August 27, 2021
Approval: 9/8/21

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/46-2

2:30 p.m., June 5, 2019

2. Dominican Republic—2019 Article IV Consultation

Documents: SM/19/114 and Correction 1; and Supplement 1

Staff: Cebotari, WHD; Sun, SPR

Length: 28 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	J. Garang (AE), Temporary
	L. Nankunda (AF), Temporary
	J. Di Tata (AG)
	N. Heo (AP)
A. Tombini (BR)	
	Y. Zhao (CC), Temporary
	A. Del Cid-Bonilla (CE), Temporary
	C. Williams (CO), Temporary
	S. Benk (EC)
	A. Castets (FF)
	V. Lucas (GR), Temporary
	P. Dhillon (IN), Temporary
	M. Psalidopoulos (IT)
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	F. Al-Kohlany (MI), Temporary
	M. Josic (NE), Temporary
	J. Sigurgeirsson (NO)
	A. Tolstikov (RU), Temporary
	W. Al Hafedh (SA), Temporary
	Z.Mahyuddin (ST), Temporary
	P. Trabinski (SZ)
	A. Clark (UK), Temporary
	S. Vitvitsky (US), Temporary

G. Tsibouris, Acting Secretary
S. Maxwell, Summing Up Officer
V. Sola, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: I. Luca. Strategy, Policy, and Review Department: Y. Sun. World Bank Group: J. Herderschee. Western Hemisphere Department: F. Arze del Granado, O. Bespalova, A. Cebotari, J. Faltermeier, R. Garcia-Saltos, J. Okwuokei, M. Rousset, A. Santos. Executive Director: A. Mahasandana (ST). Alternate Executive Director: P. Fachada (BR), B. Saraiva (BR). Senior Advisors to Executive Directors: F. Fuentes (BR), E. Rojas

Ulo (AG). Advisors to Executive Directors: M. Bangrim Kibassim (AF), M. Bernatavicius (NO), M. Coronel (BR), J. Corvalan (AG), K. Florestal (BR), M. Kikiolo (AP), A. Maciá (BR), M. Mehmedi (EC), F. Rivadeneira (BR), A. Urbanowska (SZ), D. Vogel (AG), K. Hennings (BR).

2. DOMINICAN REPUBLIC—2019 ARTICLE IV CONSULTATION

Mr. Tombini and Mr. Fuentes submitted the following statement:

The authorities of the Dominican Republic want to thank the mission team for the open and constructive dialogue during this year's Article IV consultation. They welcome staff's thorough analysis and valuable recommendations and look forward to continuing a constructive relationship with the Fund. The authorities take note of staff appraisal and reiterate their commitment to sound macroeconomic policies focused on strong growth, social progress, financial stability, and sustainable public finances.

Recent developments and outlook

The Dominican economy maintained a strong growth performance in 2018. The country led growth in the Latin America and the Caribbean region at 7.0 percent, underpinned by a robust private consumption and investment amid less supportive external conditions. In the first quarter of 2019, economic activity continued to grow, albeit at a more moderate pace, reaching 5.7 percent despite severe drought conditions impacting agricultural production. The ongoing expansion is headlined by the dynamism of the construction sector and the sustained growth in services, particularly in tourism. Authorities forecast real GDP growth will finish the year at around 5.5 percent, driven primarily by domestic demand.

Sustained and better focused social expenditure is generating a significant improvement in socioeconomic indicators. In addition to bolstering investment in health and education, social programs focused on anti-poverty initiatives and on aid to farmers and small businesses have been instrumental to reduce the poverty headcount from 39.7 percent in 2012 to 22.8 percent in 2018, and extreme poverty from 9.9 percent to 2.9 percent in the same period. More importantly, rural poverty has experienced a substantial reduction underpinned by public policies directed to boost credit access, infrastructure investment and promote gender inclusion. The sustained growth trend in recent years has contributed to reduce the unemployment rate to 5.8 percent as of March 2019. Approximately 80 percent of the jobs generated during last year were in the formal sector, reducing overall labor informality.

Fiscal policy

Authorities are committed to fiscal consolidation and to strengthening medium term fiscal sustainability. The Non-Financial Public Sector (NFPS) deficit descended to 2.7 percent of GDP in 2018 on the back of strong revenue growth. It is expected to decline further to 1.7 percent of GDP in 2019, supported by additional efforts to improve tax administration and the decline in transfers to the electricity sector as the Punta Catalina coal-fired power plants become operational. Regarding the institutional framework, the Ministry of Finance is operating under a medium-term fiscal framework for 2018-2022 that provides the guidelines to strengthen fiscal sustainability and monitor risk exposure to macroeconomic shocks. Additionally, fiscal authorities understand the relevance and benefits of a fiscal responsibility framework and have begun discussions regarding its prospective design and future implementation.

Public debt remains sustainable. The debt-to-GDP ratio reached 50.4 percent at end 2018, with a sustainable medium-term outlook and resilient to external shocks, as highlighted by staff in the Debt Sustainability Analysis. In order to strengthen the institutional framework of debt management, the Ministry of Finance has received valuable technical assistance from a mission comprised by experts from MCM and FAD. Regardless, authorities are cognizant of the vulnerabilities associated with the public debt and have emphasized their commitment to place the debt-to-GDP ratio on a firm downward trajectory. Against this background, the government is persuaded that there is room for strengthening tax administration further to reduce evasion and fraud and boost fiscal revenue.

Monetary policy

Monetary authorities have preserved price stability notwithstanding high economic growth. The inflation targeting regime, in place since 2012, has supported the Central Bank of the Dominican Republic (CBDR) in fostering low inflation and well-anchored inflation expectations. Since mid-2018, the combination of tighter monetary conditions and lower oil prices have eased the pressure off domestic prices in the context of brisk economic activity, driving down headline inflation below the lower limit of the 4.0 ± 1.0 percent target range (1.17 percent at year-end, the lowest registered since 1984). Inflationary pressures remain muted as year-on-year CPI inflation is still well below the target band reaching 1.6 percent in April 2019. After the staff report was circulated, the CBDR reduced the reserve requirements to provide additional liquidity to support credit to the private sector.

The new electronic platform will support CBDR efforts to organize and deepen the FX market. The implementation of the electronic FX platform that will become operational in late June, will enhance efficiency and increase market liquidity and transparency in line with international best practices. After the full implementation of the platform and market adaptation to the system, authorities are planning to introduce an explicit intervention rule to moderate sharp fluctuations in the exchange rate. In preparation, the CBDR has reduced market interventions for stabilization purposes since January.

New plan to recapitalize the Central Bank will be signed into law soon. The CBDR and the Ministry of Finance are diligently working to finalize negotiations to reform Law 167-07 to address the outstanding amount of the instruments for the recapitalization of the Central Bank. The new plan will allow for better coordination between the CBDR and the Ministry of Finance regarding debt issuance. Moreover, this framework aims to contribute to lower issuance costs, and systematically reduce the CBDR quasifiscal deficit and debt level in the medium term.

Financial stability

The banking system remains well-capitalized, liquid and profitable. According to financial soundness indicators, at the end of April the capital adequacy ratio stood at 15.6 percent, the return on assets (ROA) at 2.0 percent, the return on equity (ROE) reached 18.9 percent, and Non-performing loans (NPL) decreased to 1.6 percent. The CBDR and the Superintendency of Banks are taking actions to boost financial inclusion, including by leveraging advances in financial sector technology (Fintech) under strict regulation. Regarding risks to financial stability, authorities recognize the challenges related to nonbank institutions. As a result, a project to revamp supervision and regulation of the cooperative sector is being evaluated by the Presidency and Congress.

Authorities are making steadfast progress in strengthening the AML/CFT framework. In June 2017, the Dominican Republic carried out a comprehensive reform of its AML/CFT legal framework by enacting Law 155-17, which is broadly in line with international standards. Moreover, the 2018 assessment by the Financial Action Task Force of Latin America (GAFILAT) found relatively strong technical compliance with the FATF standards and the country continues to work diligently in implementing the recommendations rendered in the Mutual Evaluation Report. In addition, authorities have strengthened the Financial Analysis Unit (UAF) with the technological and financial resources warranted to implement the new legislation, as the country remains engaged in becoming a member of the Egmont Group.

The CBDR and the banking sector have taken important steps towards enhancing cybersecurity. The creation of a Cybersecurity Incidents Response Center will enable financial authorities to monitor threats and prevent attacks on financial institutions and participants of the payments and securities settlement system. In this process, the CBDR has received valuable support from the Fund during two staff visits to headquarters in 2017 and 2018, and ongoing training and technical assistance provided by Israel. A high-level interinstitutional commission is currently working to reform Law 53-07 against High Technology Crimes and Offences to provide a national legal framework to combat cybercrimes.

External sector

External sector performance continues to be solid. The current account deficit averaged 0.9 percent of GDP during 2016-18, well below its historical mean, buttressed by tourism and gold and maquila exports in the context of low oil prices. Staff assess the external position and the real exchange rate as broadly in line with medium-term fundamentals and desirable policies. Foreign direct investment (FDI) continues to play a prominent role in financing the external gap, averaging 3.7 percent of GDP since 2010 and fostering economic diversification and job creation. Regarding international trade, relations with the Unites States, the country's main trading partner, remain strong and anchored by the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA). Nonetheless, the authorities continue to monitor the risks emanating from global trade tensions and the potential impact on the country's terms of trade and external competitiveness.

Reserve adequacy has improved. The level of foreign international reserves has increased steadily since the 2003-04 banking crisis and currently exceeds all traditional reserve adequacy metrics. Nevertheless, authorities are taking actions to continue reserve accumulation in order to solidify the external position, increase the resilience to external shocks and get closer to the adequacy threshold set by the Fund's risk-weighted metric (ARA). Authorities plan to further build-up reserves as opportunities arise.

Structural reforms

The structural reform agenda is anchored by the National Development Strategy (NDS) 2030. The NDS was signed into law in 2012 to serve as the strategic roadmap to achieve the Dominican Republic's development goals. The law mandates that three national pacts must be agreed upon between the government, the civil society and the private sector to build the consensus to address key issues in public education, electricity generation and public finances. The national pact for education was signed in 2012 and prompted authorities to double public investment in education to 4 percent of GDP to build new schools, reform the curriculum and boost teacher quality. Thus far, lack of political consensus has delayed the completion of both the electricity and fiscal pacts.

Regarding the electricity sector, the government is expecting to boost generation and ease fiscal pressures as the new power plants become operational. The plants have initiated operations with a joint capacity of 752 MW, approximately 30 percent of the country's gross energy output. To support the project, the government is expected to invest heavily in distribution infrastructure to improve energy reliability and reduce costs for the state-owned distribution companies. Despite being coal-fired, the plants performed well against IFC performance standards. Authorities are now preparing to open the project to private investors (up to 50 percent of ownership). This operation will allow the government to lessen budget pressures and reduce consolidated public debt further. In the meantime, authorities remain committed to take further actions to continue addressing the sector's structural bottlenecks.

The government remains engaged in discussions on labor and social security reforms. While extended dialogue with the private sector and trade unions have delayed consensus building to reform the labor code and the social security law, authorities continue to act proactively to advance negotiations. In February, the Executive branch sent a bill to Congress to lower commissions charged by the Pension Fund Administrators (AFPs). The AFPs' high gains and the affiliates low profitability is one of the aspects to be revised in the impending reform. Regarding the labor code, discussions have revolved around finding mechanisms to boost formal employment, add flexibility and increase wages without reducing workers labor rights. In this process, the government continues to mediate between employers and employees, and recently introduced a legislation to raise pensions and the minimum wage in the public sector.

The National Competitiveness Council have implemented important initiatives to improve the business climate. Measures to raise the efficiency of public institutions and forge a more efficient and competitive economy have been adopted, including streamlined procedures to open new businesses and fulfill tax obligations. In addition, a new bill to institute the legal framework for Public-Private Partnerships (PPPs) was submitted to Congress last May.

This mechanism will be key to close the infrastructure gap and broaden the range of sectors attracting investment.

Authorities continue to work in strengthening the rule of law. The ongoing corruption probe has forcefully pursued allegations against former high-level officials, sending to trial seven defendants, including congressmen and former ministers. The present administration has repeatedly stressed its commitment to sanction those involved in corruption acts. Further progress in enhancing public sector transparency and accountability has been achieved with the revamped asset declaration requirements and measures to enhance fiscal transparency, by prosecuting tax evasion, fraud and money laundering.

Mr. Benk and Mr. Mehmedi submitted the following statement:

We thank staff for the comprehensive report, and Mr. Tombini and Mr. Fuentes for their informative buff statement. The Dominican Republic's economic growth has been strong since 2014, supported by stable macroeconomic and financial policies which have led to improved social outcomes and continued income convergence with the US. Near-term prospects are favorable, but downside risks stemming from the high fiscal deficit, contingent liabilities, low productivity, and structural impediments weigh on medium-term growth. The authorities' objective of reaching high-income status by 2030 will require them to embark on a fiscal consolidation path to ensure the sustainability of public finances, strengthen financial sector stability, while also improving productivity and enhancing governance. We share the thrust of staff's appraisals and advice, and would like to provide the following comments for emphasis.

Putting debt on a sustainable downward trajectory will entail the implementation of a front-loaded revenue-based fiscal consolidation while strengthening the fiscal responsibility framework. Considering that debt has reached 53 percent of GDP due to persistent structural deficits, averaging around 4½ percent of GDP over the last five years, points to the urgent need for the authorities to implement a revenue-based fiscal adjustment to improve the fiscal position. We welcome the authorities' planned fiscal adjustment measures but note that they rely on an overoptimistic yield from revenue administration reforms which may not fully materialize. Against this backdrop and in view of the very low revenue-to-GDP ratio, the authorities' efforts should be focused on broadening the tax base by eliminating tax exemptions, reducing the high PIT threshold, and phasing out electricity subsidies while concurrently enforcing expenditure restraint. The fiscal framework should also be strengthened by adopting a medium-term debt target to anchor the medium-term fiscal framework, strengthen policy credibility, and increase fiscal transparency.

Exchange rate flexibility should continue to serve as a key absorber of external shocks.

The monetary policy stance remains appropriate and should continue to be data-dependent. We welcome that the authorities have recently introduced forward guidance in the monthly press releases and are in the process of launching a foreign exchange trading platform. Considering that the reserve coverage is below the reserve adequacy ARA metric, there is scope to accumulate international reserves, but the rate of accumulation should be balanced against the cost of sterilizing the reserves. Staff's comments on the timeline for the implementation of the agreement to recapitalize the central bank, which is essential in reducing the burden of the quasi-fiscal losses on monetary policy, are welcome.

Increasing the resilience of the financial sector will require strengthening of the supervisory framework and enhancing the AML/CFT framework. We take positive note of staff's assessment that the banking sector is well-capitalized, liquid, and profitable. Nonetheless, pockets of vulnerabilities stemming from the large share of foreign currency loans extended to non-exporters should be closely monitored. The establishment of the Systemic Risk Committee is a step in the right direction, but further progress is needed in enhancing the banking and non-banking supervisory flameworks, including through moving to a full risk-based supervision, and adopting IFRS and Basel III principles. We note that the AML/CFT legal framework was overhauled in 2017 and GAFILAT's 2018 assessment concluded a relatively strong technical compliance with the Financial Action Task Force (FATF) standard and overall moderate effectiveness. However, the assessment also revealed that the AML/CFT regime is only effective to some extent and that major improvements are needed to mitigate money laundering and terrorism financing risks. Staff's comments on whether and what measures are being taken to address the shortcomings in the AML/CFT framework are welcome.

The expeditious implementation of the structural reform agenda, underpinned by the National Development Strategy, is essential to increase potential growth, improve productivity, increase per capita income, enhance education outcomes, and advance the Dominican Republic to high-income status. In this context, the focus should be on enhancing the business and investment environment, improving governance, and reforming the electricity sector. Boosting productivity will also require measures aimed at reducing the regulatory burden, addressing the infrastructure gaps, and making the labor and product markets more flexible while enhancing human capital and reducing skills mismatch. Staff's comments on the current impediments to the social security system and whether the authorities are planning to implement any parametric adjustments are welcome.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the interesting Article IV report on the Dominican Republic. The Dominican economy has had an impressive growth record in recent years, underpinned by sound macroeconomic policies. The auspicious environment provides an opportune timeframe to address the upward trend in public debt and further implement structural reforms to boost productivity and median incomes. We broadly agree with the staff appraisal in the Article IV.

We agree with staff that a degree of fiscal consolidation is warranted given the upward trend in public debt dynamics. The large share of foreign currency debt is also concerning, limiting debt carrying capacity amid a high interest burden. While politically difficult, we encourage the authorities to address the key deficit drivers, including in the electricity sector, and design measures to help offset the negative distributional effects.

We agree that the current monetary policy stance is appropriate given muted inflation. We note that staff determine that the external position is broadly in line with fundamentals, but that the foreign exchange reserve position is 68 percent of the IMF reserve adequacy metric (ARA). Staff then acknowledge that shifting to a flexible exchange rate regime would increase the ARA metric to 100 percent. With inflation expectations well anchored, stable economic conditions, and a new electronic foreign exchange platform launching soon, the authorities should continue moving towards a flexible exchange regime. Still, there are risks toward exchange rate flexibility, including the large share of public and banking sector foreign currency loans. Staff elaboration on how to mitigate these risks would be welcome.

Finally, we agree with staff that the authorities should take further steps to increase productivity and boost median incomes. We support efforts to remove trade and investment barriers, strengthen governance, cease anti-competitive business practices, and bolster the education and health systems. These steps would further build on the Dominican Republic's already impressive social gains and continue income convergence.

Mr. Saito and Mr. Komura submitted the following statement:

We thank staff for the comprehensive report and Mr. Tombini and Mr. Fuentes for the informative statement. It is welcoming that the economic growth has been strong over the last five years. The economy expanded by 7 percent in 2018, widening the estimated output gap to 0.9 percent of potential GDP. Despite strong growth and positive output gap, the economy has not shown a sign of overheating with modest inflation. We would ask staff to deepen the analysis on the background of subdued inflation. At the same time, we agree with staff that the current favorable economic environment provides a window of opportunities to address remaining challenges to achieve strong, sustainable, and inclusive growth. As we broadly concur with staff appraisals, we would like to offer some comments for emphasis:

Fiscal Policy

Dominican Republic needs to undertake fiscal adjustments and strengthen fiscal framework. Regardless of strong growth, public debt to GDP continues to grow. In addition, interest rate costs are high and tax base remains low, indicating low debt carrying capacity. Against this backdrop, the authorities should undertake fiscal adjustments and strengthen fiscal framework to create additional fiscal space and reduce interest rate costs by taking advantage of the current economic environment. On fiscal adjustments, we note that reforms in the electricity sector and tax incentives and exemptions are politically and socially sensitive. However, we encourage the authorities and staff to discuss measures to mitigate such sensitiveness, including increase in social spending, in the future Article IV consultations. On the fiscal framework, while we commend that the authorities are improving fiscal statistics and debt management capacity, we agree with staff that Dominican Republic needs a framework anchored on a medium-term debt target.

Monetary Policy

The current monetary policy stance is appropriate and should remain data dependent. Furthermore, we commend that the central bank has strengthened its monetary policy framework, better anchoring inflation expectations. Related to this point, the central bank has recently introduced forward guidance in the monthly press releases. Could staff elaborate on its forward guidance? How does staff evaluate its effectiveness to improve the credibility of its conduct of monetary policy? In addition, we agree that recapitalization of the central bank is necessary to strengthen the central bank's financial position and improve public debt management. We urge the authorities to steadily implement their plan.

Financial Sector

We welcome the staff's assessment that Macro-financial risks appear limited. However, we take note that pockets of vulnerability remain. In particular, we are concerned that financial cooperatives are not regulated or supervised although some are as large as banks. We urge the authorities to establish a regulation and supervision framework for financial cooperatives. In this regard, the authorities views mention that "views differed on whether the supervision should rest with the current bank authorities or with a new self-supervisory authority." In staff's opinion, who and how should regulate and supervise the financial cooperatives?

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the comprehensive report, and Mr. Tombini and Mr. Fuentes for their informative buff statement. The Dominican Republic has continued its solid economic performance over the last several years. Growth has been above the potential and the most dynamic in the Western Hemisphere, helping to deliver welcome labor market and social outcomes, including increased employment, and declined poverty and inequality. Inflation is muted, and external and fiscal positions have improved. Staff assesses that the outlook for the economy is favorable, with broadly balanced risks. In this context, the policies in the discussions have focused on addressing key factors that hold back growth and safeguarding against potential headwinds. The staff report highlights the need for far-reaching policy reforms and measures to sustain growth, and faster income convergence to advance country levels. On the structural front, priority should be on measures to ensure that the benefits of economic growth are shared more broadly. We broadly agree with the staff's assessment and wish to make following remarks for emphasis.

Further strengthening fiscal position will help reducing sustainability risks given the rising public debt in the context of robust growth, although the public debt remains sustainable as per the DSA. Staff has highlighted the still prevailing vulnerabilities to financing and market risk. In this context, the front-loaded adjustments will help improve the fiscal position in the medium-term. While welcoming the recent progress made in curbing tax evasion, we stress that broadening the tax base, improving tax administration and managing the growing interest bill as well as losses in the electricity sector are also important to address the persistent structural deficit. Could staff comment on the possibility of increasing revenue through direct taxes without heavily affecting some segments in the economy? We share the staff's recommendation for a medium-term fiscal framework, which will help reduce greater risk of rising fiscal deficit and ensure policy credibility.

Staff assesses that the current monetary policy is appropriate given the muted inflationary pressures, and see no signs of overheating, despite the strong activity. Nevertheless, the authorities should stand ready to take appropriate monetary policy measures following a data dependent approach. We welcome the recent reforms to strengthen the monetary framework, including a plan to recapitalize the central bank. The progress in the inflation targeting regime and the developments in the foreign exchange market towards a more flexible exchange rate are also encouraging; these should be continued.

The financial system remains healthy, in terms of its capitalization, asset quality and profitability. We welcome the continuous measures to strengthen the financial system through improved bank and systemic risk oversight and upgrading regulation and institutional framework and stress the need for their effective implementation. Staff highlight pockets of vulnerabilities, particularly in the non-bank sector, that need closer attention. The significant improvement in the AML/CFT framework is commendable. However, we note that the GAFILAT's 2018 assessment has found the need for major improvements to mitigate money laundering and terrorism financing risks. Staff's comments are welcome.

We commend the CBDR's progress and ongoing reforms towards strengthening cyber defense framework in the Dominican Republic. In particular, the creation of a Cyber Security Response Center, and training and technical assistance from the Fund as well as from Israel are very positive developments. Could staff comment on this process in the broader context of enhancing Cybersecurity in Fund's member countries with similar backgrounds and the possible lessons from Dominican Republic's experience?

On the structural side, continued reforms are needed to address long standing structural bottlenecks to boost productivity and strengthen social safety nets. In this regard, the progress in the national pact for education under the NDS 2030 is encouraging. However, the buff statement indicates that the lack of political consensus has delayed the completion of the pacts on electricity generation and public finances. Could staff comment? We encourage the National Competitiveness Council to play a pivotal role in identifying obstacles to easier trade, business environment and innovation. Improving infrastructure, strengthening institutions and governance, and measures for social protection and poverty reduction are also among the areas that need continued attention.

With these remarks, we wish the authorities all success in their future endeavors.

Mr. Merk, Mr. Trabinski, Ms. Lucas and Ms. Urbanowska submitted the following joint statement:

We thank staff for the informative report and Messrs. Tombini and Fuentes for their helpful buff statement. We broadly agree with staff's appraisal and policy recommendations and would like to offer the following comments for emphasis.

The Dominican economy continues to experience robust growth, underpinned by strong consumption and private investment. Additionally, inflation remains subdued and the external position is strong, with no apparent signs of overheating. We welcome the authorities' commitment to macroeconomic stability and note the continued progress in income convergence with advanced economies as well as the notable reduction in poverty and inequality rates. Nevertheless, weakening global demand, tightened financial conditions, and higher energy prices pose significant challenges to future growth. Against this backdrop, the strong cyclical position provides an opportunity to focus on reducing uncertainty about fiscal sustainability and making growth more inclusive.

Comprehensive fiscal consolidation measures are needed. A frontloaded adjustment will be paramount in ensuring fiscal sustainability and creating policy buffers, given the country's upward debt trajectory. We share staff's debt dynamics concerns and value the realism of the baseline estimates. While we are encouraged by the ambitious revenue administration reforms, as described in Annex V, we support staff's call for an adoption of a credible overarching fiscal framework with a clear debt anchor. The framework would also strengthen the management of fiscal risks in the short- and medium term.

The current monetary stance seems appropriate and should remain data dependent. Well-anchored inflation expectations and clear communication by the central bank remain at the center of an effective and credible monetary policy. Greater exchange rate flexibility, with limited interventions, would help build adequate reserve buffers and better shield the economy against external shocks. In addition, we encourage the authorities to further strengthen the monetary policy framework. Furthermore, we welcome the progress toward further development of financial market infrastructure and instruments.

Current efforts to strengthen the financial system should continue. We welcome the authorities' commitment to improve systemic risk oversight by deploying a macroprudential toolkit and developing a cybersecurity framework. We take positive note of the various institutional reforms undertaken recently, in particular the revised AML/CFT framework, aimed to address institutional and governance gaps, and call for further improvement of the effectiveness of the AML/CFT regime. We also welcome the GAFILAT's 2018 findings, which confirm the authorities' broad technical compliance with FATF standards; however – as the staff report points out – potential vulnerabilities remain in the non-financial sector. We strongly encourage the authorities to strengthen supervisory oversight of nonbank institutions and cooperatives and improve data provision, especially on non-financial corporates and households.

Structural reforms are needed to reinforce growth and resilience. Policy actions focused on improving the business climate by removing trade and investment barriers, enhancing education and the health system, as well as improving access to the social security system are key to boost productivity and achieve inclusiveness. The authorities' ambitious goal to reach a high-income status by 2030, as specified in the National Development Strategy for 2010-30, would require decisive policy actions to address the structural weaknesses in the fiscal sector, as well as the bottlenecks in electricity generation and distribution.

Ms. Levonian and Mr. Williams submitted the following statement:

We thank staff for their well-written report and Messrs. Tombini and Fuentes for their informative buff statement. It is noteworthy that the authorities' prudent macroeconomic policies continue to stimulate strong domestic demand and to enable the Dominican Republic (DR) to reap rich growth dividends from favorable external conditions. The robust economic expansion supported by a well-targeted social policy framework has contributed to a significant reduction in poverty and unemployment. Still, poverty remains elevated and fiscal pressures loom. Moreover, the risks of a less supportive external environment underscore the importance of advancing the reform momentum to preserve the hard-won gains and to strengthen the economy’s resilience to shocks. We broadly concur with staff’s assessments and recommendations and offer the following remarks for emphasis.

Fiscal policy should remain focused on debt sustainability while protecting social spending and supporting inclusive growth. We commend the efforts to enhance tax administration, which have so far yielded positive returns. However, as these flows may be inadequate to sustainably improve fiscal outcomes, we encourage the authorities to re-examine the existing VAT and income tax exemptions, among others, and assess the scope for deeper reforms to mobilize revenue. In addition to strengthening fiscal buffers, higher revenue intake will be key to enhancing social support and upscaling growth-friendly public investment. Relatedly, while the authorities’ medium-term fiscal framework is a good step toward promoting fiscal transparency and discipline, a well-designed fiscal responsibility framework codified in law will enhance credibility and provide a better debt anchor. Can staff comment on the report’s limited coverage on building resilience to natural disasters?

On monetary policy, holding a neutral stance is sensible. While risks appear broadly balanced, the central bank should continue to closely monitor developments in the external and domestic environment and be ready to act if inflationary pressures shift. Importantly, inflationary expectations are well-anchored and legislative plans to recapitalize the central bank will be key to reinforcing policy credibility and should be pursued without delay.

The authorities continue to make steady progress in enhancing the stability of the financial sector. We commend the authorities’ actions to strengthen risk-based supervision and welcome their prudent steps toward implementing Basel III principles. These are critical measures to further buttress financial sector soundness. Furthermore, we welcome efforts to mitigate cybersecurity risks and encourage the authorities to remain resolute in effectively implementing the recently upgraded AML/CFT framework. We invite staff to elaborate on the appropriate supervisory authority for the financial cooperatives.

Finally, efforts to improve the business environment and enhance social support must continue. The DR is rightly focused on uplifting human and physical capital and upgrading the electricity sector. These, alongside labor and social security reforms, are vital to boosting potential growth and advancing DR’s ambitions toward developed country status by 2030.

Mr. De Lannoy, Mr. Psalidopoulos, Mr. Di Lorenzo and Mr. Josic submitted the following joint statement:

We thank staff for the well-written paper and Messrs. Tombini and Fuentes for their helpful buff statement. We agree with the thrust of staff's appraisal and we would like to limit our comments to the following.

Capitalizing on the strong economic momentum is key for Dominican authorities to further reduce remaining vulnerabilities and improve social outcomes. The steady economic growth has generated tangible improvements in life conditions, without creating internal and external imbalances. Even in a context of a gradual deceleration toward the potential growth rate, the still very favorable outlook represents an ideal backdrop for the reforms needed to buttress debt sustainability and remove structural bottlenecks to higher productivity.

Some degree of fiscal adjustment would help to mitigate raising fiscal vulnerabilities. The high growth dividend has not been translated in a sound fiscal position. The procyclical expansion and the impact of large below-the-line operations have drifted debt dynamics upward. Although the debt ratio is projected to remain comfortably below the 70 percent benchmark, also in the stress tests scenarios, we concur with staff and the authorities on the need to place the debt-to-GDP ratio on a firm downward trajectory. We commend the authorities for the significant reform efforts to improve revenue administration that are bearing fruits; however, the intrinsically uncertainty about the amount of revenues that can be actually mobilized suggests complementing them with tax base-broadening measures, in line with staff's advice. We welcome the pro-active stance in enhancing resilience to natural disasters, including by establishing a contingent credit line with the World Bank. We also welcome the tailored natural disaster scenario in the DSA and we wonder if the effects of the disbursement of the CAT-DDO has been factored in the scenario, along the lines of what has been done in the very recent Art. IV report for Bahamas.

We take favorable note of the authorities' commitment to address many of the factors holding back productivity and income growth. We believe that a reform of the electricity sector is long overdue, given its low efficiency despite the significant budget costs. While it is possible that the new coal-fueled plant would bring about some improvements in this sense, investments in green energy sources and in improving transmission should remain a priority. Finding a growth-optimal role of the state in this sector and addressing poorly designed subsidies would be particularly important. As for social policies, the authorities' well-placed focus on social outcomes and income convergence would benefit by reforms addressing the low coverage and the fiscal risks from the social security system.

The central bank should keep monitoring inflation pressures while further increasing the credibility of its inflation targeting framework. Monetary policy has been appropriately accommodative when inflation pressures were subdued, and then tightened in a gradual way as the stimulus was received by the economy. As the different factors mentioned by staff can push inflation in either direction, further monetary policy decisions should remain data-dependent and well-communicated to keep the inflation expectations anchored. Monetary policy has a large role to play in case of a mayor shock, according to the results of the interesting GaR analysis. Finally, the introduction of the foreign exchange platform will make this market more transparent and efficient; in the meantime, we welcome that market interventions have been reduced and that the introduction of an intervention rule is in the pipeline.

Mr. Di Tata submitted the following statement:

We thank staff for the very well-written report and Mr. Tombini and Mr. Fuentes for their informative buff statement.

The Dominican Republic has had a commendable economic performance in recent years, supported by a strengthened policy framework and favorable external conditions. In 2018 the country recorded the highest growth in the Latin American and Caribbean Region, while this year the growth rate is expected to the third highest after Dominica and Panama. Inflation remains subdued, the external position is supported by strong receipts from tourism and remittances, and international reserves have increased although they remain below the Fund’s reserve adequacy metric. In addition, the significant progress that has been made in reducing poverty since 2012, especially rural poverty, is noteworthy. Real GDP growth is projected by staff to slow down to 5 percent over the medium-term. Main risks to the outlook include a possible weakening of demand from the U.S. and higher energy prices.

We concur with staff that further fiscal consolidation is needed to ensure medium-term fiscal sustainability, given the country’s weak debt carrying capacity. In this regard, we are inclined to agree on the need for an additional fiscal effort based on reducing generalized subsidies on electricity, rationalizing CIT incentives and VAT exemptions, and lowering the PIT threshold. We note, however, that instead of these measures the authorities intend to rely primarily on further efforts to strengthen tax administration and a decline in the electricity sector deficit with the entry into operation of the Punta Catalina plant. Staff estimates that in the absence of substantive tax and electricity reforms and due to increases in minimum wages and pensions and higher investment, the consolidated fiscal deficit is likely to remain at around 4 percent of GDP, with the public debt gradually increasing over the medium term. Could staff elaborate further on the differences of opinion with the authorities regarding fiscal adjustment? On a related matter, we concur with staff that the authorities should pay proper attention to the distributional effects of the proposed measures, which may require strengthening social protection.

We are encouraged that the authorities agree on the relevance and benefits of developing a fiscal responsibility framework. Such a framework would be useful to clarify the government's medium-term objectives and remove policy uncertainties. At the same time, we welcome the development of a medium-term fiscal framework for 2018-22, accompanied by an analysis of fiscal risks around the baseline projections. We also take positive note of the efforts underway to enhance debt management with technical support from MCM and FAD experts, as well as to strengthen institutional capacity to assess risks from public-private partnerships. In addition, we encourage the authorities to continue with their efforts to broaden the coverage of fiscal reporting to municipalities and decentralized institutions.

We agree that the monetary policy stance is appropriate in the current juncture, and that it should remain data dependent. At the same time, there is a need to continue building reserve buffers, although the pace of such buildup is constrained by sterilization costs. Meanwhile, we are encouraged by the ongoing negotiations on a new plan to recapitalize the central bank, which aims to gradually move its quasi-fiscal liabilities to the central government.

We notice that the financial system remains healthy in terms of capitalization, asset quality, liquidity, and profitability. However, intermediation spreads are large because of high operating costs, a large share of foreign currency loans to non-exporters may create credit risks, and banks have large investments in sovereign debt that could expose them to interest risk. Going forward, we agree with staff on the need to improve the prudential toolkit and bring the nonbank financial system into the supervisory perimeter. We also encourage the authorities to continue with their efforts to enhance cybersecurity and effectively implement the AML/CFT framework, including the recommendations made in the Mutual Evaluation Report. Could staff comment on the advantages/disadvantages of maintaining the regulation and supervision of financial cooperatives with the current bank authorities or creating a new self-supervisory authority?

The structural agenda is anchored by the National Development Strategy 2030, which mandates three national pacts to address key issues in public education, electricity generation and the public finances. Although the national pact on education was signed in 2012, extended negotiations have delayed the completion of the other two pacts. Going forward, we concur with staff on the need to tackle further reforms in the electricity sector, align education with needed skills, address weaknesses in product and labor markets, and further strengthen the business environment. We also share the view that a deeper reform of the social security system is necessary. In this regard, could staff elaborate further on the reforms that would be needed to ensure broader access to the system and adequate retirement income when the system matures?

With these comments, we wish the Dominican Republic and its people every success in their future endeavors.

Mr. Sigurgeirsson and Mr. Bernatavicius submitted the following statement:

We thank staff for the informative report and Mr. Tombini and Mr. Fuentes for their helpful buff statement. We broadly concur with staff's appraisal. While economic growth has been robust in recent years, tighter fiscal policies are warranted, as public sector debt continues to grow. At the same time, there is a need to step-up implementation of structural reforms to improve institutional quality and the business environment. Measures to enhance social inclusion and educational outcomes should remain high on the agenda. We encourage the authorities to consent to the publication of the report.

We concur with staff that tighter fiscal policies are clearly warranted. There is ample room to further improve tax administration: according to recent estimations, non-compliance with VAT and income taxes remains at a prominent level of 9.5 percent of GDP. There is also an urgent need to close widespread tax loopholes and exemptions. In the context of increasing public sector debt and a high interest burden, we strongly support the recommendation of introducing a credible fiscal policy framework anchored on a medium-term debt target.

Inflation expectations are well anchored after seven years since converting to inflation targeting. We urge the authorities to continue their gradual move towards a more flexible exchange rate regime and welcome recent policy efforts to scale back the size of the foreign exchange interventions. As the reserve coverage ratio remains below the recommended level, the strong external position allows for further accumulation of reserve buffers. We welcome the recent preliminary agreement to recapitalize the Central Bank and look forward to its approval in Congress and to the adherence to the agreed recapitalization schedule.

We welcome the significant progress achieved in recent years in social outcomes and poverty reduction. As was indicated in the buff statement, extreme poverty was reduced from 9.9 percent in 2012 to 2.9 percent in 2018. Despite significant progress in recent years, income inequality remains relatively high, especially in rural areas. Further measures to strengthen the social security system are therefore warranted.

Finally, we agree with staff's assessment on the need to strengthen education outcomes and institutional quality, as well as measures to improve the investment environment and focus on promoting innovation. This is especially important in light of the ambitious target to reach the high-income country status by 2030. We welcome that most of the necessary reforms are on the authorities' agenda, but further sustained action is warranted.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for well-written report and Mr. Tombini and Mr. Fuentes for their informative buff statement. We commend the authorities for their sound economic policies. The Dominican Republic maintained solid growth in 2018 supported by robust private consumption and investment, as well as by still favorable external environment. Good economic performance has strengthened policy buffers and resilience to shocks. At the same time, some vulnerabilities remain in place. To ensure sustainable development over the medium term, fiscal policies should aim at reversing debt accumulation, and further reforms should strengthen financial sector, lift structural barriers to long-term growth and boost human capital. As we broadly agree with staff assessment, we will make a few comments for emphasis.

Despite rapid economic growth, fiscal deficit remains high and public debt continues to grow. We note that under the baseline scenario public debt is set to increase to 56.5 percent by 2024. While the DSA concludes that public debt remains sustainable, staff point to high interest cost, low revenue base, and high share of foreign currency debt as risk factors. The efforts to improve tax compliance and reduce high informality are welcome, but they should be complemented by measures to broaden tax base and by electricity sector reforms. It is encouraging that the authorities see value in developing the fiscal responsibility framework.

We agree with the authorities and staff that the monetary policy stance is appropriate. After some tightening in 2018, monetary policy could be kept on hold for a while, as economic indicators suggest risks to be broadly balanced. While the authorities continue accumulation of foreign exchange reserves, they remain well below the level recommended by the ARA metric. Reserve accumulation is constrained by the high sterilization costs and the CBDR's balance sheet vulnerabilities. The recapitalization of the central bank, thus, remains a priority. The introduction of the electronic forex trading platform will help further strengthen the monetary policy framework.

The financial system is healthy, well capitalized and profitable. However, the authorities are well advised to address remaining pockets of vulnerabilities and emerging risks. We support their efforts to improve bank and systemic risk oversight, upgrade regulations and improve institutional framework, including transition to international regulatory and reporting standards. We also welcome progress in strengthening the AML/CFT framework.

The authorities should be commended for implementation of broad structural reforms agenda anchored in the National Development Strategy 2030. Further steps should support more inclusive growth and address barriers to higher productivity. It is regrettable that lack of political consensus has delayed the conclusion of the Electricity and Fiscal Pacts. The forthcoming completion of power-generating project will alleviate energy shortages and provide an opportunity to lessen budget pressures. We also urge the authorities to advance the reforms in the labor and social security areas.

With these remarks, we wish the authorities further success.

Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for their detailed report, as well as Mr. Tombini and Mr. Fuentes for their helpful buff statement. We welcome the good economic performances of the Dominican Republic and the significant progress made in the reduction of poverty and inequality. Tackling the structural bottlenecks, especially electricity production and distribution, ensuring long-term debt sustainability, and building resilience against natural disasters remain important challenges. We share the thrust of staff's appraisal and would like to add the following comments for emphasis:

Macroeconomic situation

Dominican Republic growth is strong with no sign of overheating. As the economy remains heavily exposed to the United States (tourism, remittances), we see a slowdown in the US as one of the main downside risks. On the contrary, the ongoing negotiation of a free trade agreement with China could have a positive impact on growth.

Could staff comment on the quality and reliability of the growth statistics?

Fiscal consolidation

We encourage the authorities to improve debt transparency and reduce the tax exemptions and distortions. Tackling structural deficits is a priority, notably through enhanced efforts to fight tax evasion, increasing the tax revenue which remains low at 13.7 percent of GDP by reducing tax exemptions and the significant subsidies to the electrical sector (1.7 percent of GDP). The entry into operation of Punta Catalina should contribute to create the conditions of a decrease of electricity prices. The enacting of a fiscal responsibility legislation would represent an important step forward to strengthen the fiscal policy framework. As interest expenditures represent a high share of debt, and 75 percent of the non-financial public sector debt is denominated in foreign currency, policies to reduce the risk exposure linked to the evolution of financing conditions and to the exchange rate risk are of particular importance.

Could staff elaborate on the "curentos por pagar" and their impact on the consolidated public finances?

Monetary policy and financial sector

We welcome the prudent monetary policy and the resilience of the financial sector. Monetary policy seems appropriate, as inflation expectations are better anchored, and the policy stance should evolve according to the publication of new data. However, we encourage authorities to boost credit growth as the level of credit to GDP remains low at 27 percent of GDP.

The financial sector appears globally resilient, as the banking sector remains liquid and profitable, and we encourage the improvement of the supervision of the nonbank financial system. We also strongly encourage the authorities to pursue their efforts to fully and effectively implement the AML/CFT framework and note positively the authorities' strong efforts to prepare against cyberattacks through a dedicated framework.

We welcome that the foreign exchange trading platform, to be implemented this month, could limit foreign exchange interventions. Does staff anticipate a change from the current crawl-like exchange rate arrangement to a flexible exchange rate and could staff precise its recommendations on dollarization? As the level of reserves remains under ARA metrics at 68 percent, we encourage the building up of reserves so as to cushion against the significant exchange rate risk.

Structural reforms

Addressing electricity sector bottlenecks is a key priority. The lack of progress on this issue during the last years is a major impediment to economic and social development and we share staff's recommendations to undertake the needed reforms even in the absence of the pact. We also see the development of a social security system and pension fund fees as a priority. Reducing these bottlenecks and implementing other reforms should help to boost potential growth and the convergence process.

Regarding natural disasters, we welcome the contingent precautionary loan granted by the World Bank. The potential impact of natural disasters is integrated in the EBA and DSA analysis but we would have expected more detailed developments in the report on resilience to natural disasters and climate change given their potential adverse impact on the economy.

Mr. Moumiah, Mr. Alkhareif and Mr. AlHafedh submitted the following statement:

We thank staff for the informative report and Mr. Tombini and Mr. Fuentes for their helpful buff statement. It is encouraging to note that the Dominican Republic continues to enjoy strong growth, with a stable macroeconomic environment and improving labor markets and social indicators. However, while the outlook is favorable, important challenges remain. Against this background, we broadly concur with staff conclusions and policy recommendations and would like to focus our comments on the following issues.

A meaningful fiscal adjustment would contribute to creating additional fiscal space necessary to strengthen social safety nets and undertake priority infrastructure projects. While the public debt does not breach accepted sustainability thresholds in line with other emerging markets, the high interest costs, low revenue base, and large share of foreign currency debt limit the country's debt carrying capacity. Here, we agree with staff that reforming tax administration and addressing the electricity sector and base-eroding tax incentives and exemptions would be required to create additional fiscal space.

The banking system remains well-capitalized, liquid and profitable. Here, we welcome the authorities' plans to revamp CBDR supervision and regulation of the cooperative sector and the progress made in strengthening the AML/CFT framework and enhancing cybersecurity in the banking sector.

We commend the authorities' steadfast implementation of structural reforms to remove trade and investment barriers, strengthen the education and health systems, and improve the administration and regulation of the social security system. Going forward, efforts should be stepped up to improve the business environment, including through the implementation of the Electricity Pact, reducing the complexity of the tax system, avoiding anti-competitive business practices, especially in transportation, and modernizing the labor code to allow for more flexible work arrangements.

With these remarks, we wish the authorities all the success in their future endeavors.

Ms. Mahasandana, Mr. Heo, Mr. Mahyuddin and Mr. Kikiolo submitted the following statement:

We thank Mr. Tombini and Mr. Fuentes for their useful buff statement and staff for their comprehensive set of reports. We broadly agree with the thrust of the staff analysis and recommendations and limit our comments on these few points for emphasis.

We commend the Dominican Republican economy for the exceptional growth performance since 2005, a growth level that is second only to Panama within the Latin America and the Caribbean region. The strong growth combined with focused social expenditure policies resulted in encouraging social outcomes such as improved education and health systems, lower poverty headcount that stood at 22.8 percent in 2018 and lower unemployment rate of 5.8 percent in March 2019. Notwithstanding these positive outcomes, the authorities are encouraged to address potential downside risks that could stem from the weaker and uncertain external environment, and policy implementation challenges domestically.

We are encouraged by the authorities' ongoing commitment to fiscal consolidation but noted the fiscal risks that could undermine fiscal sustainability. Strong revenue growths in 2017 and 2018 that contributed to the fall in the non-financial public sector deficit is commendable. However, we are concerned on the tax base, which continue to remain low at 13 percent of GDP due to widespread exemptions. In view of the large spending pressures from wages and infrastructure investments, we agree with staff that the planned fiscal adjustment would not be achievable without substantive tax increases and aggressive reforms in the electricity sector. We invite staff to comment if the planned fiscal adjustment for 2019 is still on track based on recent year to date data the authorities may have provided?

Given the favorable cyclical conditions, we concur with staff that it is timely to advance fiscal reform that keeps debt sustainable in the medium term. However, it is crucial that fiscal adjustments appropriately account for the impact on the most vulnerable segments of society. Staff recommendation for fiscal adjustment of 2-2.5 percent of GDP over two years and lowering debt to 45-47 percent of GDP over five years is likely to involve substantial cut in government expenditure. Where relevant, we view that appropriate measures and safety nets should be put in place to mitigate the potentially adverse impact on the vulnerable segments. Given that the economy will be affected by both revenue measures and expenditure cut, we welcome staff's comments on the potential impact of overall fiscal reforms to socio-economic. We also welcome staff to elaborate on the authorities' concerns on adopting staff's fiscal responsibility framework in the near term as highlighted in the authorities' views.

We positively note the build-up in reserves since 2012 but this still falls short of the IMF's recommended ARA metric of 100-150 percent. We agree with staff for the authorities to take advantage of the favorable external position to increase the reserve buffers. We also noted that there is already large quasi fiscal deficit on the central bank's books since the 2003-04 banking crisis and as highlighted by staff, the central bank needs recapitalization from the government to reduce the quasi-fiscal debt. We welcome staff's explanation on how recently agreed recapitalization schedule could be adhered to as planned but given the fact that the previous plan hasn't proceeded as successfully as we had hoped (footnote 13), how certain are staff that the new recapitalization plan would be implemented?

The authorities should sustain the reform momentum to create an enabling environment for businesses to thrive and contribute to higher productivity and inclusive growth. The authorities are commended for preserving financial stability and having a robust AML/CFT framework that technically complies with FATF requirements. We also welcome the authorities' anti-corruption initiatives to date and commend staff's plan to include fuller discussions on institutional and governance issues in the next Article IV. To improve business conditions, we call on the authorities to prioritize institutional and legislative reforms to address shortcomings indicated by the survey-based competitiveness indicators. We welcome the continuous engagement with private sector and civil society, however, such engagement should not drag the critical reforms needed to address weaknesses in product and labor market. Mr. Tombini and Mr. Fuentes' assurance of advancing the negotiations, as emphasized in the buff statement is welcome.

Finally, we noted that the authorities have not decided on the publication of these reports and would encourage the authorities to agree to do so. We believe other member countries would find the experiences in the Dominican Republic useful and inspiring.

Mr. Villar and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for a well-written and insightful report and Mr. Tombini and Mr. Fuentes for their informative buff statement. The Dominican Republic's economic performance over the last 5 years has been impressive. With strong growth accompanied by sound macroeconomic and financial policies and a favorable external environment, the economy has positioned itself among the most dynamic in the Western Hemisphere. Inflation is low and stable, unemployment is at historical lows, and the external position is broadly in line with fundamentals. The strong growth performance supported by policies focused on strengthening social outcomes is bearing fruits. Per capita income is moving towards advance economy levels, and poverty and inequality have significantly declined. The outlook is favorable, and risks are moderated according to staff. We broadly agree with staff's assessment and offer the following comments:

Fiscal policy and framework

Persistent structural deficits pose challenges for medium-term fiscal and debt sustainability. Staff recommends a fiscal adjustment of 2-2.5 percent of GDP over two years to decrease the fiscal deficit and bring down debt to 45-47 percent of GDP over 5 years (from current 53 percent), with frontloaded adjustment warranted by the cyclical position. From the authority's perspective, the envisaged revenue administration measures, along with the decline in electricity sector deficits from lower electricity prices with the entry into operation of Punta Catalina (and from its expected profits), will delivered the adjustment needed. While recognizing the authorities' ongoing efforts, staff considers that sustainably improving the fiscal position will require more comprehensive reforms in both the tax and the electricity sectors. At the same time, it recognizes that reforms in these areas are politically and socially difficult. Can staff clarify how it envisages a government strategy for the passing of these reforms?

We concur with staff that a policy framework anchored on a medium-term debt target and fiscal responsibility could contribute to enhance credibility. It would clarify the government's medium-term objectives, guide policies toward the debt anchor through an operational rule and remove policy uncertainty.

We commend the authorities for the progress achieved in strengthening Public Financial and Debt Management and enhancing Governance and Transparency. Authorities modernized the procurement system, eliminated bearer shares and criminalized tax bribery and fraud. They have also improved the quality and frequency of published fiscal statistics.

Monetary policy (MP)

The MP stance is appropriate and further decisions must remain data dependant. We commend the authorities for strengthening the monetary policy framework; increased credibility in the framework is reflected in a strong anchoring of inflation expectations. We welcome the recent introduction of forward guidance in the central bank's monthly press release which will enhance transparency and communication, and the planned enhancements to the exchange rate system to increase market transparency, lower price dispersion and reduce information asymmetry among market participants. The approval of the central bank's recapitalization is crucial to strengthen its financial position and remove the constraint to the pace of accumulation of reserve buffers, associated to the high sterilization costs.

Financial sector

The authorities' commitment to reforms in the financial sector since the 2003-04 crisis have bear fruits. They have improved bank and systemic risk oversight, upgraded regulation and strengthened the institutional framework, including putting in place a strong cybersecurity framework. The financial system is sound and robust, and the authorities continue their commitment to vigilance and they have integrated additional tools for further strengthening oversight over banks and the overall system to prevent buildup of risks. We also commend the authorities' progress in implementing a sound institutional framework for macroprudential policies. Although the authorities agree with the need to regulate and supervise financial cooperatives, their views differ from staff's on whether the supervision should rest with the current bank authorities or a new self-supervisory authority. Staff's comments on the alternatives discussed with the authorities and success experiences in other countries with either approach would be appreciated.

Structural reforms

The authorities' efforts to improve the investment climate over the past few years are reflected in the progress achieved in both the WB doing business and in the world competitiveness index. The National Competitiveness Council has promoted a structural agenda aimed at trade facilitation and easing regulatory requirements, including through the introduction of a one-stop window for exports and for construction permits. Progress has been also made in strengthening institutions and governance in some areas including revenue administration and AML/CFT. We encourage the authorities to continue these efforts.

Deeper structural reforms to tackle weaknesses in the electricity sector are warranted. The electricity sector faces multi-decade weaknesses caused by infrastructure gaps and inefficiencies in the state-run transmission and distribution sectors. Staff is of the view that the authorities could undertake needed reforms in this sector even in the absence of a broadly supported pact. Could staff expand on how in its view it could be accomplished?

With these remarks, we wish the authorities success in their future work.

The Acting Chair (Mr. Zhang) made the following statement:

The Dominican economy has enjoyed dynamic growth for the past several years. This is supported by stable macroeconomic and financial policies. Directors' gray statements have highlighted the importance of the improvement of the fiscal position and of establishing a framework with fiscal responsibility elements; tackling the remaining pockets of vulnerabilities in the financial sector, including supervision of the non-bank institutions; and addressing structural bottlenecks, particularly in the electricity sectors. These are well recognized in the staff report.

Ms. Zhao made the following statement:

We did not issue a gray statement, as we are in broad agreement with the staff appraisal. We thank the staff for the comprehensive report and Mr. Tombini and Mr. Fuentes for their informative buff statement.

The Dominican Republic’s economic growth has been strong since 2014, supported by stable macroeconomic and financial policies, as well as a favorable external environment. This provides an excellent opportunity for the authorities to step up the implementation of their structural reforms to lift barriers to long-term growth.

On fiscal consolidation, despite strong growth, consolidated public debt continues to grow as a share of GDP due to persistent structural deficits. We encourage the authorities to broaden the revenue base, improve tax administration, and close widespread tax loopholes and exemptions. We see the need for the authorities to strengthen the fiscal framework by adopting a medium-term debt target in order to enhance policy credibility and transparency.

On the exchange rate, we believe that the exchange rate’s flexibility should continue to serve as a key absorber of external shocks. The monetary policy stance remains appropriate and should continue to be data-dependent. With inflation expectations well anchored and a new electronic foreign exchange platform to be launched soon, we encourage the authorities to continue their gradual move toward a more flexible exchange rate regime.

On structural reforms, the timely implementation of the structural reform agenda plays a key role in addressing the barriers to higher productivity, income convergence, and social inclusion. In this context, the focus should be on enhancing the business environment, improving governance, reforming the electricity sector, and promoting innovation.

With these remarks, we wish the authorities every success.

Mr. Trabinski made the following statement:

We thank staff for an insightful report and Mr. Tombini and Mr. Fuentes for their informative buff statement. We issued a joint gray statement with Mr. Merk and Ms. Lucas. However, we would like to raise three points for emphasis and further clarification.

First, we commend the authorities for their commitment to macroeconomic stability and improved social outcomes. We note the positive progress in income convergence with the advanced economies' income levels. With robust growth per capita in the post-crisis period, the Dominican Republic has made significant progress in catching up with its regional peers, even surpassing the median of Latin America and the Caribbean income levels. Yet more reform efforts will be needed to address the sizable poverty and inequality rates, boost productivity, and tackle areas of longstanding constraints, such as the electricity infrastructure gap, education, the investment environment, and product and labor markets.

Second, we welcome and commend the authorities for the ambitious revenue administration reform and encourage them to remain committed to reform efforts. Specifically, the progress in broadening the tax base, reducing electricity subsidies, and targeting debt below 50 percent of the GDP level will be important to enhance fiscal policy credibility and sustainability. Nevertheless, we wonder why specific public financial management (PFM) reforms were not highlighted in the staff report. Is it because the authorities are not planning to improve PFM in the near future, or are there other reasons for this?

Third, we appreciate the detailed analysis of cybersecurity reforms, which are decisively pursued by the authorities. Nevertheless, we would like to know more about the reasons behind such a strong cybersecurity reform effort. Was the Dominican Republic hit by any recent cyber attack? Moreover, the report indicates existing infrastructure gaps, for example, in the energy sector. It would be interesting to know to what extent the cyber strategy addresses infrastructure deficiencies, rather than focusing solely on providing necessary software. The reason behind this question is that typically cybersecurity strategies work well with well-developed infrastructure, both in the telecommunications and energy sectors because they serve as a backbone for cybersecurity.

With this, we wish the authorities all the best.

The staff representative from the Western Hemisphere Department (Ms. Cebotari), in response to questions and comments from Executive Directors, made the following statement:[1]

I would like to start with an update on the developments since the staff report, and then I will answer some of the questions from the gray statements and the questions that were raised in the Board.

In the first four months of the year, economic indicators have so far been consistent with the staff's views in the staff report, in the sense that the economic momentum continues to remain strong but is easing toward its potential. As was noted in the authorities' buff statement, flash estimates for the first quarter indicate that growth has been 5.7 percent. This is broadly in line with the staff's projections and suggests that growth is on track to reach the projected 5.5 percent for 2019. So far, the slowdown was accounted for by the weaknesses in agriculture and related manufacturing as a result of the drought that continues.

Labor markets have also continued to improve. Labor force participation picked up even more from the end of last year to 65 percent, reflecting continued employment growth, while unemployment remained broadly stable at 5.8 percent.

Inflation also continues to remain muted. Headline inflation in April picked up barely to 1.6 percent, which is notably below the authorities' inflation target band. Core inflation has remained broadly stable at 2.1 percent.

External indicators have also been strong and in line with the staff's projections of a slight deterioration relative to last year. The remittances, tourism and FDI receipts have been very strong and have been only partly offset by high imports driven by consumption and oil.

In addition, some upside risks to the external position have firmed up recently, with the announcement of a large prospective FDI in the mining sector, which will mitigate some of the reduction in gold exports in the staff's baseline projections, as well as the related fiscal revenues.

---

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes

With that, I wanted to switch to the answers from gray statements. We wanted to thank Directors for their helpful comments and questions. We answered all of the questions in writing, except for the question on cybersecurity.

The question was on the cybersecurity reforms in the broader context of Fund members and what lessons we could learn from the experience of the Dominican Republic. As cybersecurity is becoming a more macro-critical risk in member countries, it becomes more necessary to engage with the authorities on these issues and to share institutionally the knowledge and the lessons and best practices from this experience.

In the staff's view, the example of the Dominican Republic highlights three lessons. The first one is the role of prioritizing cybersecurity as a policy commitment. The second one is the importance of engaging early on with the technical experts in the field, both on the technical level and on the policy level. The third one is the importance of rolling out the cybersecurity effort beyond the financial sector to protect all of the countries' digitally connected infrastructure, as well as privacy of the citizens.

These three lessons were in line with the recommendations that were made in staff work on Latin America and the Caribbean. But more broadly, the Fund's Work Program recognizes the importance of developing cyber resiliency, particularly for smaller countries that could be more vulnerable to attacks.

Technical assistance (TA) efforts have focused on enhancing cybersecurity supervision in the financial sector for the low- and medium- to low-income countries. A forthcoming Monetary and Capital Markets Department (MCM) paper will set out the best practice findings based on this TA.

Additional work is being done on improving the analytical and modeling approaches, which will help countries better manage cybersecurity risk. Finally, work is also being done by international standard setters to establish common policies and frameworks, but much more remains to be done.

On the question of why there is a focus on cybersecurity, the central bank wishes to become a center of excellence in the region in terms of their infrastructure for cybersecurity. They are establishing a physical center where all the infrastructure will be concentrated and all the cybersecurity efforts and cybersecurity attacks will be reported. Given the help that they have received, the assistance from other countries, they would be able to share this experience with other countries in the region.

Why not focus more on the infrastructure gaps? The infrastructure gaps are more in the realm of the Ministry of Finance. These are more a part of the fiscal policy discussions and cybersecurity is more in the realm of the central bank's policy focus, given the risk for the financial sector.

On the PFM reforms, these are very important. The authorities continuously reform their PFM. We did not cover it so much in the staff report because the annex that discusses institutional strengthening covers PFM reforms in depth, including the development of the Treasury Single Account, the procurement system, and aspects of the public financial development that have to do with institutional development strengthening.

Mr. Tombini made the following concluding statement:

On behalf of my Dominican authorities, I thank the Board for their valuable comments, and Ms. Cebotari and the rest of the team for their high-quality dialogue with the authorities. We also commend the staff for properly reflecting the authorities' views at the end of each section of the staff report.

As highlighted in the report, the recent Article IV consultation found the Dominican economy in a strong cyclical position, expanding at 7 percent in 2018 at a context of low inflation, a sustainable external position, and improving public finances. In 2019, the economy has started converging back to its estimated potential, growing at 5.7 percent in the first quarter, as credit to the private sector has gradually slowed down.

With the inflationary pressures muted, the central bank resumed its plan to reduce reserve requirements to provide additional liquidity to boost credit and support growth.

Amid this impressive macroeconomic performance, the Dominican authorities have successfully increased investments in education and implemented poverty reduction initiatives. In the medium term, the structural reform agenda will continue to focus on promoting more inclusive growth, strengthening governance, improving the business climate, and addressing legal issues in the electricity sector.

The fiscal deficit is expected to decline to 1.7 percent of GDP, backed by expenditure control and stronger revenue growth. In the near term, the authorities will continue to strengthen tax administration to further reduce evasion and fraud, while removing distortions in the tax structure. Yet the authorities are fully aware of the decreasing marginal benefit of revenue administration reforms, as rightfully indicated by many, including Mr. Benk and Mr. Mehmedi. Therefore, they expect to finalize negotiations for the fiscal pact after the 2020 elections to implement a comprehensive reform agenda to broaden the tax base, reduce exemptions, and phase out electricity subsidies.

Regarding debt dynamics, the Debt Sustainability Analysis (DSA) assessed the Dominican Republic's debt levels as moderate, with a sustainable medium-term outlook, and resilient to external shocks. Nonetheless, the authorities are conscious of the outstanding challenges and remain committed to a consolidation path that will lead to a reduction of the public debt-to-GDP ratio over the medium term. In addition, the Ministry of Finance is now operating under a medium-term fiscal framework to strengthen fiscal sustainability and risk monitoring. Concurrently, the authorities have begun discussions regarding a fiscal responsibility framework and its prospective design and future implementation.

Regarding the agreement to recapitalize the central bank, the Ministry of Finance and the central bank are diligently working to finalize negotiations in the coming months and submit the agreement to parliament later this year. This framework aims to contribute to lower issuance costs and systematically turn the central bank's quasi-fiscal balance into positive.

The central bank agrees with the staff that the exchange rate flexibility is a strategic mechanism for shock absorption and balance of payments adjustment. Consequently, with the support of the IMF Regional Technical Assistance Center for Central America, Panama, and the Dominican Republic (CAPTAC-DR) and experts from the Bank of Mexico, a new electronic platform will be introduced later this month to support the central bank's efforts to organize and deepen the foreign exchange market.

Furthermore, the authorities are planning to introduce an explicit intervention rule to accumulate reserves and to smoothen excessive volatility to reduce real exchange rate deviations from fundamentals.

The country has strengthened its external buffers, as the central bank has gone from a very weak position in the aftermath of the 2003 banking crisis to its highest level of international reserves in history in 2019.

While the current reserve levels meet all traditional adequacy indicators, the monetary authorities are committed to continue to build up reserves to meet the level recommended by the Assessing Reserve Adequacy metric, whose binary classification system might benefit from some fine-tuning to account for intermediate exchange rate regimes, as is the case of the Dominican Republic.

Regarding the electricity sector, the government has successfully expanded generation capacity, with two new power plants becoming operational in 2019, which are expected to drastically reduce the government's electricity transfers. That being said, the electricity sector remains a focal point in the structural reform agenda, with extensive implications for fiscal sustainability, potential growth, and economic development. Therefore, the authorities remain engaged in negotiations to reach consensus and implement the electricity pact to address the sector's deep-seated structural restrictions.

The Dominican Republic carried out a comprehensive reform of its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) legal framework, which is now broadly in line with international standards. While the Financial Action Task Force of Latin America (GAFILAT) found relatively strong technical compliance, the short time window between the enactment of the new AML/CFT legislation and the GAFILAT assessment limited the chance to fully evaluate the application of the new framework. In any case, the authorities are currently taking the necessary actions to address any outstanding weaknesses in the AML/CFT framework.

Due to its geographical location, the Dominican Republic is exposed to fiscal risks stemming from natural disasters. Against this background, the authorities have taken important steps to build resilience, including signing a contingent precautionary loan with the World Bank for catastrophic risk to improve the climate and disaster resilience in priority sectors, and to establish mandatory regulations for climate and disaster risk reduction in public investment and construction.

To conclude, the authorities agree with the staff that the currently favorable economic conditions provide a window of opportunity to tackle the structural bottlenecks to attain more inclusive growth, as they remain committed to addressing these challenges. In this process, the authorities continue to view the Fund as a trusted adviser and value their longstanding and productive relationship with the institution. Particularly President Danilo Medina and the rest of the Dominican authorities want to thank Ms. Cebotari for her candor and professionalism during her four years as mission chief and wish her the best in her future endeavors.

The Acting Chair (Mr. Zhang) noted that the Dominican Republic is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the strong economic performance, including dynamic growth, low inflation, stable external position, and improved social outcomes. Directors noted that while the outlook remains favorable, it is subject to risks. They encouraged the authorities to take advantage of the current favorable environment to further increase the economy's resilience to shocks by building fiscal and reserve buffers, while strengthening long-term growth and social outcomes through reforms to address structural bottlenecks.

Directors welcomed the authorities' commitment to improve the fiscal position, including through ambitious tax administration reforms to curb evasion, mobilize revenues, and improve governance. Nonetheless, given that public debt is trending up despite strong growth, Directors called for further efforts to improve debt sustainability. They underscored the need for a front-loaded fiscal adjustment aimed at widening the tax base and curtailing the electricity sector's drag on the budget, while safeguarding fiscal space for growth-enhancing public investment and social spending. Directors also supported adoption of a medium-term fiscal framework, with a clear policy anchor and fiscal responsibility elements, to ensure policy credibility and limit fiscal risks.

Given subdued inflation, Directors supported maintaining the current neutral monetary policy stance, while remaining data dependent should pressures emerge. They welcomed the continued efforts to strengthen the monetary policy framework, highlighting the dividend from anchoring inflation expectations, and supported plans to recapitalize the central bank and introduce the foreign exchange trading platform to increase transparency and efficiency of foreign exchange markets and policies. In light of the favorable external position, Directors encouraged the continued accumulation of international reserves.

Directors welcomed financial system stability and wide–ranging reforms to further enhance financial resilience. They supported the ongoing modernization of the institutional framework for systemic risk oversight, strengthening of banking regulation and supervision, and cybersecurity reforms. They encouraged the authorities to take further action, including to strengthen the supervisory oversight of non-bank financial institutions. Directors welcomed recent progress in updating the AML/CFT legal framework and encouraged the authorities to enhance the effectiveness of the regime.

Directors emphasized the importance of continued structural reforms to address impediments to higher productivity, income convergence, and social inclusion. Building on recent gains, they encouraged further measures to improve the business environment, remove trade and investment barriers, and continue reforms to education, health, and the pension system. Directors reiterated the need to decisively address the long–standing structural weaknesses that continue to weigh on potential growth, particularly losses in the electricity sector and inefficiencies in the product and labor markets. They also noted the need to broaden and strengthen the social security system, which will require additional fiscal space.

It is expected that the next Article IV consultation with the Dominican Republic will be held on the standard 12-month cycle.

APPROVAL: September 8, 2021

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Could staff comment on the quality and reliability of the growth statistics?***

- Growth statistics compiled by the central bank are overall timely and reliable. Some weaknesses remain, however, including lack of proper annual GDP data estimation since 2013 (annual data are instead estimated based on the aggregation of quarterly figures). STA and the regional technical assistance center CAPTAC continue to provide assistance to the authorities on further improving National Account statistics (e.g. annual GDP estimates for 2014-16 are expected to be published this year).

Fiscal Policy

2. ***Given that the economy will be affected by both revenue measures and expenditure cut, could staff comment on the potential impact of overall fiscal reforms on socio-economic outcomes? Could staff comment on the possibility of increasing revenue through direct taxes without heavily affecting some segments in the economy?***

- Staff looked in-depth at the distributional effects of fiscal adjustment measures during the last Article IV consultations (SIP on "Poverty, inequality and redistribution in the Dominican Republic"). The results suggested that a permanent increase of 2 percentage points in the revenue base would reduce output by close to 1 percent, although various fiscal instrument would have different growth-equity tradeoffs.

- In case of direct taxes, for example: (i) personal income taxes were assessed to be the most detrimental in terms of growth and inequality, in line with the literature, although in practice this effect is likely to be muted by the strong progressivity of this tax in the Dominican Republic (due to a high exemption threshold); and (ii) corporate income taxes were assessed to have the most benign social effects, but their impact on growth could be relatively strong.

- Given the broad scope of the needed reforms, any fiscal adjustment package would likely have to involve most direct and indirect taxes. Their detrimental growth and social effects will have to be offset with a combination of higher infrastructure investment (efficient in boosting growth) and targeted transfers (potent at reducing inequality). The fiscal space created by the accompanying reduction in the interest bill can be used to boost this spending.

3. ***Could staff elaborate further on the differences of opinion with the authorities regarding fiscal adjustment?***

- The authorities believe there is significant scope to mobilize revenues through ongoing revenue administration reforms and reduce expenditures with the coming on stream of the electricity generation plant Punta Catalina. Once the ability of these reforms to improve the fiscal accounts becomes clearer, the authorities believe they would be in a better position to determine the residual adjustment needed to put debt on a downward path. Firming up a medium-term debt target would also help the decision on the residual fiscal adjustment needs. Given the uncertainty associated with the ongoing reforms, staff took a more conservative approach in estimating their yield until more information becomes available.

4. ***Can staff clarify how it envisages a government strategy for passing the politically and socially difficult reforms in the tax and the electricity sectors?***

- Discussion and agreement on these reforms in the context of mandated "pacts" with the social partners could be a useful venue for such reforms. Broad agreement on the electricity pact has already been reached after several years of discussions, with only some abstentions (see questions 19-20). The launch of discussions on the fiscal pact, as mandated by the national development strategy, could help muster social and political support for the revenue reform, although it is more likely to be launched after the upcoming elections.

- The government could also pursue the needed reforms outside the process of the pacts, but in close discussions with the social partners. This will require enhanced social dialogue through an effective communication with stakeholders about the intended purpose of the collected resources, including their use for financing social spending, particularly education, health, reliable electricity supply and other critical infrastructure. Measures that improve the efficiency of spending of these resources, enhance governance and the transparency of the fiscal sector, and mitigate the impact of the reforms on the poor should also support this effort. A similar communication strategy has also been identified to be fundamental to effectively implement energy sector reforms.

5. ***We invite staff to comment if the planned fiscal adjustment for 2019 is still on track based on recent year to date data the authorities may have provided****?*

- Preliminary data for the first quarter suggest that the fiscal position has deteriorated relative to the same period of last year, broadly in line with staff expectations.

Revenues have underperformed relative to the budget so far, but the authorities have restrained spending to limit the impact on the overall deficit.

- It is too early, however, to draw firm conclusions from these outcomes, as there are many factors that could be affecting current and future performance, including one-off revenues, timing of collections, bunching of expenditures, and other.

6. *Could staff elaborate on the "cuentas por pagar" and their impact on the consolidated public finances?*

- The fiscal accounts are reported on an accrual basis, therefore all obligations that gave rise to accounts payable ("*cuentas por pagar*") have already been recorded as spending and reflected in the consolidated public sector deficits in previous years. As the repayment of this floating debt falls in subsequent years, it is recoded as a below-the-line negative financing item. While the existence of floating debt is not unique to the Dominican Republic, transparency could be enhanced by reporting the details of the accounts payable in the budget.

7. *We also welcome staff to elaborate on the authorities' concerns on adopting staff's fiscal responsibility framework in the near term as highlighted in the authorities' views?*

- The authorities consider a fiscal responsibility framework along the lines suggested by staff as desirable. However, they are concerned that given the forthcoming elections, it would be politically difficult to design and implement such a framework in the near term due to lack of consensus from all stakeholders. They have therefore opted to develop some elements of such a framework internally (e.g. a fiscal risk statement, a medium-term fiscal framework).

8. *Can staff comment on the report's limited coverage on building resilience to natural disasters?*

- During the current Article IV consultations, staff initiated discussions with the authorities on their disaster resilience strategy. The discussions were contained to ministry-specific resilience plans and staff saw merit in a more whole-of-government approach in developing such a comprehensive strategy. These discussions are set to continue during the next consultations, which will aim to cover more in-depth the government's resilience strategy and help the authorities incorporate the financial resilience costs and benefits in the debt sustainability analysis. Recently compiled data on the Dominican Republic's exposure to various disaster will also make such discussions during the next cycle more meaningful, especially in what regards tradeoffs involved in purchasing disaster insurance in order to determine the optimal level of insurance.

- By way of background, the authorities have chosen to build financial resilience through contingent credit lines from IFIs (CAT-DDO) and have an open contingent line from the central bank in case of a national emergency, but they have so far not participated in the regional insurance pool CCRIF. More recently, the authorities made progress on post-disaster resilience building, by putting in place a platform to plan and coordinate post-disaster response, with assistance from the World Bank.

9. ***Could staff comment if the effects of the disbursement of the CAT-DDO has been factored in the DSA scenario, along the lines of what has been done in the very recent Art. IV report for Bahamas?***

- The increase in debt as a result of the natural disaster subsumes any disbursements under CAT-DDO or other debt instruments. The growth mitigation effects of a faster disbursement under the CAT-DDO compared to other debt instruments has not been taken into account—in part because the contingent liability shock is not based on the effects of a specific disaster, as in the Bahamas report—but is expected to be small. During the next consultations staff expects to incorporate in more detail various financial resilience instruments into a stochastic debt sustainability analysis.

Monetary Policy

10. ***Could staff comment on the timeline for the implementation of the agreement to recapitalize the central bank, which is essential in reducing the burden of the quasi-fiscal losses on monetary policy?***

- The central bank and the ministry of finance are expected to finalize the agreement to recapitalize the central bank within the next few months, after which it will be submitted to Parliament, for likely approval during 2019. The implementation of the agreement is expected to begin in 2020.

- The current draft agreement envisages a return to positive quasi-fiscal balance by 2026 and to positive capital by 2034, following the full transfer of the central bank debt to the balance sheet of the central government. The agreement remains to be finalized soon, and staff will report on it during the next consultations.

11. ***We welcome staff's explanation on how recently agreed recapitalization schedule could be adhered to as planned but given the fact that the previous plan hasn't proceeded as successfully as we had hoped (footnote 13), how certain are staff that the new recapitalization plan would be implemented?***

- The recapitalization agreement still remains to be formalized. The agreement is expected to put in place mechanisms that would ensure compliance with the recapitalization schedule (e.g. penalties, approval through higher level legislation) and enhance coordination between the monetary and fiscal authorities. Once the recapitalization plan is finalized and made public, staff will be able to provide a more detailed assessment in the context of the next consultations.

12. ***Could staff elaborate on how to mitigate risks related to a move towards exchange rate flexibility, including the large share of public and banking sector foreign currency loans?***

- With the real exchange rate broadly in line with the fundamentals, a move towards more exchange rate flexibility is not expected to be accompanied by large adjustments in the exchange rate. The remaining risks could be managed, inter alia, by:

  - Gradually increase exchange rate flexibility to encourage a proper market assessment and internalization of risks, and a higher demand for exchange risk management instruments like foreign exchange derivatives;

  - Increasing focus on obtaining reliable financial information on the non-exporting borrowers in foreign currency, as available payment history does not guarantee that their cashflows can tolerate plausible scenarios of peso depreciation, followed by appropriate mitigating prudential measures.

  - In the public sector, continued focus on issuing debt in local currency. Recently, the authorities issued for the second time a peso bond in international markets (1.2 percent of GDP), which met a high demand (1.5 times oversubscribed) and helped the gradual move towards local currency financing to mitigate foreign exchange risks.

13. ***Does staff anticipate a change from the current crawl-like exchange rate arrangement to a flexible exchange rate and could staff clarify its recommendations on dollarization?***

- The authorities are moving towards a more flexible regime with reduced interventions, and if the exchange rate shows more volatility going forward, the staff will reassess the classification of the exchange rate regime. The imminent introduction of the foreign exchange trading platform to increase market transparency and encourage the use of foreign exchange derivatives will facilitate such a move.

- Dollarization in the Dominican Republic is moderate, at around 25-30 percent of assets and liabilities, and has remained stable over the past five years reflecting sound fundamentals, credible policies and strengthened institutions. With the banking system's dollar assets and liabilities broadly matched, risks are contained to the public sector debt and credit risk from non-dollar earners that borrow in foreign currencies. Options to deal with such risks are discussed in question 12 above.

14. ***Could staff elaborate on central bank's forward guidance? How does staff evaluate its effectiveness to improve the credibility of its conduct of monetary policy?***

- The Central Bank officially began forward guidance in its monthly monetary policy press releases in July 2018, including explicit indication of future policy actions through elaboration on the factors that will influence its decisions. This has helped to improve the transparency of its decision-making and the credibility of its policy actions, further anchoring inflation expectations around the inflation target.

- The evidence on the improvements in inflation target credibility as well as the gradual reduction in inflation uncertainty (annex VII) suggest that the policy has been effective in reaching this objective. Moreover, monetary policy uncertainty, as measured by the dispersion of forecasts of the policy rate, has steadily declined in recent years.

Financial Policies

15. ***Could staff comment on whether and what measures are being taken to address the shortcomings in the AML/CFT framework? Could staff comment on the need for major improvements to mitigate money laundering and terrorism financing risks identified in the GAFILAT's 2018 assessment?***

- GAFILAT's 2018 assessment was done a year after the AML/CFT legal framework has been revamped. This has been reflected in their finding of a relatively strong technical compliance and overall moderate effectiveness, the latter reflecting lack of time to implement the new framework.

- The authorities continue to take measures to address the areas where weaknesses were identified, including the supervision of cooperatives and insurance, understanding of risk inherent in designated non–financial businesses and professionals (DNFBP; such as car dealerships, real estate agencies, lawyers, accountants, etc), application of customer due diligence, and low number of suspicious transactions reporting by non-banks.

- In particular, the newly designated entity to supervise DNFBPs (the Internal Revenue Administration Authority) has begun the AML/CFT supervision of these activities, is developing the infrastructure for risk-based supervision, and has intensified the investigation of tax fraud. Supervisory agencies have also stepped up enforcement of customer due diligence requirements, particularly for nonbank financial institutions. They are also taking steps to enhance the understanding of money launderings risks in the most vulnerable sectors through additional analysis, greater training, and outreach to reporting institutions. Efforts are also ongoing to achieve membership of the Egmont Group to improve information sharing with foreign counterparts.

16. ***In staff's opinion, who and how should regulate and supervise the financial cooperatives? Could staff elaborate on the appropriate supervisory authority for the financial cooperatives? Could staff comment on the advantages/disadvantages of maintaining the regulation and supervision of financial cooperatives with the current bank authorities or creating a new self-supervisory authority? Could staff comments on the alternatives discussed with the authorities on the supervision of financial cooperatives and success experiences in other countries with either approach?***

- Staff is of the view that there are advantages to putting the supervision of large nonbank financial cooperatives on par with the banks by placing them under the supervision of the Bank Superintendency. This, however, would require choosing strict eligibility criteria to ensure that the payment system and banking supervision are not overwhelmed with the monitoring of a large number of new entities that could affect the financial oversight of the core banking system. The remaining cooperatives, which are more professional rather than financial in nature, could remain under the umbrella of the Institute for Development and Cooperative Credit (IDECOOP), an organism that would be transformed into a new Superintendency of Cooperatives. Such a tiered supervision model is used in several Latin American countries, whereby cooperatives passing the established eligibility criteria are regulated by the banking supervisor, while smaller institutions remain in the domain of other agencies.

- The second model being considered is keeping all non-bank cooperatives under the cooperative Institute/Superintendency. While such a model works well in some countries, in light of the self-regulatory and self-supervisory nature of the cooperative Institute/Superintendency in the Dominican Republic, this would risk diluting the quality of their regulation and supervision.

17. ***Could staff comment on the cybersecurity reforms in the broader context of enhancing Cybersecurity in Fund's member countries with similar backgrounds and the possible lessons from Dominican Republic's experience?***

- Staff will respond to this question during the Board meeting.

Structural Policies

18. ***Could staff comment on the current impediments to the social security system and whether the authorities are planning to implement any parametric adjustments? Could staff elaborate further on the reforms that would be needed to ensure roader access to the system and adequate retirement income when the system matures?***

- The main bottlenecks in the social security system are that (i) two of the system's pillars have not been fully operationalized due to high fiscal costs, restricting access to the system for the self-employed or employed in the informal sector; (ii) the replacement rate is expected to be low due to contributions and retirement age that are lower than many regional peers, and due to low compliance with contributions both on behalf of the employees and employers; and (iii) high fees collected by the pension funds.

- The recent measures implemented by the government (discussed in the staff report) addressed some of these issues, including to strengthen the management and control of the system, regularize arrears, and reduce pension fund fees in order to increase pension benefits.

- Further reforms may however be needed to ensure adequate benefits at retirement: broadening access to social security, ensuring strict compliance with the contributory requirements, likely parametric reforms to increase retirement age (currently at 60) and/or contribution rates (currently at 8 percent), and considering gradually removing the restrictions on investing abroad while maintaining macroeconomic stability.

19. ***Could staff comment on buff statement's indication that the lack of political consensus has delayed the completion of the pacts on electricity generation and public finances?***

- The electricity pact has not been signed into effect because the authorities sought to reach full agreement among the social partners in the support of the reforms. Some parties, however, withheld their support so far as they looked for more ambitious scope of reforms.

- Because of delays in the agreement on the electricity pact, the fiscal pact is now on hold as well, and appears unlikely to be launched before elections.

20. ***Could staff expand on how in its view the authorities could undertake needed reforms in the electricity sector even in the absence of a broadly supported pact***?

- The electricity pact would generate broad social consensus to ensure lasting solutions to the multi-decade weaknesses in the sector, since the reforms could be socially difficult to implement.

- In staff's view, necessary reforms can still be implemented under the current electricity sector legislation. These include implementing an appropriate cost recovery tariff, strengthening the institutional governance in the sector; ensuring a stable and effective regulatory framework for the sector, including transparency about the financial performance of electricity companies and regulatory decisions affecting the sector; rehabilitation of the distribution grid and introduction of meters to monitor and charge for electricity consumption, among other.