adoption of prior actions
2004	**0.893**	**0.616**	**7.5**	
March 24	0.447	0.308	3.8	First review under the PRGF; end-December 2003 performance criteria; and adoption of prior action.
August 6	0.447	0.308	3.8	Second review under the PRGF; and end-March 2004 performance criteria
2005	**3.468**	**2.392**	**29.2**	
March 7	1.785	1.231	15.0	Third and fourth reviews under the PRGF; end-June 2004, end-September 2004, and end-December 2004 performance criteria.
August 15	1.683	1.161	14.2	Fifth review under the PRGF; and end-June 2005 performance criteria.
2006	**3.367**	**2.322**	**28.3**	
February 15	1.683	1.161	14.2	Sixth review under the PRGF; and end-December 2005 performance criteria.
August 15	1.683	1.161	14.2	Seventh review under the PRGF; and end-June 2006 performance criteria.
Total	**11.148**	**7.688**	**93.8**	
Memorandum item:				
Quota (in millions)	11.890	8.200	100.0	

Source: Fund staff estimates and projections .

1/ For illustrative purposes only, SDR amounts have been converted into U.S. dollars at an US$/SDR exchange rate of 1.45.

Table 10. Dominica: Indicators of Capacity to Repay the Fund, 2003–08

			Projections			
	2003	2004	2005	2006	2007	2008
Fund repurchases and charges (Obligation basis) 1/						
In millions of SDRs	0.05	0.09	0.40	1.24	1.33	0.46
On existing credits	0.05	0.09	0.38	1.20	1.29	0.42
Of which: Repurchases on an obligation basis	0.00	0.00	0.26	1.10	1.23	0.38
On assumed future disbursements			0.02	0.04	0.04	0.04
In millions of U.S. dollars	0.07	0.13	0.62	1.91	2.05	0.71
In percent of exports of goods and services	0.06	0.10	0.40	1.19	1.22	0.40
In percent of debt service 2/	0.30	0.50	3.53	10.62	12.23	4.78
In percent of quota	0.61	1.09	4.88	15.12	16.22	5.61
In percent of net international reserves 3/	0.16	0.39	1.81	5.38	5.17	1.68
Fund credit outstanding 1/						
In millions of SDRs	5.3	5.9	8.1	9.3	8.1	7.7
In millions of U.S. dollars	7.5	8.8	12.4	14.3	12.4	11.9
In percent of exports of goods and services	5.9	6.3	8.2	8.9	7.4	6.8
In percent of debt service 2/	32.4	32.9	71.4	79.7	74.2	79.9
In percent of quota	65.0	72.5	98.5	113.4	98.4	93.8
In percent of net international reserves 3/	17.0	26.2	36.6	40.4	31.4	28.2

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Including assumed future disbursements under the PRGF, and assuming all repurchases on an obligation basis.
2/ Including IMF repurchases in total debt service.
3/ Net international reserves of the monetary authorities; net imputed reserves of the ECCB and transactions with the Fund.

Dominica: Fund Relations

(As of December 31, 2004)

I. Membership Status Joined 12/12/78; Article VIII

II. General Resources Account	**SDR Million**	**Percent of Quota**
Quota	8.20	100.00
Fund holdings of currency	11.16	136.15
Reserve position in Fund	0.01	0.11

III. SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	0.59	100.00
Holdings	0.03	5.82

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
PRGF Arrangements	2.97	36.27
Stand-by arrangements	2.97	36.25

V. Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved** (SDR Million)	**Amount Drawn** (SDR Million)
PRGF	12/29/03	12/28/06	7.69	2.97
Stand-by	08/28/02	01/02/04	2.97	2.97
SAF	11/26/86	11/25/89	2.80	2.80
Stand-By	07/18/84	07/17/85	1.40	0.97
EFF	02/06/81	02/05/84	8.55	8.55

Projected Payments to the Fund on an Obligation Basis (SDR Million)[11]:

	Forthcoming				
	2005	**2006**	**2007**	**2008**	**2009**
Principal	0.26	1.10	1.23	0.38	0.50
Charges/Interest	0.12	0.10	0.06	0.04	0.03
Total	**0.38**	**1.20**	**1.29**	**0.42**	**0.53**

VI. Exchange rate arrangement: Dominica is a member of the Eastern Caribbean Currency Union, which has a common central bank (the Eastern Caribbean Central Bank) and currency (the Eastern Caribbean dollar). Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

[11] Based on existing use of resources and present holdings of SDRs.

VII. Safeguards Assessment: Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB), of which Dominica is a participating government, is subject to a full safeguards assessment.

The on-site safeguards assessment was completed on February 20, 2003, and concluded that the ECCB has in place appropriate mechanisms to manage resources, including Fund disbursements and that the vulnerabilities that remain do not present an undue risk. The safeguards assessment proposed specific measures to address these vulnerabilities, which have been substantially implemented by the ECCB.

VIII. Article IV consultation: The last Article IV consultation was concluded by the Executive Board on August 28, 2002; the relevant documents are IMF Country Report No. 02/223 and IMF Country Report No. 02/224. Dominica is on a 24-month cycle.

IX. Technical assistance: FAD missions visited Roseau to provide technical assistance on tax policy and administration, with special emphasis on VAT implementation (2002 and 1999), on urban property taxation (1997), and on tax policy and administration, and expenditure control (1995).

X. FSAP: A joint IMF/World Bank team performed an assessment of the financial sector of the member states of the ECCB, in two missions—September 1–19 and October 20–31, 2003. The principal objective of the missions was to assist the authorities in assessing the development needs and opportunities for the financial sector and identifying potential vulnerabilities of financial institutions and markets to macroeconomic shocks, as well as the risks to macroeconomic stability from weaknesses and shortcomings in the financial sector. An The Financial System Stability Assessment (FSSA) was discussed by the Executive Board on May 5, 2004, and subsequently published on the IMF's external website including the Report on the Observance of Standards and Codes (ROSC) on Banking Supervision.

Dominica: Relations with the Caribbean Development Bank (CDB)

(As of December 31, 2004)

The CDB has approved loans and grants for Dominica totaling approximately US$140.1 million. Of this amount US$136.5 million represented loans aimed at boosting real sector activity, particularly in agriculture, manufacturing and tourism. Significant resources were also dedicated towards improving road access, sea defenses and other physical infrastructure. A large portion of loans to the productive sector was channeled to the private sector through the Dominica Agricultural, Industrial and Development Bank (DAIDB).

In 2003, CDB completed a detailed poverty assessment in Dominica. Among other things, this will serve to inform government strategic interventions aimed at sustained poverty reduction. Moreover, CDB in collaboration with other development partners, has provided critical budget support to Dominica through an Economic Stabilization Loan. This intervention seeks to facilitate an orderly adjustment process in Dominica and will also allow for the formulation of a longer-term structural adjustment strategy.

Ongoing capital projects financed by CDB include the Fourth Consolidated Line of Credit, Roseau Water and Sewerage Project, Seventh Consolidated Line of Credit, OECS Solid Waste Project, and Eco-tourism project, and the Seventh Consolidated Line of Credit to DAIDB for on-lending to the productive sectors and to students.

Dominica: Financial Relations With CDB

(In millions of U.S. dollars)

Item	1999	2000	2001	2002	2003
Cumulative total credit approved	96.21	113.20	118.63	128.01	136.18
Cumulative disbursements	72.79	82.73	94.56	101.54	110.58
Disbursements	5.51	9.94	11.83	6.98	9.04
Outstanding debt	44.69	51.41	60.39	65.02	71.50
Amortization	2.73	2.73	2.70	2.59	2.79
Interest	1.14	1.35	1.61	1.89	2.01

Dominica: World Bank Relations[12]

(As of December 31, 2004)

The World Bank role in Dominica: The Bank will continue to collaborate with the Fund and other donors in supporting the authorities efforts in stabilizing macroeconomic conditions and in restarting economic growth and reducing poverty. The Bank will lead the policy dialogue on key structural reforms, including public investment, social protection, and on the environment for private sector development.

Bank-Fund collaboration in specific areas: The World Bank and the IMF will continue to collaborate on the financial sector, on the medium-term structural reform agenda and in providing of technical assistance to Dominica on macroeconomic management issues jointly with the Caribbean Regional Technical Assistance Center (CARTAC).

Bank Group strategy: The World Bank's strategy for Dominica is a part of the Country Assistance Strategy (CAS) for the Eastern Caribbean (OECS) sub-region, presented to the Bank Board on June 4, 2001. The CAS which covers FY 2002–06, proposes new commitments of around US$110 million for the five borrowing member states of the OECS (Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines). The main goals of the strategy are to reduce income insecurity and vulnerability at the national and household levels, and build human and institutional capacity to meet the challenging economic and social environment facing these small states.

Ongoing projects: There are currently two ongoing World Bank projects in Dominica (as well as other OECS borrowing countries) with total commitments of approximately US$7.5 million.

(i) The *OECS Telecommunications Reform Program*, approved in FY 1998 seeks to introduce pro-competition reforms in the telecommunications sectors and increase the supply of informatics-related skills in the OECS borrowing countries. The project has helped these countries establish a regional regulatory authority, negotiate with the sub-regional telecommunications monopoly, and lower telephone rates. Dominica's share of the US$6.0 million loan is US$1.2 million.

(ii) The *OECS Emergency Recovery Project*: This project was approved in FY 2002 to help mitigate the impact of the September 11 events on the tourism sector. The project supports improvements to airport and sea port security arrangements. The World Bank's assistance for this sub-regional program is US$21 million, including US$3.2 million for Dominica.

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[12] Source: World Bank.

Negative pledge update: Dominica remains ineligible for new Bank lending operations in light of the apparent violation of its negative pledge clauses under the earlier IBRD loans. The government continues to make efforts to resolve this issue.

Analytical and Advisory Services: The Bank has recently prepared a number of analytical reports for Dominica including a Country Financial Accountability Assessment, Social Protection Review, a Country Procurement Assessment, and a Public Expenditure Review. The Bank is also providing technical assistance to support public sector reforms and actions in the petroleum, electricity and financial sectors.

Key aspects of the Bank's Caribbean research and technical assistance program include:

(i) a study of Growth and Competitiveness in the OECS, scheduled for completion during FY 2005;
(ii) a recently completed FSAP in collaboration with the IMF;
(iii) an ongoing study of energy options in the OECS; and
(iv) a review of the relationship between poverty and the environment.

Financial Relations

(In millions of U.S. dollars)

Gross Disbursements and Debt Service During Fiscal Year

	1997	1998	1999	2000	2001	2002	2003	2004*
Total disbursements	0.5	1.9	1.4	2.1	0.5	1.7	2.7	4.0
Repayments	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6
Net disbursements	0.5	1.8	1.3	1.9	0.4	1.6	2.3	3.4
Cancelled	0.0	0.0	0.0	0.0	0.0	1.0	2.3	0.0
Interest and fees	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.4

* Projections as of March 25, 2004.

Dominica: Statistical Issues

Dominica's statistical database is inadequate for meeting the authorities' needs and for Fund surveillance. There are weaknesses in coverage, frequency, quality, and timeliness that continue to frustrate effective economic analysis and policy formulation. The weakest areas are the fiscal accounts, public debt, and the balance of payments.

The authorities are aware of the deficiencies in their statistical database and started participation in the General Data Dissemination System (GDDS) in September 2000. Metadata and plans for improving Dominica's statistical system are posted on the Internet on the IMF's Dissemination Standards Bulletin Board (http://dsbb.imf.org).

Real sector

CPI data are provided on a timely basis. The Eastern Caribbean Central Bank (ECCB) compiles semi-annual GDP estimates, which are then available with a one-quarter lag. Estimated annual data on nominal GDP (by activity) are available within a few months of the end of the year. Data on employment are very limited and there are no official data on producer prices or wages in the private sector.

Government finance

Statistical capacity problems affect the timely production of quality government finance statistics—in particular, the data are subject to frequent revisions stemming in part from data omissions and misclassifications. Data on central government operations are incomplete and must be supplemented with additional information from external sources. For instance, some investment spending is undertaken outside the consolidated fund, as are some loan and grant receipts as well as on-lending and transfers to public enterprises. As a result the authorities' capital expenditure data, recorded by the Treasury, must be supplemented with additional donor financing information, particularly because the Public Sector Investment Program (PSIP) data are not timely. Delays in the reporting of the PSIP data reportedly stem from reporting delays from the line ministries.

The authorities do not provide consolidated nonfinancial public sector data, and data for the rest of the public sector—Dominica Social Security and the public enterprises—must be obtained directly from each entity during Fund Article IV consultation missions.

In addition, only limited financing data are available. Although much progress has been made in improving the measurement of the government's debt, there are concerns that there is still some under-recording of government commitments. However, there are several ongoing initiatives to strengthen expenditure management, which should help minimize the extent of this problem. In particular, there is an ongoing effort to automate the expenditure execution process. The new automation technology will be fully installed in all line ministries in 2004, at which point all local purchase orders (LPOs) will be entered and tracked electronically. Automatic commitments will be charged against a specific budget allocation once LPOs are generated electronically. All ministries and suppliers of goods and services will be compelled to use the new system following the completion of the automation program.

No government finance data are reported to STA for publication in the *International Financial Statistics* (*IFS)* or the *Government Finance Statistics* (*GFS) Yearbook*.

The authorities have been receiving technical assistance from the United Kingdom's Department for International Development (DIFID) on the cash management system and from CARTAC on monitoring implementation of the stabilization program and treasury accounting.

Monetary statistics

Monetary statistics are compiled by the ECCB on a monthly basis and reported to the Fund regularly, although the coverage merits improvements. For instance, the banking statistics do not explicitly capture loans from ECCB's fiscal reserve tranche to the government of Dominica. The monetary survey does not include the accounts of credit unions that accept demand deposits. The ECCB is aware of the need to improve coverage of the monetary statistics and is taking steps to collect data on credit unions. Data on the activities of offshore banks are not reported to the Fund.

Balance of payments

Balance of payments data are compiled by the ECCB on an annual basis and are not reported in the format recommended in the fifth edition of the IMF's *Balance of Payments Manual*. The timeliness of the data has improved recently but the data still suffer from exceptionally high and volatile errors and omissions, at times reaching levels of 12 percent of GDP.

External debt

The ministry of finance maintains a database on public and publicly-guaranteed external loans that provides detailed and reasonably current information on disbursements, debt service, and debt stocks. The Treasury maintains the data on bonds placed abroad. Unfortunately, the two government agencies do not consolidate their databases to provide a comprehensive external debt picture. The external debt data are deficient with the result that debt stock cannot be accurately measured. Monthly information on payments by creditor (actual and scheduled) is not fully and readily available, which impedes the compilation of up-to-date information on arrears.

Dominica: Core Statistical Indicators
(As of February 10, 2005)

	Exchange Rate 1/	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	n/a	Nov. 2004	Nov. 2004	Dec. 2004	Dec. 2004	Dec. 2004	Nov. 2004	June 2004	December 2003	Dec. 2004	Dec. 2003	Dec. 2004
Date Received	n/a	11-21-04	11-21-04	1-25-04	1-25-05	1-25-05	12-21-04	8-11-04	2-1-04	1-15-05	1-30-04	1-15-05
Frequency of Data	n/a	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly	Annual	Monthly
Frequency of Reporting	n/a	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly	Annual	Monthly
Source of Update 2/	n/a	ECCB	ECCB	ECCB	ECCB	ECCB	CSO	CSO	CSO	Ministry of Finance	CSO	Ministry of Finance
Mode of Reporting	n/a	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail or fax
Confidentiality	n/a	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	C	C	C	C	C	C
Frequency of Publication	n/a	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Annual	Quarterly	Annual	Annual

1/ Dominica is a member of the Eastern Caribbean Currency Union, in which the common currency of all member states (E.C. dollar) is pegged to the U.S. dollar at US$1=EC$2.70.
2/ The abbreviations are for the Eastern Caribbean Central Bank (ECCB), and the Central Statistical Office (CSO).

Roseau, Dominica
February 16, 2005

Mr. Rodrigo de Rato,
Managing Director,
International Monetary Fund
700 19th Street, NW,
Washington, DC 20431
USA

Dear Mr. de Rato,

1. The letter of intent and memorandum of economic policies (MEP) of December 10, 2003, requesting an arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF), outlined the Government's strategy to address the economic crisis facing Dominica and resolve our fiscal and debt difficulties. We further defined these policies in the context of the first two reviews of the programme, concluded in March and August 2004, respectively.

2. Performance under the programme has remained satisfactory. All (but one) performance criteria for the period June-December 2004 were met, with significant margins in most cases. We have also made progress at structural reforms and all the structural benchmarks established under the programme have now been implemented, except for the further reform of the electricity sector. On the latter, Cabinet considered the issue recently and we remain committed to implementing the reform after further public consultations. This resolute commitment to the programme is already yielding visible benefits. Despite being hit by a significant earthquake late last year, the economy is growing and our fiscal position has improved.

3. We have made significant progress in collaboratively restructuring our debt. We have decided to close our debt exchange offer, which had been maintained open for several months even after its formal deadline of June 11, 2004 had passed. We will continue good faith efforts to reach agreements with our non-participating creditors.

4. The attached supplement to our MEP lays out our policies for 2005. These policies are designed to consolidate the gains we have made so far and establish the basis for sustained economic growth. We request that the existing indicative targets for end-March 2005 be maintained, those for end-June 2005 be converted into performance criteria, and new indicative targets be established for end-September 2005 (Table 1). Proposed structural benchmarks and performance criteria are indicated in Table 2 of the MEP.

5. We have put in place strong procedures to ensure adherence to the performance criterion related to external debt service. On this basis, we request a waiver for the breach of

the performance criterion, completion of the third and fourth reviews of the programme and the release of the fourth, fifth, and sixth disbursements under the arrangement. We also request that future disbursements under the program be rephased into three equal amounts, with the first of these to be made available following completion of the next review, to be based on end-June performance criteria.

6. The Government of Dominica will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies, and achieving the objectives of the programme. The Government believes that the policies set out in the attached MEP are adequate to achieve the objectives of the programme, but it will take further measures that may become necessary for this purpose. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEP, in accordance with the Fund's policies on such consultation. We authorize the Fund to publish this letter and the attached supplement to our MEP to facilitate a wider access to our policies and signal the seriousness of our commitment to the programme to civil society and the international community.

Sincerely,

/s/

Honourable Vince Henderson
Acting Prime Minister and Minister of Finance and Planning

Attachment

SUPPLEMENT MEMORANDUM OF ECONOMIC POLICIES OF THE GOVERNMENT OF DOMINICA

I. BACKGROUND

1. **We continue to make progress in addressing the severe macroeconomic imbalances that resulted in the economic crisis.** These imbalances followed from a series of shocks to the economy and the inadequate policy response, which led to a rapid buildup of government debt to unsustainable levels. The magnitude of the crisis was severe—output contracted by 10 percent during 2001−03 and investment declined. Against this background, the Government adopted and has been implementing a comprehensive strategy to stabilize the fiscal position and tackle the structural weaknesses.

2. **Since its inception, our strategy has comprised four key pillars.**

- **Collaborative debt restructuring**. Recognizing that our debt had reached unsustainable levels, we approached our creditors at end-2003 for debt restructuring.

- **Fiscal reform.** The cornerstone of our macroeconomic framework has been a fiscal effort to achieve a sustainable primary surplus of 3 percent of GDP, representing an adjustment of 4½ percent of GDP over the programme period.

- **Budgetary reform and financial sector strengthening.** These reforms aim to address weaknesses in budgetary planning and implementation that were at the root of the macroeconomic imbalances, and to forestall vulnerabilities in the financial sector.

- **Structural reforms to create an enabling environment for growth.** Our efforts are focused on strengthening the investment climate through deregulation and improved competition, which are critical to realizing the economy's growth potential.

3. **Our policy framework is built around these objectives, which remain crucial for Dominica to emerge decidedly from the crisis and realize sustainable economic growth.** Accordingly, our budget for this year contains a series of bold policy initiatives to bring the fiscal position further toward sustainability. As we transition beyond the initial stages of stabilization, our medium-term programme will be guided by the Growth and Social Protection Strategy Paper (GSPSP) that is being finalized along the lines envisaged in our interim poverty reduction strategy paper adopted at the end of 2003.

II. RECENT PERFORMANCE UNDER THE GOVERNMENT'S PROGRAMME

4. **Macroeconomic stability has been achieved.** Growth resumed during 2004 on the back of strong performance of agriculture, manufacturing and construction and despite a severe earthquake, which struck Dominica late in the year. Monetary and financial developments have also been favorable—inflation was subdued in 2004 and banking sector

credit to the economy is growing again after having contracted for several years. However, buildings and roads were considerably impaired by the earthquake and the heavy flooding, which preceded it—damage to public infrastructure alone from these events is estimated at 7 percent of GDP.

5. **Macroeconomic performance under the PRGF-supported programme remains satisfactory.** Although some external arrears were temporarily incurred, all other quantitative performance criteria during June−December 2004 were met, in some cases with significant margins. In each of the instances of missed payments, the errors were corrected promptly. On the fiscal front, stepped-up enforcement of compliance and collection of one-off items have resulted in revenues higher than initially envisaged, and the improving economy has also contributed to this outcome. These receipts mostly went towards reducing our overdraft balances at commercial banks and meeting larger-than-budgeted upfront costs associated with unforeseen delays in executing our debt strategy, including reduction of arrears and pre-payments into escrow accounts. As regards expenditures, the implementation of the public investment program has been slower than anticipated, on account of both delays in disbursements of project-related external grants and slower than expected execution. Domestically-financed capital expenditures have, however, picked up, including on account of some of the emergency recovery and rehabilitation work following the earthquake. As regards current expenditures, while savings from the wage bill have been larger than expected, they have been offset by higher subsidies and transfers.

6. **Structural reforms are progressing.** We completed the review of statutory tax exemptions in June, and Cabinet approved the key parameters for the VAT ahead of schedule in August. In January 2005, Parliament passed legislation increasing the retirement age for public employees, which maintains the option of early retirement. And, following a visit by a World Bank technical assistance team in December 2004, Cabinet considered the package of measures to reform the regulatory framework for electricity supply. The draft legislation for the reform has been prepared and the pricing formula has been specified but we consider it important to engage in further public consultations on this important matter before the changes are submitted for consideration to Parliament—we hope this will occur by June 2005.

7. **Our debt restructuring strategy has passed a critical point.** The debt exchange offer had been kept open past its formal deadline of June 11, 2004. We have decided that, as of September 30, the offer is no longer open and we have sent letters to all nonparticipating creditors to that effect. Parliament also passed legislation in January 2005 stopping the earmarking of tax revenues to service debt held by some nonparticipating creditors. We consider this to be an important step in restoring debt sustainability over the medium term. For all creditors who have thus far not participated in the debt restructuring, we calculated the accrued interest up to June 11 on original terms and made payments on their behalf into an escrow account at the Eastern Caribbean Central Bank (ECCB). Thereafter, as interest payments came due (under the existing agreements) to such creditors, we continued to make deposits into the escrow account but on restructured terms, along the lines envisaged in the

2004/05 government budget. We will maintain dialogue and continue to share with creditors relevant non-confidential information. We will also continue the practice of making deposits under restructured terms into the escrow accounts for non-participating creditors. We are hopeful that our difficult decisions will prompt remaining creditors to join in our debt restructuring effort.

III. Policies for 2005

A. Macroeconomic and Fiscal Policy

8. **Our macroeconomic framework remains broadly unaltered from that underpinning the budget at the time of its approval.** Economic growth for 2004 is estimated at upwards of 2 percent, higher than had been envisaged. Despite some recent moderation in the growth of the agricultural sector, we expect economic activity during 2005−06 to remain strong and receive a boost from the expected stepping-up of the public investment program. Growth for 2005 is therefore likely to be upward of 2½ percent of GDP. Inflationary developments have largely been in line with expectations during 2004. Accordingly, the projection for inflation for 2005 is being maintained, also at 1½ percent.

9. **We remain committed to implementing the 2004/05 budget approved by Parliament.** The public sector retrenchment effort will also continue as planned—we are fully on target to realize the savings programmed for the 2004/05 fiscal year and will aim to generate additional savings by keeping vacated positions largely unfilled. This will ease the task of attaining the further planned reduction of the wage bill next year. Except for earthquake-related expenditures, line items will be held at budgeted levels. Emergency relief and rehabilitation operations at end-2004 following the earthquake were financed with a mixture of budgetary savings and additional grants. Much of the damage from the earthquake, however, remains to be addressed. Accordingly, in the context of preparing the budget for the next fiscal year, we will reassess the medium-term public investment program to prioritize earthquake-related reconstruction, which we hope will be financed mainly from grants. Nevertheless, some of the necessary repairs cannot wait further, and while we will maintain the program targets for this fiscal year, we will use any budgetary savings above programmed amounts for earthquake-related expenditures. There is also some possibility that transfers will need to be made within this fiscal year to set up the Caribbean Court of Justice, for which provisions had not been made in the approved budget. In that eventuality, we would adjust the program targets accordingly.

10. **At the time of the next review, we will comprehensively reevaluate the primary surplus that we need to achieve over the medium term.** This assessment will take into account the revised public investment program. and the final outcome of the debt strategy on which we hope there will be greater clarity. In the context of our reassessment, we will also consider the possible need for contingency funds to safeguard against the economic impact of natural disasters, to which Dominica and neighboring countries are vulnerable because of their geographic location. Pending the preparation of the FY 2005/06 budget, we have adopted indicative targets for end-September 2005 to guide our policies (Table 1). For the

time-being, these targets continue to be predicated on achieving an annual primary surplus of 3 percent of GDP, our original medium-term objective. However, we will review and update these targets, as appropriate, in the context of the next review, which will also establish performance criteria for the remainder of the next fiscal year.

11. **We will continue our efforts to reform the tax system.** The Government remains committed to introducing the VAT during FY 2005/06. We have, however, decided to postpone its introduction from the start of the fiscal year to allow sufficient time for public education and for the inland revenue service to prepare adequately. This will help ensure that the VAT is indeed a success when it is introduced. As regards tax exemptions, by July 2005 we will, with technical assistance, carry out detailed cost-benefit analyses of the impact of those statutory exemptions that account for a significant share of revenue foregone, as indicated in the June 2004 review. Depending on the findings and recommendations of these analyses, we will propose changes to the legislation to repeal some provisions for concessions. Also, we reiterate our previous commitment to the policy of significantly reducing discretionary exemptions.

12. **We are also improving the administrative regime for the granting and monitoring of tax concessions.** Pending a more comprehensive review of administrative and procedural arrangements planned for later this year, the Ministry of Finance will assist in processing, monitoring and assessing the impact of tax exemptions with immediate effect. Specifically, a designated official from the Ministry will give support to the work of officials from initiating Government agencies, starting with the stage of screening the application for relief and preparing supporting documentation. The Ministry of Finance will also report regularly to the Cabinet on the operation of the concessions regime, including contribution to the economy and quarterly revenues foregone from all tax concessions granted and utilised. With a view to increasing transparency, the Government will publish in the official Gazette, a list of concessions granted. This list will be published in July 2005 in respect of concessions granted during FY 2004/05, and monthly thereafter in respect of each preceding month. Among other things, it will identify decisions taken, the legal basis for granting the tax relief, the length of time for which the relief will be in effect, the expected benefit from the individual concessions granted, and (where applicable), an estimate of revenue foregone in each case.

13. **Steps are being taken to strengthen the budgetary process.** By April 30, 2005 the Ministry of Finance and Planning will prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These discussions will assist in informing the preparation of the 2005/06 budget. In addition to providing numerical targets and procedures to follow in the design of the budget, these amendments will aim to improve processes and structures to strengthen accountability, reporting requirements and fiscal transparency. The passage of such legislation during FY 2005/06 will help ensure fiscal discipline over the medium term.

14. **We are improving public expenditure management practices.** Specifically, the system of reporting and analysis is being strengthened to ensure that all Government cash transactions are properly captured, outstanding commitments accurately established, and compliance with expenditure targets continually monitored. To this end we have made tremendous progress with our bank reconciliations; all ancillary accounts have been reconciled, and we expect the main account to be completed by March 2005. Updated balances will be adjusted in the General Ledger on completion of the (Smartstream) system review. Future reconciliations are expected to take place on a monthly basis. All transactions conducted through Government bank accounts will be captured in the General Ledger by end-June 2005. Other cash management measures that we implemented (with effect from end-December 2004) are as follows: (i) all Government purchases of goods and services are required to be supported by a Local Purchase Order (LPO) or a contract approved by the Ministry of Finance (except for authorized petty cash flows); (ii) all LPOs above EC$1,000 are now required to be co-approved by the Ministry of Finance; and, (iii) all executed LPOs are being reported to the Ministry of Finance on a monthly basis. We also implemented at end-2004, a system for the comprehensive capture of transactions, most importantly those related to capital expenditures that were previously left out of the treasury accounting system.

B. The Financial Sector and Social Security

15. **Vulnerabilities in the financial system represent potential costs for the State and we are implementing a number of initiatives to strengthen prudential oversight.** The new uniform banking act for the Eastern Caribbean Currency Union (ECCU) has been submitted to Parliament. As part of our efforts to improve the supervision of nonbank financial institutions (NBFIs), a Financial Services Unit (FSU) has recently been established within the Ministry of Finance with the intention of making it the sole regulatory authority for such institutions. The legislative basis for the FSU's authority to supervise credit unions is already in place, and the consultative process for putting in place enhanced supervision of insurance companies is expected to commence by March 2005 (subject to the date of the general elections), with a view to bringing the necessary legislation to Parliament during FY 2005/06. Work is expected to start soon on empowering the FSU to regulate other NBFIs, including the Agriculture and Industrial Development Bank (AID Bank). Starting with the credit unions, we will put in place internal regulations and guidelines, revise reporting requirements as necessary, and empower the FSU to impose penalties and sanctions for regulatory noncompliance by all nonbank financial institutions. To enhance the FSU's technical capacity, we have requested technical assistance from CARTAC for the latter to assist the FSU in developing its capacity to carry out on-site examinations of credit unions—we expect this to occur by end-March 2005. Thereafter, the FSU will update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU), which will, *inter alia*, follow up on the status of measures outlined in the 2003 draft memorandum of understanding between RCCU and the Department of Cooperatives.

16. **A key priority for the Government is to assess the financial condition of the Dominica Social Security Fund (DSS).** Prior to the debt restructuring, it had been estimated that DSS would continue to generate cash surpluses for a number of years even as its long-term actuarial balance was in deficit because of the demographic structure. The bulk of DSS's assets are, however, concentrated on Government instruments. Hence, the debt restructuring is likely to have an adverse impact on the DSS's cash flow position and its reserves. There is also a pressing need to ensure that the investment portfolio and risk management practices of DSS reflect best practices. We will, therefore, request external assistance to carry out a comprehensive pension system review during this fiscal year. We expect the review, *inter alia*, to help determine whether the current structure of contributions and benefits needs to be altered to ensure the long-term health of DSS. The review will also consider the implications of the increase in the public employee retirement age for the medium-term financial position of the enlarged Government (including DSS); we stand ready to make any further changes to the pension system that may be appropriate in light of this study.

C. Advancing the Growth Agenda

17. **Building on the initial gains in stabilization, the Government is elaborating the long-term growth strategy for Dominica.** In late October 2004, we organized a number of meetings with the general public, the business community, and other stakeholders (including donors). The purpose of these meetings was to help identify bottlenecks in key sectors and areas where the Government can take steps to improve the enabling environment for private-sector led growth, without increasing direct Government involvement in commercial activity or providing subsidies. The outcomes of these meetings will be important ingredients in the formulation of the GSPSP. We have launched a series of consultations with stakeholders on the draft GSPSP early this year, with the aim of having the final document endorsed by Cabinet ahead of the start of FY 2005/06. In the period ahead, we are placing special emphasis on fleshing out and prioritizing sectoral strategies and linking them to the overall macroeconomic framework.

18. **The aid programme agreed with People's Republic of China will allow us to further expand investment without adding to the debt burden.** We have identified a series of infrastructure projects that will be sequentially financed with this assistance over the next several years. There will be a domestic labor component to the projects to be financed by the grants. Most of the financing is, however, expected to go towards paying for the necessary imports of goods and services. The aid programme will be fully incorporated into the public sector investment programme and the Government budget will show both the disbursements of the grants and the corresponding expenditures as they occur.

19. **Government will continue to reassess the functions and operations of a number of key growth agencies in order to maximize the efficiency of Government services in the post-stabilization environment.** To this end, Government will undertake strategic reviews of the AID Bank, Dominica Export Import Agency (DEXIA) and the National Development Corporation (NDC). We intend to begin the assessment of the AID Bank

during this fiscal year. The Government will prepare an action plan for DEXIA and NDC that will address issues of reorganization. It is expected that this plan will be submitted to Cabinet in 2005. We will also ensure that the 2004 audited financial accounts for all three of these bodies will be tabled to Parliament by June 2005.

Table 1. Dominica: Quantitative Performance Criteria and Indicative Targets Under the PRGF, June 2004–September 2005 1/

	2004			2005		
	June 30 Actual 2/	Sept. 30 Actual 3/	Dec. 31 Actual 3/	Mar. 31 Program 3/	June 30 Program 3/	Sept. 30 Targets 6/
I. Performance Criteria (PC)						
(In millions of Eastern Caribbean dollars)						
Central government primary balance	40.1	0.1	14.0	11.0	14.7	4.5
Central government wage bill	104.2	25.3	51.5	78.5	102.7	24.9
Banking system net credit to central government	-41.4	4.0	-2.2	0.0	0.0	4.8
Net changes in central government arrears to private domestic parties	-7.2	3.2	4.4	15.0	15.0	3.0
(In millions of U.S. dollars)						
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year	27.6	2.9	3.4	8.0	10.0	2.0
Net changes in the outstanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 4/	Met	Met	Met	0.0	0.0	0.0
Net changes in external payments arrears of the central government 4/ 5/	Met	Not met	Not met	0.0	0.0	0.0
II. Indicative Targets (IT)						
(In millions of Eastern Caribbean dollars)						
Central government overall balance	-1.6	-13.5	-8.2	-25.6	-31.6	-8.9
Central government revenues	221.6	55.3	116.4	160.3	210.6	57.0
Central government primary savings	41.4	12.5	27.6	29.6	36.3	13.7

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ All variables and any adjustors that apply, are defined in the Technical Memorandum of Understanding.
2/ Cumulative amounts from June 30, 2003.
3/ Cumulative amounts from June 30, 2004.
4/ These performance criteria will be monitored on a continuous basis.
5/ External arrears that were known at the time of the Executive Board discussion on August 4, 2004, were waived.
6/ Cumulative amounts from June 30, 2005. Targets for September 30, 2005 are all indicative targets.

Table 2. Structural Benchmarks

For Fifth Review

Update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU) with technical assistance, and follow up on the status of measures outlined in the 2003 memorandum of understanding (end-May, 2005).

Prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These proposals will include numerical targets and procedures to be followed in the design of the annual budget (end-April, 2005).

Approval of 2005/06 budget, containing a primary balance target consistent with the programme (end-June, 2005).

For Sixth Review

Establish legislative basis for the Financial Services Unit (FSU) to supervise insurance companies and regulate all nonbank financial institutions, including the Agriculture and Industrial Development Bank (end-September, 2005).

Endorsement by Cabinet of an action plan for DEXIA and NDC that will address issues of reorganization and cost effectiveness (end-September, 2005).

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. Dominica's performance under the Poverty Reduction and Growth Facility (PRGF), described in the letter of the Government of Dominica dated February 16, 2005, will be assessed by the IMF on the basis of the observance of quantitative performance criteria as well as compliance with structural performance criteria and benchmarks. This Technical Memorandum of Understanding (TMU) sets out and defines the quantitative performance criteria, indicative targets, and benchmarks specified in Tables 1 and 2 of the Supplement Memorandum of Economic Policies (SMEP), as well as the monitoring and reporting requirements.

2. The Dominican authorities are committed to transmit to the Fund staff the best data available. All revisions or expectations thereof shall be promptly reported to the Fund staff.

3. The variables mentioned herein for the purpose of monitoring the performance criteria, which are not explicitly defined, are consistent with the Government Financial Statistics (GFS). For variables omitted from the TMU which are relevant for the program targets, the authorities of Dominica shall consult with the Fund staff on their appropriate treatment, based on GFS principles and Fund program practices.

IV. FISCAL TARGETS

Indicative Target on the Overall Balance of the Central Government

4. The **central government overall balance** will be measured from the financing side as the sum of the net domestic borrowing plus net external borrowing.

5. **Net domestic financing** by the central government is the sum of: (i) net domestic bank financing as measured by the change in the domestic banking system credit to the central government net of deposits, as reported by the consolidated balance sheet of the monetary authorities[1] and commercial banks, including special tranches from the ECCB and excluding net changes in (a) "double signature accounts"[2] and (b) the deposits of the cash grants from the People's Republic of China; (ii) net nonbank financing as measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions; (iii) the change in the stock of domestic arrears of the central

[1] Consolidating the ECCB's balance sheet (excluding the government's IMF operating account) and the government's transactions with the IMF.

[2] The "double signature accounts" include the accounts 115002797, 115002976,115002220, 115001912, 115003051, 115001911, 115003025, 115001471, 115001523, 115003053, 115001710, and 100038724 held in the National Commercial Bank of Dominica (NBD), and any new account in which grant receipts are deposited and which requires a signature of an external party for the release of its funds. It is expected that the forthcoming grants from the European Union in early 2005 will be released through a "double signature account."

government defined as net changes in unpaid checks issued, unprocessed claims, pending invoices, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid; (iv) gross receipts from divestment; (v) financing from debt restructuring measured as domestic debt service payments (principal and interest) on a due basis less actual debt service payments; and (vi) any other exceptional financing.[3]

6. **Net external financing** of the central government is defined as the sum of (i) disbursements of project and nonproject loans, including securitization, but excluding the use of IMF resources; (ii) proceeds from bonds issued abroad; (iii) exceptional financing (rescheduled principal and interest), net changes in cash deposits held outside the domestic banking system, (iv) net changes in short-term external debt; (v) any change in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid; (vi) financing from debt restructuring measured as external debt service payments (principal and interest) on a due basis less actual debt service payments; (vii) any other exceptional financing; and less (viii) payments of principal on current maturities for bonds and loans on a due basis but excluding the use of IMF resources, and including any prepayment of external debt.

7. The programmed amounts of debt service on a due basis are shown in Table 1 below:

Table 1. Domestic and External Debt Service Payments on a Due Basis

	External interest payments	External amortization payments	Domestic interest payments	Domestic amortization payments
	(in millions of Eastern Caribbean dollars)			
Cumulative flows (from June 30, 2004)				
End-September 2004	8.4	7.2	5.2	0.8
End-December 2004	12.0	36.2	10.2	1.7
End-March 2005	20.4	38.9	15.3	2.5
End-June 2005	23.4	43.2	20.4	3.4
Cumulative flows (from June 30, 2005)				
End-September 2005	8.3	3.2	5.1	0.9

[3] Treasury bills will be recorded at face value, except for those held by the banking system which will be recorded on a purchase price basis.

8. The program floors on the overall balance are reported in Table 2 below.

Table 2. Indicative Target on the Overall Balance of the Central Government

	(in millions of Eastern Caribbean dollars)
Cumulative balance (from June 30, 2004)	
End-September 2004 (actual)	-13.5
End-December 2004 (actual)	-8.2
End-March 2005 (indicative target)	-25.6
End-June 2005 (indicative target)	-31.6
Cumulative balance (from June 30, 2005)	
End-September 2005 (indicative target)	-8.9

9. The floor on the overall balance of the central government will be adjusted as follows:

(i) Upward[4] to the extent that **budgetary grants** exceed programmed amounts. Budgetary grants are defined as grant receipts that are not earmarked for capital outlays, and including the drawdown of deposits of the cash grants from China. For the purpose of this adjustor, the budgetary grants cumulated from June, 30, 2004 amount to: US$5.1 million by end-December 2004, US$6.0 million by end-March 2005, and US$7.0 million by end-June 2005.[5] Budgetary grants cumulated from June, 30, 2005 amount to US$1.0 million by end-September 2005.

(ii) Downward by the amount severance payments and the administrative expenditures linked to the debt restructuring operations exceed the grants targeted to these programs.

(iii) Downward by up to the full amount of EC$5.94 million, if the funds earmarked for the Caribbean Court of Justice (CCJ) and currently in escrow are disbursed.

Performance Criterion on the Central Government Primary Balance

10. **The central government primary balance** is defined as the central government overall balance (from the financing side as defined in paragraph 4) plus domestic and external interest payments on a due basis. Interest payments do not include either domestic or external interest payments made by the central government on behalf of other parties.

[4] Upward adjustment means lower deficit.

[5] It is expected that forthcoming grants to cover severance payments will be received as capital grants. However, if these are received as budgetary grants, then the programmed amounts of budgetary grants will be higher than stipulated by the expenditures in both these programs.

11. The program floors on the central government primary balance are reported in Table 3 below.

Table 3. Performance Criterion on the Central Government Primary Balance

	(in millions of Eastern Caribbean dollars)
Cumulative balance (from June 30, 2004)	
End-September 2004 (actual)	0.1
End-December 2004 (actual)	14.0
End-March 2005 (indicative target)	11.0
End-June 2005 (performance criterion)	14.7
Cumulative balance (from June 30, 2005)	
End-September 2005 (indicative target)	4.5

12. The same adjustors described in paragraph 9 apply to the primary balance.

Performance Criterion on the Central Government Wage Bill

13. The **central government wage bill** will be measured as the total expenditure of the central government on wages and salaries of central government employees net of wage refunds, including acting allowances, special duty allowances, responsibility allowances, subsistence allowances, the employer contribution to Dominica Social Security, and any wage payment made to units transferred outside the Treasury in the context of the 2004/05 budget, but not including retirement benefits, severance payments or other related one-off payments (i.e. accumulated leave). As such, the ceiling does not include wage-related transfers to schools, the National Development Corporation, and local governments.

14. The program ceilings on the central government wage bill are shown in Table 4 below:

Table 4. Performance Criterion on the Central Government Wage Bill

	(in millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	25.3
End-December 2004 (actual)	51.5
End-March 2005 (indicative target)	78.5
End-June 2005 (performance criterion)	102.7
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	24.9

Performance Criterion on the Central Government Arrears Accumulation to Domestic Private Parties

15. **Net changes in central government arrears to domestic private parties** is defined as changes in the sum of all pending payments by government for goods and services already purchased from these parties, as well as pending unpaid checks for payments into the escrow account set up for debt restructuring. Private domestic parties exclude DOWASCO, Dominica Social Security, National Development Corporation, Dominica Broadcasting Corporation, DEXIA, and the Ports Authority. The measure used will be unpaid checks issued and pending invoices for which payment is overdue.

16. The program ceilings on the central government arrears accumulation to domestic private parties are reported in Table 5 below.

Table 5. Performance Criterion on the Central Government Arrears Accumulation to Domestic Private Parties

	(in millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	3.2
End-December 2004 (actual)	4.4
End-March 2005 (indicative target)	15.0
End-June 2005 (performance criterion)	15.0
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	3.0

Indicative Targets on Revenues of the Central Government

17. **Central government revenues** are defined as the tax collections and nontax revenues reported in the treasury accounts (economic classification), excluding: (i) revenues from the economic citizenship program, (ii) foreign and domestic grant receipts, (iii) repayment of loans, (iv) wage refunds, and (v) privatization receipts, and includes income tax refunds.

18. The program floors on the revenues of the central government are reported in Table 6 below.

Table 6. Indicative Targets on Revenues of the Central Government

	(In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	55.3
End-December 2004 (actual)	116.4
End-March 2005 (indicative target)	160.3
End-June 2005 (indicative target)	210.6
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	57.0

Indicative Targets on the Primary Savings of the Central Government

19. **Central government primary savings** is measured on an accrual basis (including unpaid checks issued and unprocessed invoices) and is defined as the central government revenue before grants (i.e., excluding grants) minus current noninterest expenditure. The adjustors described in paragraph 9 apply to the central government primary savings.

20. The program ceilings on the central government primary savings are reported in Table 7 below.

Table 7. Indicative Targets on the Primary Savings of the Central Government

	(in millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	12.5
End-December 2004 (actual)	27.6
End-March 2005 (indicative target)	29.6
End-June 2005 (indicative target)	36.3
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	13.7

Monitoring discretionary tax exemptions

21. **Discretionary tax exemptions** are defined as tax exemptions granted under Sections 6(2) and 31 of the Consumption Order Act, Section 26 of the Sales Tax Act, Section 60 of the Customs (Control and Management) Act, Section 25(2) of the Income Tax Act, or remissions of tax under Section 109 of the Income Tax Act (except in cases where the Comptroller certifies that the tax to be remitted is uncollectible).

22. The number of discretionary tax exemptions will be monitored on a continuous basis.

V. Monetary Targets

Performance Criterion on the Net Credit of the Banking System to the Central Government

23. **Net credit of the banking system** is defined as in paragraph 5. The program ceilings on the net credit of the banking system to the central government are reported in Table 8 below.

Table 8. Performance Criterion on the Net Credit of the Banking System to the Central Government

	(in millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	4.0
End-December 2004 (actual)	-2.2
End-March 2005 (indicative target)	0.0
End-June 2005 (performance criterion)	0.0
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	4.8

24. The ceiling on net credit of the banking system will be adjusted upward (downward) to the extent that actual interest payments are higher (lower) than the programmed amounts on a cash basis. The programmed amounts of interest payments on a cash basis are shown in Table 9 below.

Table 9. Interest Payments on a Cash Basis

	Total interest payments	Domestic interest payments	External interest payments
	(in millions of Eastern Caribbean dollars)		
Cumulative flows (from June 30, 2004)			
End-September 2004	9.0	2.7	6.3
End-December 2004	13.4	5.3	8.1
End-March 2005	19.5	8.2	11.3
End-June 2005	24.5	10.8	13.7
Cumulative flows (from June 30, 2005)			
End-September 2005	5.5	3.3	3.2

VI. External Sector Targets

Performance Criterion on Disbursements of Nonconcessional External Central Government or Central Government Guaranteed Debt with Maturity of at Least One Year

25. Disbursements of nonconcessional external central government and central government guaranteed debt with maturity of at least one year will be monitored by the Accountant General's office on a monthly basis. Central government and central government guaranteed debt is defined to include debt contracted or guaranteed by the central government.

26. The program ceilings on disbursements of nonconcessional external central government or central government guaranteed debt with maturity of at least one year are reported in Table 10 below.

Table 10. Performance Criterion on Disbursements of Nonconcessional External Central Government or Central Government Guaranteed Debt with Maturity of at Least One Year

	(In millions of U.S. dollars)
Cumulative flows (from June 30, 2004)	
End-September 2004 (actual)	2.9
End-December 2004 (actual)	3.4
End-March 2005 (indicative target)	8.0
End-June 2005 (performance criterion)	10.0
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	2.0

27. The term **"debt"** is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000):

"(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 21(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

28. **Nonconcessional debt** is defined as debt having a grant element (in net present value relative to face value) **of less than 35 percent**, based on the currency- and maturity-specific Commercial Reference Rates (CIRR), published monthly by the OECD.[6] The limit excludes the disbursements of short-term import-related debts, the use of Fund resources, and refinancing operations.

Performance Criterion on the Net Changes in the Outstanding Stock of Short-Term External Debt with Original Maturity of Less than One Year Contracted or Guaranteed by the Central Government

29. The **stock of short-term external debt outstanding** is defined as debt with original maturity of less than one year contracted or guaranteed by the central government. The term debt is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with

[6] For loans with a maturity of at least 15 years, the 10-year average commercial interest reference rates and for loans with shorter maturities, the 6-month average CIRRs, as of February 2005 published by the OECD will be used as the discount rates. To both the 10-year and 6-month averages, the following margins for differing repayment periods will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 years or more.

Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000) (see paragraph 27 above), but excludes normal import-related credits.

30. No short-term external debt with original maturity of less than one year, will be contracted or guaranteed by the central government. This ceiling will be monitored on a continuous basis.

Performance Criterion on Nonaccumulation of Central Government and Central Government Guaranteed External Payment Arrears

31. **Central government and central government guaranteed external payment arrears** are defined as overdue payments (principal or interest) on debt contracted or guaranteed by the central government. The definition of external payment arrears under the program **excludes**: (i) debt claims that were irrevocably tendered in the debt exchange closed on September 31, 2004 (the "Debt Exchange”), (ii) debt claims that were eligible to participate in the Debt Exchange but have not been tendered, and (iii) debts claims of official bilateral creditors which are under rescheduling or refinancing negotiation. It also does not include outstanding subscription payments to regional and international organizations, for which understandings will be reached to ease payment obligations consistent with the program.

32. No external payment arrears of the central government and central government guaranteed debt, will be allowed in the program. This ceiling will be monitored on a continuous basis.

VII. Structural Benchmarks

For Fifth Review

- Update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU) with technical assistance, and follow up on the status of measures outlined in the 2003 memorandum of understanding (end-May, 2005).

- Prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These proposals will include numerical targets and procedures to be followed in the design of the annual budget (end-April, 2005).

- Approval of 2005/06 budget containing a primary balance target consistent with the program (end-June, 2005)

For Sixth Review

- Establish legislative basis for the Financial Services Unit (FSU) to supervise insurance companies and regulate all nonbank financial institutions, including the Agriculture and Industrial Development Bank (end-September, 2005).

- Endorsement by Cabinet of an action plan for DEXIA and NDC that will address issues of reorganization and cost effectiveness (end-September, 2005).

VIII. PERIODIC REPORTING

33. **Regular reporting on a monthly basis** (and when possible weekly) will include the following:

- Data for monitoring the program's performance criteria and monthly indicative targets, including

    - Fiscal sector

        (i) Central government budgetary accounts.

        (ii) Dominica Social Security Balance Sheet, showing amounts receivable from central government for contributions and interest.

        (iii) Central government domestic debt data.

        (iv) Current grant inflows.

        (v) Stock of unpaid checks issued and stock of unprocessed claims due and invoices pending.

        (vi) Capital expenditure (project by project) and composition of financing, including revised projections for the remainder of the fiscal year.

        (vii) Balances in the debt servicing account linked to the Royal Merchant Bank Bond Issue.

        (viii) Total number of exemptions issued (by type of exemption).

        (ix) Severance payments and administrative expenditures linked to the debt restructuring operations, and details about how they were financed.

    - Financial sector

        (x) Monetary survey for Dominica as prepared by the Eastern Caribbean Central Bank, including balances in central government double signature accounts.

    - External and real sectors

        (xi) Imports and exports data by product.

(xii) Detailed (creditor by creditor) external debt report from the Debt Unit in the Ministry of Finance and Planning, showing fiscal year-to-date disbursements, amortization, interest payments, and outstanding stocks, for the central government, public enterprises and AID Bank.

(xiii) Total disbursements/grant receipts, monthly, disaggregated into: (a) budgetary support (by type—either loans or external "bonds" and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.

(xiv) Stock of external payment arrears of the NFPS, including amortization and interest payment arrears, and supplier arrears for the central government, public enterprises, and AID Bank.

(xv) Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.

(xvi) Consumer price index.

(xvii) Real sector indicators

All information will be reported to Fund staff within three weeks of the end of each month.

34. Reporting **on an annual basis** will include the following:

- External and real sectors

(xviii) GDP and its components.

(xix) Balance of payments accounts.

35. Other reporting will include:

- Reports of legislative changes pertaining to economic matters.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third and Fourth Reviews Under Dominica's PRGF Arrangement and Reviews Noncomplying Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the third and fourth reviews of Dominica's performance under its three-year Poverty Reduction and Growth Facility (PRGF) arrangement.

Dominica's macroeconomic performance under the program has remained very strong. All quantitative performance criteria were met during the June-December 2004 period, except for the continuous performance criterion on nonaccumulation of external payment arrears..

The Board also reviewed a noncomplying disbursement under the PRGF arrangement, which arose as a result of misreporting on the observance of the continuous performance criterion on nonaccumulation of external payments arrears due to administrative oversights. The Board was satisfied with the authorities' swift actions to correct this problem and granted a waiver for the noncomplying disbursement.

As a result of the Executive Board review, Dominica can draw an amount equivalent to SDR 1.2 million (about US$1.8 million) under the arrangement, which will bring total disbursements to SDR 4.2 million (about US$6.4 million). The Executive Board approved Dominica's three-year PRGF arrangement on December 29, 2003 (see Press Release No. 03/228) for an amount equivalent to SDR 7.7 million (about US$11.7 million).

Following the Executive Board's discussion of Dominica, on March 7, 2005, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair, said:

"The Dominican authorities deserve much credit for the continued successful implementation of their economic program. Significant fiscal consolidation has been achieved ahead of schedule, and substantial progress has been made in debt restructuring. As a result, recent macroeconomic trends are positive. In particular, the economic recovery is gathering strength, notwithstanding the earthquake late last year, and inflation has declined.

"The conduct of fiscal policy, the corner-stone of Dominica's adjustment program, has been especially commendable. Higher-than-anticipated revenues have been saved, providing a budgetary cushion which the authorities appropriately have decided to use toward meeting pressing rehabilitation and reconstruction needs following the earthquake, which caused an estimated damage to public infrastructure amounting to 7 percent of GDP. Less urgent earthquake-related projects will be incorporated into the government's medium-term investment program which, together with strengthened public expenditure management, will help ensure overall budgetary discipline going forward.

"Dominica continues to make progress in resolving its debt problems. The authorities have followed international best practice in seeking to pre-emptively restructure Dominica's debt, and, for the most part, creditors have responded very favorably. The authorities continue to maintain an open dialogue with creditors who have so far chosen to remain outside the restructuring process, and continue to make good-faith efforts to reach collaborative agreements with them. In this context, these creditors are encouraged to work with the authorities towards a timely agreement.

"Despite the substantial progress that has already been achieved, the task of placing Dominica's public finances on a firm footing is not yet complete. The debt restructuring is still ongoing, a medium-term economic growth strategy remains to be finalized, and the economy needs to be shielded from the impact of natural disasters. Accordingly, the authorities plan to undertake a comprehensive review of their medium-term fiscal framework, taking into account potential negative shocks.

"Dominica's remaining structural reform agenda for the medium-term remains large but appropriate for consolidating the gains in macroeconomic stabilization and achieving sustained high growth. Specific measures included in the program at this time are steps to improve the fiscal framework and strengthen the financial sector. Going forward, the government that takes office after the elections will need to continue to push ahead vigorously with the implementation of the reform agenda. For its part, the international donor community will need to continue to provide timely technical and financial assistance in support of the authorities' program objectives, " Mr. Carstens said.

On the issue of the noncomplying disbursement, Mr. Carstens said:

"The Executive Board regretted the Dominican authorities' failure to ensure the accuracy of information relating to the continuous performance criterion on nonaccumulation of external arrears, which gave rise to a noncomplying disbursement under the PRGF arrangement. The Board took note of the authorities' explanation that the missed payments on external debt were due to an oversight, and of the very prompt settlement of the payments upon the discovery of the errors. In view of the minor amount of the arrears and the additional corrective actions taken to strengthen Dominica's monitoring capabilities in this area, the Executive Board decided to grant a waiver for the nonobservance of the performance criterion on external payments arrears."

Statement by Kevin G. Lynch, Executive Director for Dominica
and Chris Faircloth, Advisor to Executive Director
March 7, 2005

Key Points

- *The macroeconomic stabilization and growth strategy underpinning the PRGF is bearing fruit, due in large part to Dominica's demonstrated strong commitment to program implementation.*
- *Prudent fiscal policy is the cornerstone of Dominica's macroeconomic strategy. The authorities are committed to implementing agreed fiscal targets for this budget year and will carry out a comprehensive reassessment of the medium-term fiscal program in the period ahead.*
- *The reform agenda will increasingly shift its orientation towards growth-enhancing structural reform initiatives in the period ahead.*
- *Dominica's pre-emptive debt restructuring is nearly complete as agreements have been reached with creditors on about 70 percent of eligible debt. While the debt-exchange offer has now closed, the authorities will continue to engage non-participating creditors in "good faith" and in line with international best practices.*
- *In view of the extensive policy actions that have been taken by the Dominican authorities, we are hopeful that the Board will look favourably on the decision to complete the third and fourth reviews as well as the authorities' request for a waiver on the performance criterion on external arrears.*

I would like to begin by thanking and commending the staff for the quality of its work in support of Dominica, which has truly been of the highest calibre. My Dominican authorities deeply value the collaborative and constructive policy discussions with the Fund staff and, it is fair to say, that the country's recent economic successes are in part, testament to the very positive collaboration in difficult economic circumstances.

The PRGF program intended to resolve significant macroeconomic imbalances and strengthen Dominica's basis for growth is progressing well. The severe and prolonged economic contraction of recent years – nearly 10 percent in real terms between 2001 and 2003– has given way to an increase in real GDP in 2004 estimated at upwards of 2 percent, notwithstanding the severe earthquake that struck the island late in the year. This economic turnaround reflects better-than-expected tourism receipts and relatively strong performances in the agriculture, manufacturing, and construction sectors. Inflation remained subdued and bank credit to the economy is growing again following several years of contraction. On the basis of these developments, real GDP projections for growth 2005 have been revised up to 2.5 percent.

While these recent favourable economic outcomes reflect the value of the proactive Fund strategy to stave off a major fiscal crisis and restore the basis for sustained growth, the bulk of the credit rests with the Dominican authorities and their firm commitment to implement an ambitious set of corrective fiscal and structural reforms. Indeed, performance under the program has remained strong, particularly on the fiscal front where performance has outpaced expectations. The realization of savings well above programmed targets sends a clear signal of Dominica's decisive shift towards prudent fiscal management. Moreover, measures have been implemented to address weaknesses that gave rise to the recent non-complying disbursement, which reaffirms the authorities' intention to maintain its collaborative relationship with the Fund.

Notwithstanding these recent impressive economic gains, the government recognizes that the economic and fiscal situation in Dominica remains fragile and is committed to broadening and deepening the process of economic stabilization and growth embedded in the PRGF arrangement.

The upcoming elections, which are to be held no later than mid-2005, provide an important window of opportunity to establish a broad-based public and political consensus on a fiscal and structural program aimed at both consolidating recent gains and building further upon them.

Fiscal Policy and the Reform of Public Finances

Dominica has made significant progress towards resolving an unstable fiscal situation, and is moving forward with initiatives to institutionalize fiscal discipline in the long run. The primary balance has now shifted solidly into surplus (3.8 percent of GDP in the first half of 2004/05) and the government is on track to reduce the overall fiscal deficit to 3.5 percent of GDP, thus exceeding the program target by a margin of nearly 1 percent. This stronger-than-expected fiscal performance reflects improved revenue collection and transitory revenue gains, better expenditure controls, and the ongoing implementation of the agreed set of corrective fiscal adjustment measures.

Fiscal prudence is the cornerstone of the program. Notwithstanding the economic shocks of the recent and severe earthquake, the authorities were resolved to implement the Board-endorsed fiscal program and therefore reached an agreement with the staff to preserve quantitative targets for the 2004/05 budget year. Given the fiscal over-performance to date, this provides a much-needed margin to accommodate unanticipated earthquake-related expenditures.[1] The government emphasizes, however, that this should not be misconstrued as a weakening in the government's commitment to fiscal discipline. Indeed, in the management of the fiscal plan, line items are to be held to budgeted levels and the hope is to finance earthquake reconstruction from grants. Nevertheless, repairs to public infrastructure in priority areas simply cannot wait and excess savings will be used to accommodate expenditures in these areas. A fiscal adjustor may also be required to create fiscal room to establish the Caribbean Court of Justice which is an important element of a broader CARICOM sponsored regional-integration initiative.

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[1] Damage to public infrastructure resulting from the earthquake is estimated at 7 percent of GDP.

As noted above, Dominica is continuing to make inroads on core elements of the agreed fiscal adjustment package to restore and safeguard fiscal sustainability. Indeed, while transfers and subsidies have increased, the authorities' decision to leave vacated civil service positions unfilled implies that the savings on the wage bill for this fiscal year – the key fiscal adjustment measure – will be realized ahead of schedule. Moreover, following unavoidable delays to resolve constitutional and equity-related concerns with the proposed public service retirement legislation, parliament successfully passed legislation to increase the retirement age in the civil service. The review of statutory tax exemptions was carried out and Cabinet has begun consideration of recommendations to reform the administrative arrangements for the granting of exemptions, to include the publication of exemptions granted. The authorities intend to follow-up on these recommendations with legislative measures where these are necessary. In the meantime, the government will hold the line on granting new exemptions and continue to strengthen the exemption procedures from a transparency perspective. Finally, the government remains committed to implementing the VAT in a pragmatic fashion and will continue to work with the staff to identify procedural options to further enhance budget design in keeping with the overarching objective of safeguarding fiscal sustainability.

Structural Agenda

There is broad agreement that the structural agenda, which has largely focused on resolving fiscal imbalances and strengthening the fiscal framework, needs to broaden its scope to include the implementation of growth-enhancing reforms. The authorities agree that the Article IV discussion, scheduled for later this spring, is an appropriate springboard that could usefully inform the upcoming discussions on both the growth strategy and the medium-term macroeconomic framework. The authorities look forward to working collaboratively with the staff on these issues in the period ahead including the articulation of a strategy to better insure against the effects of the prevalent natural disasters in the region.

Debt Restructuring

In December 2003, Dominica embarked on the difficult task of a pre-emptive sovereign debt restructuring - the first country in the region to have attempted this. Successfully completing the debt restructuring process is a vital component of Dominica's strategy to restore fiscal sustainability and the authorities are determined to carry this through to fruition.

Significant progress on debt negotiations has been achieved. As of late January, agreements, at least in principle, had been reached with creditors on about 70 percent of the debt subject to restructuring. And, while the authorities had no choice but to close the exchange offer in September 30, 2004 (following several extensions), they have sustained their efforts to engage with non-participating creditors in the hopes of reaching a collaborative restructuring. In this context, it is revealing that Dominica has adopted a policy to deposit payments for these creditors (as they fall due) on restructured terms into an escrow account in the ECCB – this sends a clear signal of the government's commitment to sustain good faith efforts to reach a cooperative and equitable resolution of the debt problem with its creditors. Moreover, in keeping with the principle of comparability of treatment, Parliament recently passed legislation to eliminate the earmarking of revenues to service debt to a select group of creditors on original terms. This removes a longstanding bottleneck to reaching agreement on a debt-exchange with these creditors that should help breathe new life into debt negotiations.

As noted by the staff, the unfinished debt restructuring and decision to close the debt exchange offer continues to pose risks. On balance, however, these risks as a whole have fallen since the Fund program was first approved, particularly in light of Dominica's recent track record on implementing corrective policies and the country's handling of the debt negotiations. As indicated by the staff, the approach by Dominica to debt restructuring is consistent with a "good faith model" and in that context, is deserving of the IMF's continued support under the lending into arrears policy as recommended by the staff.

Conclusion

On the above grounds, and in view of the extensive policy actions that have been taken by the Dominican authorities, we are hopeful that the Board will look favourably on the decision to complete the third and fourth reviews as well as the authorities' request for a waiver on the performance criterion on external arrears.