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SM/84/161
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

August 6, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Dominican Republic - Staff Report for the 1984 Article IV Consultation

The following corrections have been made in SM/84/161 (7/5/84):

Page 18, para. 1, lines 13-15: for "peaking at almost 45 percent... and 1988.2/"
read "peaking at 41 percent...in 1988.2/"

Page 19, column 2, line 1: for "336" read "366"

line 13: for "711" read "633"

line 14: for "420" read "408"

line 16: for "44.8" read "39.9"

footnote 2, line 7: for "US$298 million" read "US$258 million

line 8: for "20.9 percent" read "18.1 percent"

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

and services were granted an exchange incentive of RD$0.48 per U.S. dollar. Also, the exchange rate guarantee for private foreign borrowing was abolished. This was followed on May 10 by the transfer of certain outstanding central bank obligations for letters of credit and accumulated requests for dividend remittances for which no peso deposits had been lodged. As a result of the April transfers, prices (including controlled prices) of many basic foodstuffs and other basic products were increased sharply, giving rise to strong popular protest and civil disturbances in the capital and other parts of the country. The situation was aggravated by the development of temporary scarcities in those cases where the controlled prices were not, or not fully, adjusted.

In view of these developments, by late May the Dominican Republic authorities had concluded, reluctantly, that it would not be prudent politically to proceed with the adjustment of the exchange rate for petroleum imports as scheduled. They explained that they had failed to secure support for this measure from any of the major constituencies in the country, and that now such action probably could not be taken before the beginning of 1985.

They recognized that their decision meant that the extended arrangement could not be continued and asked that the feasibility of a stand-by arrangement in its stead be explored. The staff explained that the failure to adjust the oil import exchange rate carried with it a sizable additional cost, which would have to be covered in some fashion if a viable stand-by program were to be worked out.

As regards the exchange system, apart from the dual exchange market, the Dominican Republic maintains three other multiple currency practices, resulting from (1) the exchange incentive of RD$0.48 per U.S. dollar for exports subject to surrender at the Central Bank; (2) the partial exemption from the surrender requirement for certain nontraditional exports; and (3) the levying of a tax on remittances of profits from foreign investments, including a surtax on the amount of this tax. In addition, as of May 18, 1984 the Dominican Republic still had outstanding some US$109 million of external payments arrears for which peso deposits have been lodged with the Central Bank. Also, an amount of dividend remittances totaling around US$80 million had accumulated for which the Central Bank has failed to make foreign exchange available at the official rate, but for which no peso deposits are maintained under a special ruling of the Monetary Board. These aspects of the Dominican Republic's exchange system are subject to Article VIII jurisdiction and are described in detail in the Exchange and Trade System section of the Recent Economic Developments paper. Fund approval of these restrictions and multiple currency practices was granted on January 21, 1983 and lapsed at the end of the first program year.

Under the refinancing arrangement with commercial banks, delays in the delivery of foreign exchange by the Central Bank under letters of credit were eliminated as of December 21, 1983, but close to US$20 million of such delays had re-emerged as of May 18, 1984.

b. External debt

With the refinancing of short-term debt with the banks,1/ the Dominican Republic's medium- and long-term external public debt stood at US$2.2 billion at the end of 1983, some US$445 million or 25 percent above the 1982 level. The refinancing reduced sharply the debt service burden in 1983, and further relief was obtained from the ongoing renegotiation of the CEA export loan and the standstill of payments since the approach to the Paris Club (see Section II.2 above). The actual debt service ratio (on total public debt) is estimated to have been 21 percent in 1983, whereas in the absence of the refinancing and other debt relief it would have been 36 percent (Table 8). The medium-term projections for the servicing of the Dominican Republic's external public debt (including projected disbursements in 1984-88) show the debt service ratio peaking at 41 percent in 1985 and then declining to less than 35 percent in 1988.2/ The debt service due in 1984 includes US$74 million of amortization payments to banks, which the Dominican Republic authorities are requesting to have rescheduled, and US$111 million of amortization and interest payments to Paris Club creditors.

2. Fiscal and monetary policies

a. Fiscal policy

The financing requirement of the consolidated public sector in 1983 was, at just below RD$490 million, about the same as in 1982, which represented a decline in relation to GDP from 6.2 percent to 5.6 percent, compared with the program projection of 3.9 percent (see Table 3). External financing was only slightly larger than in 1982, and far below the level anticipated in the program. Domestic financing was slightly smaller in 1983 than in 1982, but at almost RD$375 million (4 1/4 percent of GDP) it was far above the program target of RD$200 million (2 1/4 percent of GDP).

The deficit of the Central Government declined from 2.8 percent of GDP in 1982 to 2.5 percent in 1983, compared with a programmed decline to 2.2 percent. The strong growth of revenues that had started in the last months of 1982, apparently due in part to improvements in tax administration, continued through 1983 with total revenues for the year

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1/ The refinancing is for a period of five years (including one year grace), with amortization to be made in 17 quarterly installments starting January 1985; interest is to be paid quarterly at either 2 1/4 percent over three-month LIBOR or 2 1/8 percent over the U.S. prime rate (at the option of the participating banks). A downpayment of 5 percent was required.

2/ These projections are highly tentative, given the uncertain outlook for the Dominican Republic's external payments situation as no agreement on a program with the Fund has yet been reached and certain key policy decisions remain to be made.

Table 8. Dominican Republic: Projected Debt Service on Public and Publicly Guaranteed Debt, 1983-88

	Est. 1983	Projected 1984	1985	1986	1987	1988
	(In millions of U.S. dollars)					
Debt service on:						
Medium- and long-term debt	303	366	487	500	519	535
Amortization	161	193	295	294	300	300
Interest	142	173	192	206	219	235
IMF	15	28	28	64	73	45
Repurchases	8	10	11	48	61	37
Charges	7	18	17	16	12	8
Other reserve liabilities	85	162	80	90	100	110
Amortization	55	140 1/	50	60	70	80
Interest	30	22	30	30	30	30
Short-term debt	102	77	73	41	36	36
Amortization	81 3/	65	65	35	30	30
Interest	21	12	8	6	6	6
Total	505 2/	633	668	695	728	726
Amortization	305 3/	408	421	437	461	447
Interest	200	225	247	258	267	279
	(In percent)					
Debt service ratio on:						
Total debt	35.5 2/	39.9	41.1	39.9	38.9	34.7
Of which: medium- and long-term debt	19.0	23.1	30.0	28.7	27.8	25.5
Debt to IMF	1.5	1.8	1.7	3.7	3.9	2.1
Memorandum item:						
Exports of goods, nonfactor services, and private transfers (millions of U.S. dollars)	1,426	1,586	1,626	1,740	1,870	2,094

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

1/ Excludes the elimination of arrears reported by the Central Bank at the end of 1983, an amount equal to US$78.2 million.

2/ Includes all amortization and interest paid in 1983 plus US$247 million in interest and amortization either rescheduled in 1983 or unpaid in connection with proposed reschedulings. This sum is composed of US$104 million of amortization rescheduled with commercial banks and two amounts relating to proposed reschedulings: US$82 million in interest and amortization due to official creditors and US$61 million due to a consortium of banks by the State Sugar Company. Excluding these amounts, actual debt service totals US$258 million equivalent to 18.1 percent of exports.

3/ For short-term debt, only net amortization is included.

as a whole reaching 10.6 percent of GDP, compared with 9.6 percent in 1982; a number of new taxes and revenue measures were introduced in late 1982-early 1983, including in particular a temporary (one year) surcharge of 10 percent on imports. Total expenditures which had been programmed to decline from 12.4 percent of GDP in 1982 to 11.1 percent in 1983, jumped to 13.1 percent of GDP. Current outlays rose by 12 percent, with increases ranging from 5.7 percent for wages and salaries to 20 percent or more in other categories (including purchases of goods and services and transfers to both the public and private sectors). Capital outlays were up by almost 40 percent, as both investment spending and transfers to the rest of the public sector were stepped up sharply.

An ambitious housing construction program undertaken by the National Housing Institute (INVI) led to a sharp widening of the deficit of the decentralized government agencies, to more than RD$60 million in 1983 from RD$7 million in 1982. This program was financed partly by transfers from the Central Government and mostly through the issuance of special bonds redeemable for paying income taxes in future years.1/ Mainly as a result of this development, the combined deficit of the rest of the public sector increased slightly from 2.8 percent of GDP percent in 1982 to 2.9 percent in 1983; the program had called for a decline to 1.5 percent of GDP. Among the major enterprises, the CEA reduced its deficit by about RD$20 million, due mainly to the 20 percent exchange incentive it received, and INESPRE also cut its deficit by a small amount. The deficit of the CDE remained unchanged, as investment spending was cut back sharply while the current account deficit widened.

In reviewing the fiscal outcome under the 1983 program, the Dominican Republic authorities said that starting before the middle of the year Government spending had been stepped up in an effort to support economic activity and employment. However, they noted that the performance of revenues had been much stronger than projected and that new revenue measures had been introduced, such as the increase in the cigarette tax in June 1983. The mission pointed out that the general tenor of fiscal policy had not been conducive to a successful execution of the program. Early in the year, gasoline prices were reduced, at a fiscal loss of some RD$27 million (1983 annual rate). The housing construction program had ended up putting claims on 1984 revenues to the tune of at least RD$40 million. The general sales tax went into effect in late November 1983, five months later than originally scheduled, and a broad list of exemptions had been included in the law; in addition, its application was limited to industrial sales by a last-minute administrative decree, so that its yield in 1984 would be about RD$80 million, much less than estimated originally and most of it collected on imports. The staff recalled that the general sales tax had been intended as a cornerstone of the effort to bring about a structural reform of the tax

1/ For more details on this program, see the Review paper (EBS/83/155, 7/27/83, pp. 16-17) and Section III.3 of the Recent Economic Developments paper.