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EBS/83/157

CONFIDENTIAL

July 28, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Dominican Republic - Use of Fund Resources - Buffer Stock Financing Facility - Special Stocks Under the International Sugar Agreement

Attached for consideration by the Executive Directors is a paper on a request expected to be received from the Dominican Republic for a purchase equivalent to SDR 12.643 million under the decision on the buffer stock financing facility. A draft decision appears on page 9.

This subject, together with the staff report for the review of the extended arrangement for the Dominican Republic (EBS/83/155, 7/28/83), has been tentatively scheduled for discussion on Wednesday, August 24, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Chu, ext. 73753.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Use of Fund Resources--Buffer Stock Financing Facility--Special Stocks Under the International Sugar Agreement

Prepared by the Research Department and the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations, Legal, and Treasurer's Departments)

Approved by Wm. C. Hood and Eduardo Wiesner

July 27, 1983

The Managing Director has been informed that the Dominican authorities will shortly request a purchase of SDR 12.643 million, equivalent to 15.3 per cent of quota, in connection with the obligation of the Dominican Republic to constitute special stocks under the 1977 International Sugar Agreement (ISA). The expected request is to be made in accordance with the provisions of paragraph 1 of Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975, and of Decision No. 5597-(77/171), adopted December 16, 1977. The proposed purchase relates to the maximum level of sugar stocks that the Dominican Republic, as an exporting member of the ISA, is obligated to accumulate in the period ending December 31, 1983. The special stocks have been accumulated in two installments, the first in May 1982 and the second in March 1983. For the purpose of a Fund purchase, they have been valued in accordance with the provisions of Decision No. 5597-(77/171), adopted December 16, 1977.

The Dominican Republic currently has a purchase of SDR 10.547 million outstanding under the buffer stock financing facility relating to the special stocks accumulated in May 1982. 1/ The proposed purchase relates to the special stocks accumulated in March 1983. If approved, the outstanding purchases by the Dominican Republic under the Buffer Stock Financing Facility would be raised from 12.8 per cent to 28.1 per cent of quota and the Fund's holdings of the member's currency from 317.7 per cent to 333.0 per cent of quota. A waiver of the limitation in Article V, Section 3 (b)(iii) is required and is being proposed.

This paper, which is being circulated in advance of the formal request from the Dominican Republic, is presented in four sections and an annex. The sections deal with: (1) balance of payments position and cooperation

1/ EBS/82/114 (6/29/82).

with the Fund; (2) sugar exports and the performance of the Dominican Republic under the 1977 International Sugar Agreement; (3) the amount of purchase and repurchase requirements; and (4) staff appraisal and proposed decision. The member's relations with the Fund are summarized in the annex.

1. Balance of payments position and cooperation with the Fund

a. Balance of payments position

The Dominican Republic has experienced serious balance of payments difficulties in recent years. Its overall balance of payments deficit, which had averaged some SDR 90 million per year in the period 1978-81, rose to a record high of SDR 281 million in 1982, when international prices of most of its commodity exports fell precipitously, interest rates rose in international markets, and access to foreign financing became more difficult (*Table 1*). *However, in 1983 the overall balance of payments deficit is* projected to be drastically reduced--to some SDR 12 million--under an adjustment program supported by an extended arrangement with the Fund.

Recent projections indicate that the current account deficit in 1983 may not exceed SDR 160 million, compared with SDR 400 million in the previous year. Export proceeds are projected to increase by 7 per cent, mainly because of the access granted to Dominican exporters to the U.S. sugar market at the special support price, and more recently because of some strengthening of sugar prices in the free market. Special foreign exchange incentives have been granted to traditional exporters since late 1982, while such incentives have been received by nontraditional exporters since 1980. Import payments are expected to decline by some 11 per cent in 1983, reflecting the policy of progressively restricting the availability of foreign exchange at the official exchange rate to importers, which has substantially increased the cost of imports. Transactions in the official foreign exchange market take place at par with the U.S. dollar, while in the parallel market the U.S. dollar has been quoted at a premium exceeding 50 per cent since mid-1982, up from the 20-30 per cent premium that prevailed for several years. This depreciation of the peso explains the continued growth of net travel receipts, as tourism in the Dominican Republic became cheaper, while the traveling of Dominicans abroad was made more expensive. Also contributing to the sharp decline in the deficit on the services account were the decline of interest rates in international markets and the reduced expenses in insurance and freight in line with the fall in imports.

Net capital inflows in 1983 are projected to increase only marginally above the low level of the previous year. The increase is entirely attributable to disbursements by international organizations and bilateral lenders, as a renegotiation of foreign debt with commercial banks is expected to result in a reduction of their exposure in the Dominican Republic. At the same time that the overall balance of payments deficit is projected to be sharply reduced in 1983, the gross international reserves of the Central Bank are expected to rise from the unusually low level of SDR 156 million (equivalent to six weeks of imports) at the end of 1982 to the more normal level of SDR 206 million (equivalent to ten weeks of imports) at the end of 1983. However, in spite of this increase, the liquidity

Table 1. Dominican Republic: Balance of Payments, 1980-83

	1980	1981	1982	Proj. 1983
	(In millions of SDRs)			
A. Current account	-514.6	-344.2	-400.3	-154.1
Merchandise	-428.6	-223.6	-443.5	-264.2
Exports, f.o.b.	(739.1)	(1,007.5)	(695.4)	(745.0)
Imports, c.i.f.	(-1,167.6)	(-1,231.1)	(-1,138.8)	(-1,009.2)
Services (net)	-230.3	-284.3	-142.5	-87.2
Of which: Travel (net)	(5.2)	(66.6)	(162.2)	(190.0)
Transfers (net)	144.3	163.7	185.7	197.3
B. Capital account (net)	400.3	222.6	132.5	146.5
Public sector 1/	280.8	147.6	179.0	191.4
Private sector 2/	119.5	75.0	-46.5	-44.9
C. Allocation of SDRs	5.7	5.6	--	--
D. Unrequited earnings 3/	18.1	-12.0	-13.5	-4.3
E. Overall balance	-90.5	-128.0	-281.3	-11.9
F. Financing	90.5	128.0	281.3	11.9
Net use of IMF credit	-56.0	-21.5	36.8	171.1 4/
Other 5/	146.5	149.5	244.5	-159.2
Memorandum items:				
Current account (as per cent of GDP)	-11.9	-5.4	-5.5	-1.9
Overall balance (as per cent of GDP)	-2.1	-2.0	-3.9	-0.1
Gross international reserves, end of year				
In millions of SDRs	215.8	243.5	156.3	206.3
In months of imports	2.2	2.4	1.6	2.5

Sources: Central Bank of the Dominican Republic; and Fund staff estimates.

1/ Includes short-term capital.
2/ Includes errors and omissions.
3/ Includes gold monetization and gold revaluation.
4/ Includes buffer stock purchase of SDR 12.6 million.
5/ Includes other central bank foreign assets and liabilities, and net foreign assets of the commercial banks.

position of the Central Bank will remain tight because a large proportion of reserves in 1983 must be kept in special deposit accounts with foreign commercial banks to guarantee the availability of foreign exchange for the payment of letters of credit, while no such requirement was in effect during 1982.

b. Cooperation with the Fund

The request for a buffer stock financing purchase may be met only if the Fund is satisfied that the member will cooperate with the Fund in finding, where required, appropriate solutions to its balance of payments difficulties. The Dominican Republic is making efforts to solve its balance of payments difficulties in accordance with a program supported by an extended arrangement with the Fund. At the end of March, the first testing date under the arrangement, the Dominican Republic was in compliance with all performance criteria. Also, available data indicate compliance with all quantified performance criteria at the end of June. Discussions for the review of the progress made in the implementation of the program, which is an additional performance criterion, were conducted in May-June, and the relevant document is being submitted for Board approval together with this paper. 1/ The Dominican Republic does not maintain any unapproved exchange restrictions or multiple currency practices. The proposed request is expected to include a statement that the Dominican Republic will cooperate with the Fund in finding, where required, appropriate solutions to its balance of payments difficulties.

2. Sugar exports and the performance of the Dominican Republic under the 1977 International Sugar Agreement

After stagnating at about 6 U.S. cents per pound for a period of three quarters through March 1983, free market prices of sugar rose to an average of 9 cents per pound in May and about 11 cents per pound in June (Table 2). The price rise is mainly attributable to the projected decline in world sugar production in 1983/84 as a result of unfavorable weather conditions in major sugar producing areas, including drought in Australia and South Africa and heavy rains in Cuba and the European Community (EC). However, in 1982/83 world stocks reached the highest level in over 25 years; while the production shortfalls are expected to halt the rise in stocks or reduce them somewhat, the high level of stocks is expected to limit further upward movement in the free market price.

In order to secure a long-term solution to the current world crisis in sugar, a conference to negotiate a new and more effective International Sugar Agreement was convened in May 1983 in Geneva under the auspices of the UNCTAD; the EC, which is now the leading supplier of sugar to the free market but not a member of the ISO, participated in the conference. A new agreement has thus far not been concluded, and a second session of the Conference is to be convened in September 1983.

1/ A more detailed discussion of the member's performance under the arrangement is contained in EBS/83/155 (7/28/83).

Table 2. Sugar Prices on the Free Market

	In U.S. Cents Per Pound		In SDRs Per Metric Ton	
	U.S. Cents	Percentage Change 1/	SDRs	Percentage Change 1/
1976	11.56	-43.8	220.68	-40.9
1977	8.11	-29.8	153.22	-30.6
1978	7.82	-3.6	137.79	-10.1
1979	9.66	23.5	164.91	19.7
1980	28.67	196.8	485.68	194.5
1981	16.89	-41.1	315.70	-35.0
1982	8.41	-50.2	167.95	-46.8
1982 I	12.41	0.6	240.75	3.0
II	8.18	-34.1	161.43	-32.9
III	6.78	-17.1	137.65	-14.7
IV	6.25	-7.8	127.89	-7.1
1983 Jan.	6.03	-4.4	120.85	-5.0
Feb.	6.43	6.6	130.05	7.6
March	6.20	-3.6	125.93	-3.2
April	6.71	8.2	136.70	8.6
May	9.24	37.7	188.17	37.7
June	10.70	15.8	220.70	17.3

1/ From previous period.

The Dominican Republic is one of the ten largest exporters of sugar in the world, and the sugar industry is an important source of foreign exchange earnings and revenue for the public sector. Dominican sugar exports are sold on the free market under the terms of the ISA. In the period 1979-81 over three fourths of Dominican sugar exports (about 684 thousand tons annually, on average) were channeled to the United States and the rest to other free market outlets, particularly Venezuela. Dominican exports to the U.S. market declined sharply in 1982 to about 361 thousand tons, as a result of the introduction in May 1982 of quotas on imports of sugar into the United States. The country was granted a quota of about 447 thousand tons for the U.S. market for fiscal year 1983 (October-September).

Under the ISA, the Dominican Republic was assigned a basic export tonnage of 1,159 thousand tons and an export quota, or minimum export entitlement, of 985 thousand tons for 1982. Although production rose by 16 per cent to about 1.3 million tons in 1982, the country was not able to use its export quota in full. While new outlets were found for sugar formerly exported to the U.S market, with significant volumes exported to the USSR, Cuba, and Portugal, exports to other traditional markets, particularly Venezuela, declined. As a result, exports amounted to only 847 thousand tons and were 2 per cent lower than in the previous year. The country's quota for 1983 again has been set at 985 thousand tons and is expected to be used in full. The Dominican Republic accumulated special stocks of 100,399 tons in March 1983, thus fulfilling its maximum stocking obligation, as evidenced by a certificate of existence supplied by the authorities to the International Sugar Organization; the verification of the special stocks by an on-site inspection is scheduled for October 1983.

3. <u>The amount of purchase and repurchase requirements</u>

a. <u>Amount of purchase</u>

Under the terms of the ISA, the Dominican Republic is obligated to constitute an amount equivalent to 167,332 tons in special stocks of sugar during the period ending December 1983. The minimum quantity to be constituted during the first year (12 months ending June 1982), equivalent to 66,933 tons, was accumulated in May 1982 and the balance of 100,399 tons in March 1983. The Dominican Republic purchased SDR 10.547 million under the Buffer Stock Financing Facility relating to the special stocks accumulated in May 1982. The proposed purchase relates to the special stocks which were accumulated in March 1983.

Valuation of the special stocks for the purpose of determining the amount of the purchase has been made in accordance with paragraphs 3 and 4 of Executive Board Decision No. 5597-(77/171), adopted December 16, 1977, and the procedures set out in SM/78/229. Since the market price of sugar was below the floor price of the Agreement (13 cents per pound) during March, when the stocks were constituted, the stocks have been valued at the average market price for March converted to SDRs at the average daily exchange rates for the month. Valued in this way, the stocks amount to SDR 12.643 million, which is the amount of the expected request (Table 3).

The authorities of the Dominican Republic have stated that there are no outstanding loans in foreign exchange for which the special stocks held under the terms of the Agreement have been used as collateral. They have also stated that they will promptly inform the Fund of any such loans that may be obtained in future while any part of the proposed purchase remains outstanding.

Table 3. Valuation of Special Stocks of Sugar

Month of Stock Accumulation	Amount of Stocks Constituted (Metric Tons)	Price in U.S. Cents/Lb.	SDR/Dollar Rate	Price in SDR/Metric Ton	Value of Stocks (SDR Millions)
March 1983	100,399	6.20	0.92128	125.926	12.643

b. Repurchase requirements

The Dominican Republic will be required to repurchase the proposed purchase in equal quarterly installments during the period beginning three years and ending five years after the date of purchase. 1/ The Dominican Republic will also be expected to make repurchases at an earlier date in accordance with the relevant provisions of the Fund Articles and decisions relating to repurchase in the light of an improvement in a member's balance of payments and reserve position. 2/ Moreover, as required under the Fund decision regarding the financing of special stocks of sugar, 3/ the member will be expected to make repurchases at an earlier date: (i) when and to the extent that stocks are released from the control of the International Sugar Organization, and (ii) when the member obtains a loan in foreign exchange for which the special stock is used as collateral, to the extent that the amount of this loan, together with the amount of purchases outstanding, exceeds the amount that the member may purchase in accordance with paragraphs 4 and 5 of Decision No. 5597-(77/171).

In accordance with the procedures outlined in section 5 of SM/78/229, the Dominican Republic would be expected to repurchase from the Fund in the first event, within 90 days from the date on which stocks are released from the control of the International Sugar Organization, and in the second event, within a few days after the Fund has been informed of the loan for which the special stocks have been used as collateral.

1/ Article V, Section 7(c) and Decision No. 5703-(78/39), as amended by Decision No. 6862-(81/81).

2/ Article V, Section 7(b) and Decision No. 6172-(82/101).

3/ Paragraph 6 of Decision No. 5597-(77/171) and the procedures set out in SM/78/229.

4. Staff appraisal and proposed decision

The Dominican Republic is expected to request a purchase of SDR 12.643 million, equivalent to 15.3 per cent of its quota in the Fund, under the buffer stock financing facility in connection with special stocks of sugar constituted under the terms of the 1977 International Sugar Agreement.

The Dominican Republic's balance of payments position has deteriorated in recent years. The overall balance of payments deficit, after averaging about SDR 90 million annually in the period 1978-81, increased to SDR 280 million in 1982. However, in 1983, with the implementation of a financial and economic program supported by an extended arrangement from the Fund, the overall deficit is projected to decline to SDR 12 million, mainly reflecting a reduction in the current account deficit from SDR 442 million in 1982 to SDR 168 million. Gross international reserves, which declined from the equivalent of 2.4 months of imports in 1981 to 1.6 months of imports in 1982, are projected to rise to 2.5 months of imports by the end of 1983. Despite this increase, the Central Bank's liquidity position will remain tight, as a large share of reserves must be kept in special deposit accounts with foreign commercial banks to guarantee the availability of foreign exchange to pay letters of credit. The request for a buffer stock purchase is expected to include a statement that the Dominican Republic will cooperate with the Fund in finding, where required, appropriate solutions to its balance of payments difficulties.

The Dominican Republic has constituted its maximum stocking obligation amounting to 167,332 tons of sugar for the period ending December 1983 under the terms of the 1977 International Sugar Agreement. Stocks were accumulated in two installments, 66,933 tons in May 1982, in fulfillment of its obligation for the year ended June 1982, and the remainder of 100,399 tons in March 1983. The proposed purchase in respect of the special stocks of sugar accumulated in March 1983, calculated in accordance with Executive Board Decision No. 5597-(77/171) and the procedures set out in SM/78/229, amounts to SDR 12.643 million.

There are no outstanding loans in foreign exchange for which the special stocks have been used as collateral, and the Dominican authorities have indicated that they will inform the Fund of any such loans that may be obtained while the proposed purchase remains outstanding. The forthcoming request will include appropriate representations by the Dominican Republic that it will make early repurchases of outstanding amounts of the proposed purchase in accordance with paragraph 6 of Executive Board Decision No. 5597-(77/171) as outlined in Section 2 of this paper.

The staff considers that the expected request for a purchase of the equivalent of SDR 12.643 million will meet all the requirements of Executive Board Decision No. 2772-(69/74) on the Problem of Stabilization of Prices of Primary Products, and Executive Board Decision No. 5597-(77/171) on Buffer Stock Financing Facility: 1977 International Sugar Agreement. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request for the purchase has been received:

1. The Fund has received a request by the Government of the Dominican Republic for a purchase of the equivalent of SDR 12.643 million under the decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products (Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975), and the decision on Buffer Stock Financing Facility: 1977 International Sugar Agreement (Decision No. 5597-(77/171), adopted December 16, 1977).

2. The Fund determines that this purchase would be in conformity with the Decisions, notes the representations of the Dominican Republic, waives the limitation in Article V, Section 3(b)(iii), and approves the purchase in accordance with the request.

Fund Relations with the Dominican Republic
(As of June 30, 1983)

Date of membership: December 28, 1945

Status: Article VIII.

Quota: SDR 82.5 million

Fund holdings of Dominican pesos:

	Millions of SDRs	Per Cent of Quota
Total	262.06	317.65
Tranche policies	13.76	16.68
Compensatory financing facility	81.00	98.18
Buffer stock financing facility	10.54	12.78
Enlarged access	37.12	45.00
Extended Fund facility	37.12	45.00

SDR Department:

	Millions of SDRs	Per Cent of Allocation
Net cumulative allocation	31.59	100.00
Holdings	0.08	0.25

Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980): US$6.82 million

Gold distribution (four distributions): 36,800.979 fine ounces

Exchange system: The Dominican peso has been linked to the U.S. dollar, the intervention currency, at RD $1 per U.S. dollar since the initial par value of the Dominican peso was established in February 1948. A parallel exchange market also exists and the rate in this market recently has fluctuated at around RD $1.55 per U.S. dollar. The Fund's holdings of Dominican pesos are valued on the basis of a representative exchange rate under Rule O-2, paragraph (b)(i).

Exchange practice under Article VIII:	None.
Last Article IV consultation:	The 1982 Article IV consultation discussions were held in September-October 1982 (EBS/82/239) and the consultation was concluded at EBM/83/15 (1/21/83).