FOR AGENDA

EBS/82/239

CONFIDENTIAL

December 29, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Dominican Republic - Staff Report for the 1982 Article IV Consultation and Request for Extended Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with the Dominican Republic and request for an extended arrangement by that country. Draft decisions appear on pages 23 and 24.

It is proposed that this subject, together with the Dominican Republic's request for a purchase under the compensatory financing facility (EBS/82/238, 12/28/82), be brought to the agenda for discussion on Friday, January 21, 1983.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Staff Report for the 1982 Article IV Consultation and Request for Extended Arrangement

Prepared by the Western Hemisphere Department

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

Approved by E. Walter Robichek and Manuel Guitian

December 28, 1982

The Article IV consultation discussions with the Dominican Republic were held in Santo Domingo from September 28 to October 22, 1982.1/ At the same time, a program was negotiated in support of which the Dominican Republic is requesting an extended arrangement from the Fund (see the attached letter which will be dispatched on January 18, 1983). The Dominican Republic representatives included the Secretary of the Presidency; the Governor of the Central Bank; the Technical Secretary of the Presidency; the Secretaries of State for Finance, Industry and Commerce, Agriculture, and Labor; the Comptroller General; the Economic Adviser of the President; as well as other senior officials from the Central Bank, the ministries, and various government agencies and enterprises. The mission met with the members of the Monetary Board and was received by the President of the Republic. The staff representatives were Messrs. Gonzalez (Head), Baumgarten, Decarli (all WHD), Perez (ETR), van Beek (WHD), and Mrs. Orpin (Secretary-WHD); Mr. Gorrio of the World Bank was attached to the mission. Mr. Jose Gabriel-Pena, then Alternate Executive Director for the Dominican Republic, participated in the final round of discussions. A World Bank mission visited Santo Domingo in the period September 27 to October 8, 1982.

The extended arrangement requested by the authorities covers a period of three years and is in an amount of SDR 371.25 million. This amount, which is equivalent to 450 per cent of the Dominican Republic's quota of SDR 82.5 million, would consist of SDR 115.5 million of ordinary resources and SDR 255.75 million of borrowed resources. The Dominican Republic authorities are also requesting a purchase under the CFF in an amount of SDR 42.75 million equivalent to 51.8 per cent of quota, a purchase which would raise the Fund's holdings of Dominican pesos under this facility to 100 per cent of quota. Waivers of the limitation in Article V, Section 3(b)(iii), of the Articles of Agreement are required.

1/ The Dominican Republic has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Articles of Agreement.

The program in support of which the extended arrangement is being requested is described in the memorandum annexed to the attached letter and is analyzed below. Under this extended arrangement, up to SDR 123.75 million would be available to the Dominican Republic in the period through December 31, 1983 and up to SDR 247.5 million in the period through December 31, 1984. Phasing during the period through December 31, 1983 would be as follows: purchases shall not exceed SDR 45 million until April 25, 1983, SDR 74.25 million until July 25, 1983, and SDR 94.50 million until October 25, 1983.

As of October 31, 1982 the Fund's holdings of Dominican pesos amounted to 178 per cent of the Dominican Republic's quota (117 per cent if purchases under the buffer stock and compensatory financing facilities are excluded). On the assumption that repurchases are made on schedule, full use of the requested EFF arrangement, together with the requested purchase under the CFF, would raise the Fund's holdings of pesos to 646 per cent of quota by the end of the arrangement (550 per cent if purchases under the buffer stock and compensatory financing facilities are excluded)(Table 1). Thus, the arrangement would be within the limits established by the Executive Board in 1980. Further information on the Dominican Republic's relations with the Fund is presented in Appendix I.

I. Background

In recent years the Dominican Republic has experienced growing balance of payments deficits, an accumulation of external payments arrears, a marked weakening of the public sector finances, and a slowdown in the pace of economic activity. The prevalence of adverse external conditions has been one factor behind these developments, as markets for many export commodities have been depressed during much of the period since 1976 and as the Dominican Republic has had to rely on imports of petroleum to satisfy most of its energy requirements. Expansionary fiscal policies have been another major factor contributing to the deterioration in the balance of payments.

The rate of growth of real GDP slowed from 5-1/4 per cent a year in 1979-80 to 3-1/2 per cent in 1981 and an estimated 1-1/2 per cent in 1982 (Table 2). The slowdown in 1981 was centered in the services sector, but it was also quite pronounced in construction, manufacturing, and commerce. Indications for 1982 are for a weakening of growth in in the mining and construction sectors. Following a very rapid run-up in the aftermath of the September 1979 hurricane, the rate of inflation slowed down, and since about the middle of 1980 consumer prices have risen at an annual rate of 7 to 8 per cent.

Table 1. Dominican Republic: Projection of the IMF Position
(December 31, 1982-December 31, 1985)

	Outstanding 1982 Dec. 31	Operations in First Year of Arrangement 1983 Jan.-Apr.	May-July	July-Oct.	Nov.-Dec.	Outstanding 1983 Dec. 31	Operations in Second Year 1984 Jan.-Dec.	Third Year 1985 Jan.-Dec.	Outstanding 1985 Dec. 31
				(In millions of SDRs)					
Purchases	64.1	87.7	29.3	20.2	29.3	222.6	123.8	123.7	450.3
Under tranche policies	13.8	45.0	29.3	20.2	29.3	132.6	123.8	123.7	371.4
Ordinary	(13.8)	(22.5)	(14.7)	(10.1)	(14.6)	(70.7)	(53.6)	(--)	(115.6)
Enlarged access	(--)	(22.5)	(14.6)	(10.1)	(14.7)	(61.9)	(70.2)	(123.7)	(255.8)
Compensatory financing	39.8	42.7	--	--	--	79.5	--	--	69.7
Buffer stock	10.5	--	--	--	--	10.5	--	--	9.2
Repurchases		1.5	0.7	2.9	2.9		9.5	10.3	
Under tranche policies		--	--	2.1	2.9		8.7	--	
Ordinary		(--)	(--)	(2.1)	(2.9)		(8.7)	(--)	
Enlarged access		(--)	(--)	(--)	(--)		(--)	(--)	
Compensatory financing		1.5	0.7	0.8	--		0.8	9.0	
Buffer stock		--	--	--	--		--	1.3	
Net purchases		86.2	28.6	17.3	26.4		114.3	113.4	
Memorandum items									
Total holdings (end of period)	146.6	232.8	261.4	278.7	305.1	305.1	419.4	532.8	532.8
Excluding compensatory and buffer stock	96.3	141.3	170.6	188.7	215.1	215.1	330.2	453.9	453.9
				(In per cent of quota)					
Total holdings (end of period)	177.7	282.2	316.8	337.8	369.8	369.8	508.4	645.8	645.8
Excluding compensatory and buffer stock	116.7	171.3	206.8	228.7	260.7	260.7	400.2	550.2	550.2

Source: International Monetary Fund.

Table 2. Dominican Republic: Selected Economic Indicators

(Percentage changes from the preceding year)

	1977	1978	1979	1980	1981	Est. 1982	Proj. 1983
GDP at market prices	16.1	3.1	16.9	20.3	13.5	6.1	11.2
GDP deflator	10.6	1.0	11.5	13.8	9.7	4.5	9.0
Real GDP	5.0	2.1	4.8	5.7	3.5	1.6	2.0
Terms of trade	-2.2	-16.3	1.9	24.7	8.3	-27.4	-5.5
Consumer prices	12.8	3.5	9.2	16.7	7.5	7.5	9.0

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

The overall balance of payments has been in deficit in each of the past five years. The deficit averaged about US$100 million a year in 1978-80; in 1981 it rose to US$150 million and in 1982 it is estimated to have more than doubled to US$335 million (Table 3). In both 1980 and 1981 the payments deficit resulted in the accumulation of payments arrears, which have continued to build up at a substantial rate in 1982. As of the end of October 1982, the net international reserves of the Central Bank were negative at US$590 million; gross foreign assets were down to US$100 million (the equivalent to only one month of imports), and external payments arrears amounted to US$346 million (including US$210 million of delays in the delivery of foreign exchange under letters of credit). Because of the low level of gross official reserves it is estimated that external payments arrears will increase rapidly in the remainder of 1982, to about US$450 million. The premium for the U.S. dollar in the parallel foreign exchange market, which had hovered between 25 and 30 per cent (selling) in most of 1980-81, had risen to about 50 per cent by October 1982. In real effective terms, the value of the peso vis-a-vis the currencies of the Dominican Republic's major trading partners in the official market was about the same in September 1982 as in December 1977, whereas in the parallel market the peso depreciated by about 20 per cent during this period (Chart 1).

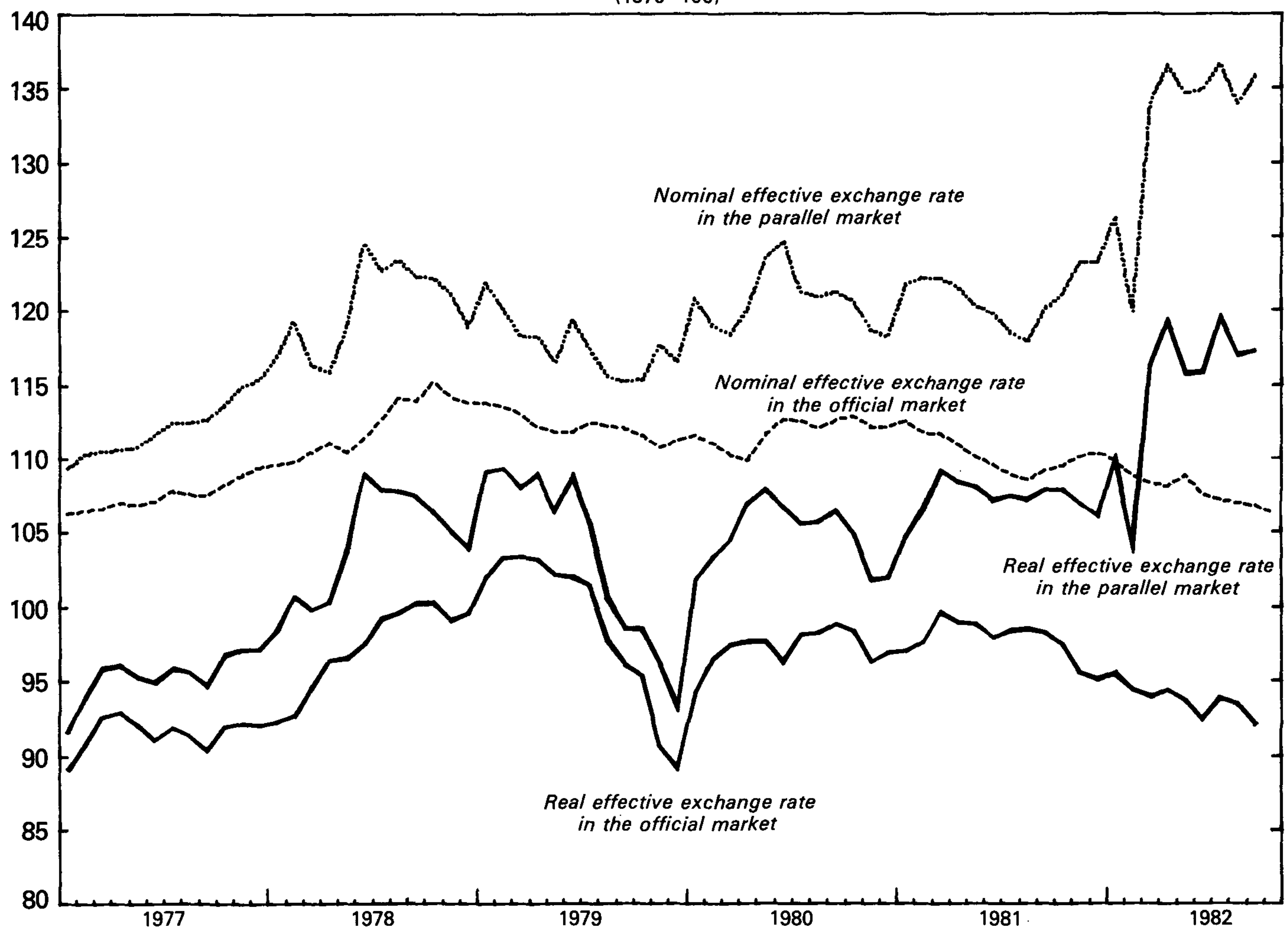
The deficit in the current account of the balance of payments reached a record US$670 million (10 per cent of GDP) in 1980, or about twice the levels registered in 1978 and 1979, reflecting a very sharp rise in merchandise imports associated in large part with the reconstruction effort following the damages inflicted by hurricane David in September 1979. Imports fell in 1981 while exports rose sharply due to

CHART 1

DOMINICAN REPUBLIC

REAL AND NOMINAL EFFECTIVE EXCHANGE RATES[1]

(1970 = 100)



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

[1] Import weighted indices defined in terms of pesos per unit of foreign exchange. Decline reflects appreciation.

Table 3. Dominican Republic: Balance of Payments Summary

(In millions of U.S. dollars)

	1978	1979	1980	1981	Est. 1982	Proj. 1983
Current account	-311.9	-331.3	-669.8	-405.9	-434.3	-269.7
Merchandise trade balance	-186.9	-268.9	-557.8	-263.7	-409.9	-300.3
Exports	(675.5)	(868.6)	(961.9)	(1,188.0)	(784.1)	(819.7)
Imports	(-862.4)	(-1,137.5)	(-1,519.7)	(-1,451.7)	(-1,194.0)	(-1,120.0)
Services (net)	-274.8	-268.2	-299.8	-335.2	-226.3	-176.4
Transfers (net)	149.8	205.8	187.8	193.0	201.9	207.0
Net capital movements	201.0	208.8	521.0	262.5	100.4	249.7
Private	43.6	13.4	155.5	88.4	-88.1	0.9
Official	157.4	195.4	365.5	174.1	188.5	248.8
SDR allocation	--	7.2	7.3	6.6	--	--
Gold revaluation and monetization	15.8	27.8	23.7	-14.1	-1.1	--
Net international reserves (increase -)	95.1	87.5	117.8	150.9	335.0	20.0
Of which: increase in external payments arrears 1/	--	43.4	106.2	166.1	131.6	-100.0

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

1/ Including delays in the delivery of foreign exchange under letters of credit.

markedly higher sugar export prices. As a result, and despite a steep climb in net payments of investment income, the current account deficit declined to US$400 million (5-1/2 per cent of estimated GDP). With the subsequent sharp drop of world sugar prices and declines in other commodity prices as well, exports are estimated to decline by US$400 million (34 per cent) in 1982. However, imports are also coming down sharply, due to weakening demand and reduced availability of foreign exchange at the official rate, and receipts from tourism are rising, suggesting that the current account deficit will not widen much in 1982.

The reduction of the current account deficit in 1981 was accompanied by a sharp decline in the net inflow of capital from the 1980 level. Foreign borrowing by both the public and private sectors was unusually large (US$365 million and US$155 million, respectively) in 1980, in connection with the post-hurricane reconstruction needs. In 1981 the net inflow of capital was only half as large as in 1980, and the indications for 1982 are that net foreign borrowing by the public sector will be of a similar magnitude as in 1981 while the private capital account can be expected to show a net outflow.

The Dominican Republic's external debt has risen rapidly in the last several years. The public and publicly guaranteed external debt (including the short-term debt of the nonfinancial public sector) almost doubled in the period 1978-81, to reach nearly US$1.6 billion at the end of 1981, equivalent to almost 21 per cent of estimated GDP compared with 15 per cent of GDP in 1977. In addition, registered private external debt of about US$270 million was outstanding at the end of 1981. Interest payments on the combined public and private external debt (registered) amounted to US$169 million in 1981 or 2.2 per cent of GDP (up from 1 per cent in 1977), and amortization payments exceeded US$200 million or 2.7 per cent of GDP (up from 1.8 per cent in 1977).

The contraction of foreign trade and lax fiscal policy led to an increase in the Central Government's overall deficit from the equivalent of 1/2 of 1 per cent of GDP in 1977 to 2 per cent of GDP in 1981 and an estimated 4 per cent in 1982 (Table 4). This progressive weakening was brought about by (1) a drop in tax collections in relation to GDP from about 13 per cent in 1976-77 to less than 10 per cent in 1981 and an estimated 7-1/2 per cent in 1982, a consequence of a reduction in export taxes, a rise in tax exemptions, and an erosion of the tax base because of excessive reliance on specific rates of taxation; and (2) a sharp increase in the Central Government's current expenditures in 1978-80, associated with both sizable wage increases granted to public sector employees and a large increase in employment. The growth of current outlays slowed in 1981-82, but an attempt to reverse the deterioration of the revenue performance by a new tax package was turned down by the Congress in 1980.

Table 4. Dominican Republic: Public Sector Operations

	1978	1979	1980	1981	Est. 1982	Proj. 1983
(In millions of Dominican pesos)						
Central government current revenue	591.3	681.5	879.8	909.0	670.0	790.9
Central government current expenditure	447.3	612.2	715.2	756.2	785.5	719.9
Central government current account surplus or deficit (-)	144.0	69.3	164.6	153.7	-115.5	71.8
Rest of public sector current account surplus or deficit (-)	21.0	-41.9	-66.8	-122.1	-140.3 1/	-27.3 1/
Public sector current account surplus or deficit (-)	165.0	27.4	97.8	31.6	-255.8	44.5
Capital revenue	15.1	21.0	18.0	19.9	18.2	19.0
Capital expenditure	421.5	362.3	517.9	470.0	329.5	395.7
Overall public sector deficit (-)	-241.4	-313.9	-402.1	-418.5	-567.1	-332.2
Central Government	-102.6	-303.5	-186.7	-154.2	-309.9	-197.0
Rest of public sector	-138.8	-10.4	-215.4	-264.3	-257.2	-135.2
Residual 2/	-12.5	32.1	5.1	-29.9	7.5	-20.0
Financing	253.9	281.8	397.0	448.4	559.6	352.2
Foreign 3/	130.0	155.7	297.0	105.6	95.9	152.2
Domestic	123.9	126.1	100.0	342.8	463.7	200.0
(In per cent of GDP)						
Central government current account surplus or deficit (-)	3.0	1.2	2.5	2.0	-1.4	0.8
Rest of the public sector current account surplus or deficit (-)	0.5	-0.7	-1.0	-1.6	-1.8	-0.3
Public sector current account surplus or deficit	3.5	0.5	1.5	0.4	-3.2	0.5
Overall public sector deficit (-)	-5.1	-5.7	-6.0	-5.5	-7.1	-3.7
Central Government	-2.2	-5.5	-2.8	-2.0	-3.9	-2.2
Rest of public sector	-2.9	-0.2	-3.2	-3.5	-3.2	-1.5
Financing	5.4	5.1	6.0	5.9	7.0	3.9

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

1/ Based on four major entities, namely the State Sugar Company (CEA), the Electricity Corporation (CDE), the Price Stabilization Institute (INESPRE), and the holding company for a group of government-owned enterprises (CORDE).
2/ Includes the surplus or deficit of certain entities not consolidated in the public sector accounts.
3/ Includes only net disbursements to the nonfinancial public sector.

The public finances also have been adversely affected by the poor financial performance of the major state enterprises. The sugar corporation (CEA), in particular, faced a sharp rise in its production costs at a time when international sugar prices were falling. At present sales prices cover only about 70 per cent of production costs, which are unduly high because of poor management, the use of obsolete equipment, an excessive work force, and the increase in the cost of energy. The electricity corporation (CDE) also has incurred large operational deficits as its rates until recently have lagged behind increases in its costs of production, and it has continued to rely on large government transfers to finance an ambitious investment program; however, monthly rate adjustments were in effect from March 1981 through June 1982 and the operating deficit has been reduced substantially. The Price Stabilization Institute (INESPRE), which handles the importation of most staple foods, incurred a very large deficit in 1981 in connection with storage and marketing problems, but approximate balance is expected to be restored in 1982. Most of the firms in the Dominican Corporation of State Enterprises (CORDE) incurred large losses in 1982, mainly as a result of excessive increases in employment.

The fiscal deficit of the consolidated public sector increased steadily from the equivalent of 1-1/2 per cent of GDP in 1977 to about 6 per cent of GDP (or RD$450 million) in 1981, and a further widening to 7 per cent of GDP (RD$560 million) is estimated for 1982. With the exception of 1980, when as noted above foreign borrowing was unusually high, these rising deficits have forced the public sector to resort increasingly to borrowing from the domestic banking system, reducing the availability of credit to the private sector and bringing pressure to bear on the net international reserves of the Central Bank. In 1981 some 90 per cent of the increase in the net domestic assets of the banking system took the form of credit to the public sector, and for 1982 this proportion is estimated at 77 per cent; net credit to the private sector showed a small decline (2-1/2 per cent) in 1981 followed by an increase estimated at 8 per cent in 1982 (Table 5).

At the same time that public sector demand for credit has been growing rapidly, the flow of funds into the domestic banking system has been sluggish. As a proportion of GDP, banking system liabilities to the private sector dropped from more than 25 per cent in 1978-79 to about 21 per cent in 1981, in the face of rising interest rates abroad and competition from other financial intermediaries at home. In 1982 these liabilities apparently are growing faster than GDP. During the period of rising international inflation and interest rates, only marginal adjustments were made to the legal ceilings on deposit interest rates in the Dominican Republic (in 1977 and in July-August, 1981), and the rate on time and savings deposits at banks was not raised above 8-1/2 per cent. Nonbank financial intermedaries, which are subject to smaller reserve requirements and can pay slightly higher interest rates than banks, have grown much faster than the banking system and have been the major source of new net credit to the private sector in recent years. At the end of June 1982, the nonbank financial institutions

Table 5. Dominican Republic: Monetary Indicators

	Level Dec. 31 1981	Change from Previous Year December 31 1978	1979	1980	1981	Est. 1982	Est. 1983
		I. Central Bank					
		(In millions of Dominican peso)					
Net international reserves	-322.3	-77.3	-124.0	-107.3	-109.6	-350.4	-20.0
Net domestic assets	718.2	97.3	193.4	114.5	156.0	394.5	84.0
Currency issue	395.9	20.0	69.4	7.2	46.4	44.1	64.0
		(Percentage change)1/					
Net domestic assets		38.5	70.9	33.5	44.6	99.6	19.1
Currency issue		7.9	25.4	2.1	13.3	11.1	14.5
		II. Banking System					
		(In millions of Dominican pesos)					
Net international reserves	-391.2	-95.1	-87.5	-117.8	-151.0	-335.4	-20.0
Net domestic assets	2,237.9	182.7	298.1	228.5	380.2	604.3	311.6
Public sector	(995.6)	(123.9)	(126.1)	(100.0)	(342.8)	(463.7)	(200.0)
Private sector	(1,019.9)	(49.7)	(64.2)	(151.4)	(-24.6)	(84.7)	(121.6)
Medium- and long-term foreign liabilities	259.0	15.9	14.0	67.6	70.8	95.6	97.6
Liabilities to private sector	1,587.7	71.7	196.6	43.1	158.4	173.3	194.0
		(Percentage change)2/					
Net domestic assets		17.6	29.4	18.7	26.6	40.0	16.5
Liabilities to private sector		6.4	16.5	3.1	11.1	10.9	9.9

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

1/ In relation to currency issue at the beginning of the period.
2/ In relation to liabilities to the private sector at the beginning of the period.

accounted for 35 per cent of the consolidated financial system's liabilities to the private sector and 43 per cent of the system's credit to the private sector.

Faced with declining reserves and mounting arrears, the monetary authorities have sought to moderate the expansion of bank credit and reduce the demand for import payments in the official exchange market. In a series of moves starting in mid-1980, rediscounts to commercial banks were curtailed, reserve requirements were raised, and the scope of the advance import deposit scheme was widened. Import payments for capital goods and automobile parts were transferred to the parallel market and quotas were established on the availability of foreign exchange for imports of raw materials (other than petroleum), staple foods, and medicines. In addition, increases in the prices of gasoline and sugar for domestic consumption were put into effect and, as was noted above, electricity rates were raised and linked to petroleum prices. In June 1981 imports of automobiles were prohibited for a period of one year; this prohibition was renewed, again for one year, in August 1982 and extended to a large number of products deemed to be nonessential.

II. The Medium-Term Program

1. General objectives and strategy

The Government which took office on August 16, 1982 intends to address the Dominican Republic's economic and financial problems in a medium-term setting with an economic program to achieve a viable external payments position in the context of high and stable rates of economic growth. As stated in the President's inauguration address, the cornerstones of this program are: (a) sound fiscal and monetary management; and (b) an adequate public investment program combined with incentives to private investment. The adjustment process will take time, and in the process the authorities wish to count on Fund support of their policies in the form of an extended arrangement.

In line with the economic growth and employment objectives, the Government's program for 1983-85 aims at an increase in the level of investment from 20.8 per cent of GDP in 1982 to 24.6 per cent by 1985 (Table 6). This increase is to be achieved by raising public sector investment and by encouraging private capital formation. The investment effort is to take place within the framework of a reduced overall fiscal deficit. Public savings, estimated at a negative 3.2 per cent of GDP in 1982, should reach 0.5 per cent of GDP in 1983 and 2-1/2 per cent by 1985. Together with appropriate incentives to private savings, this is expected to bring gross national savings to 18.7 per cent of GDP in 1983 and 22 per cent in 1985, a level similar to that attained in the mid-1970s. According to this scenario, net foreign financing, which amounted to 5-1/2 per cent of GDP in both 1980 and 1981, will be limited to 3 per cent in 1983 and 2-1/2 per cent by 1985.

Table 6. Dominican Republic: Macroeconomic Flows

(As per cent of GDP)

	1979	1980	1981	Est. 1982	Program 1983	1984	1985
I. Balance of Payments							
Current account surplus or deficit (-)	-6.0	-10.1	-5.4	-5.4	-3.0	-2.6	-2.6
Trade balance	-4.9	-8.4	-3.5	-5.1	-3.4	-2.8	-2.8
Investment income	-3.4	-3.2	-3.9	-3.9	-3.0	-3.1	-3.1
Other services and transfers	2.3	1.5	2.0	3.6	3.4	3.3	3.3
Capital account	4.4	8.3	3.4	1.2	2.8	3.4	3.3
Private capital 1/	1.4	2.9	1.1	-1.1	--	0.3	0.4
Nonfinancial public sector 2/	2.8	4.5	1.4	1.2	1.7	2.4	2.3
Financial public sector	0.2	0.9	0.9	1.1	1.1	0.7	0.6
Net monetary movements (increase -) 3/	1.6	1.8	2.0	4.2	0.2	-0.8	-0.7
II. Nonfinancial public sector 2/							
Public sector savings	0.5	1.5	0.4	-3.2	0.5	1.6	2.6
Central Government current account surplus or deficit (-)	1.2	2.5	2.0	-1.4	0.8	1.6	2.1
Revenue	(12.3)	(13.2)	(12.0)	(8.4)	(8.9)	(9.7)	(10.2)
Expenditure	(-11.1)	(-10.7)	(-10.0)	(-9.8)	(-8.1)	(-8.1)	(-8.1)
Rest of public sector current account surplus or deficit (-)	-0.7	-1.0	-1.6	-1.8	-0.3	--	0.5
Capital revenue	0.4	0.3	0.3	0.2	0.2	0.2	0.1
Public sector capital expenditure	6.6	7.8	6.2	4.1	4.4	5.3	5.7
Fixed investment	5.4	5.0	4.6	3.4	3.9	4.8	5.3
Other capital expenditure	1.2	2.8	1.6	0.7	0.5	0.5	0.4
Overall deficit	-5.7	-6.0	-5.5	-7.1	-3.7	-3.5	-3.0
Residual deficit	0.6	--	-0.4	0.1	-0.2	--	--
Financing	5.1	6.0	5.9	7.0	3.9	3.5	3.0
Foreign	2.8	4.5	1.4	1.2	1.7	2.4	2.3
Domestic	2.3	1.5	4.5	5.8	2.2	1.1	0.7
III. Savings and Investment							
Fixed capital formation	25.2	25.7	23.7	20.8	22.1	23.4	24.6
Public sector	5.4	5.0	4.6	3.4	3.9	4.8	5.3
Private sector 4/	19.8	20.7	19.1	17.4	18.2	18.6	19.3
Savings	25.2	25.7	23.7	20.8	22.1	23.4	24.6
Foreign savings	6.0	10.1	5.4	5.4	3.0	2.6	2.6
National savings	19.2	15.6	18.3	15.4	19.1	20.8	22.0
Public sector	(0.5)	(1.5)	(0.4)	(-3.2)	(0.5)	(1.6)	(2.6)
Private sector	(18.7)	(14.1)	(17.9)	(18.6)	(18.6)	(19.2)	(19.4)
Memorandum item							
Rate of growth of real GDP	4.8	5.7	3.5	1.6	2.0	3.5	5.0

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

1/ Includes unrequited transfers, gold monetization, and errors and omissions.
2/ Includes short-term borrowing. Includes four public financial institutions: the Agricultural Bank, the Industrial Development Corporation (CFI), the Cooperative Development and Credit Institute (IDECOOP), and the Workers Savings Bank. Prior to 1981 the foreign financing of the nonfinancial public sector includes movements in some private debt with public guarantee.
3/ Includes the Central Bank and the commercial banks.
4/ Includes changes in inventories.

The tightening of demand management and the pursuit of appropriate exchange rate and interest rate policies are expected to strengthen the balance of payments. As a result, the overall payments deficit will be limited to no more than US$20 million in 1983 and surpluses are to be recorded in the following two years. The achievement of these balance of payments objectives, by restoring equilibrium in the official foreign exchange market, can be expected to lead to an effective unification of the exchange system.

2. Policies to improve supply

The development effort of the Dominican Republic depends critically on improving economic efficiency. To this end, the Government plans to restructure the public investment program and facilitate private investment, provide incentives to production through an appropriate exchange rate policy, raise savings and improve their allocation through a more realistic interest rate policy, and strengthen the performance of the state enterprises.

Public sector investment has weakened in the past several years. Estimated public capital formation in 1982 is smaller even in absolute terms than it was in 1977, and in relation to GDP it fell from 7-1/2 per cent to 3-1/2 per cent. The new Administration intends to reverse this decline, but achievement of that objective requires resolution of the present fiscal difficulties. Thus, public investment in relation to GDP will show only a modest increase in 1983 and is expected to rise to 5-1/4 per cent by 1985. The public investment effort will be concentrated on the provision of infrastructure, particularly in the construction, energy, and agricultural sectors.

As regards private investment, the Government's strategy will be (a) to facilitate the expansion of activities in those sectors where the Dominican Republic has comparative advantage, in particular agriculture, export-oriented manufacturing, and tourism; and (b) to promote a low-cost housing construction program as a means of generating employment in the short run.

To increase output and efficiency in the agricultural sector, more room will be allowed for the operation of market forces. The food marketing operations of INESPRE, which have expanded greatly in scope in the last few years, will be curtailed to the seven basic products expressly prescribed in its charter. Credit facilities for agriculture in the Banco Agricola and FIDE will be expanded and streamlined, and a Special Agricultural Credit Insurance Program will be created to promote the availability of private financing for new projects and for small-scale agriculture. The Government also intends to step up settlement under the agrarian reform program.

Agricultural production for export and substitution of imports will be stimulated through the new Agro-Industrial Law that was approved in early 1982. The law provides incentives for the establishment or expansion of agricultural processing industries that are deemed to have a high social and redistributive impact and that meet certain criteria regarding value added and use of domestic resources. To improve profitability in the production of traditional agricultural products, a system of exchange incentives for exports of sugar, coffee, cocoa, and tobacco was established recently (see Section II, subsection 3 below).

The Government is also seeking to promote a substantial expansion of manufacturing for export in the so-called free-trade zones. Existing mechanisms for export promotion, including the provision of exchange rate incentives to nontraditional exports under the Export Incentive Law that took effect in 1980, will be utilized more efficiently. Another aspect of the Government's export development strategy is an accelerated program of mineral exploration, in which both the private and the public sector will participate. In order to facilitate the participation of private capital from abroad in the Dominican Republic's development effort, the Government is revising the Foreign Investment Law of 1978 to change some of its provisions which have discouraged foreign investment.

3. Demand management

Fiscal policy has been assigned a major role in controlling the expansion of aggregate demand and ensuring achievement of the program's balance of payments objectives. The program calls for limiting the overall public sector deficit to 4 per cent of GDP in 1983 (compared with an estimated deficit of 7 per cent of GDP in 1982) and reducing it to 3 per cent of GDP in 1985. As was noted above, this is to be attained with an increase in public sector savings, which will be restored to 1/2 per cent of GDP in 1983 (from a negative 3.2 per cent in 1982) and raised to 2-1/2 per cent by 1985.

To achieve this improvement in public sector savings, the Government has undertaken a major fiscal reform, including new taxes, changes in the expenditure structure, improvements in tax administration and expenditure control, and improvements in the operational efficiency of the state enterprises.

Changes in the tax system that have been approved by the Congress include (a) the introduction of two new taxes, namely an ad valorem surtax on imports and a capital gains tax on property sales; and (b) modifications to the income tax and other existing taxes. The Government has also submitted to Congress a proposal for a general sales tax, which is expected to be signed into law before April 1, 1983. The general sales tax will be the major vehicle for broadening the revenue base and reducing the dependence of the revenue system on foreign trade. It will be levied at a rate of 6 per cent on imports and sales by domestic businesses--manufacturers, wholesalers, and retailers--with a large turnover, and is expected to yield about RD$90 million in the first full year of operation. Implementation of this tax, once it becomes law, will take at least six months. Meanwhile, the surcharge on imports other than those of petroleum and other "essential" products, at a rate of 10 per cent, will serve to produce quickly a significant boost to revenues (about RD$50 million a year at current import levels). Increases in the progressivity of the personal income tax, together with certain other modifications in that tax, are expected to raise collections by some RD$20 million in the first full year. Smaller revenue increases will be produced by the new capital gains tax, by an increase in automobile license fees, and by various other minor tax changes. In addition to these new measures, the Government has launched an intensive effort to raise the yield from existing taxes, particularly income taxes and customs duties, through administrative action.

On the expenditure side, tight control will be exercised over current spending. An early action taken by the new Administration was to reduce the salaries of public sector employees above a certain level (RD$500 a month) according to a progressive scale. In addition, substantial cuts will be made in subsidies to the decentralized agencies and public enterprises. On this basis, the Central Government's current expenditures are projected to decline by about RD$65 million or 8.5 per cent in 1983 from the estimate of outlays in 1982. About half of that decline represents a reduction in the wage bill and the remainder the programed reduction in transfers to the rest of the public sector; other current expenditures are to be kept at the levels estimated for 1982. Investment spending by the Central Government is to be stepped up, in the first instance primarily by reactivating existing projects that have been interrupted or not started for lack of counterpart funds. For 1983 an increase of about RD$80 million or 40 per cent is planned in such spending, and total public sector investment is projected to rise by 20 per cent.

The authorities recognize that strict control over all categories of current spending is essential to their aim of improving the allocation of public sector resources. To this end, a major overhaul of the expenditure control mechanism is being undertaken at the Central Government's level, but extending to the decentralized agencies and state enterprises, and the system of approval of internal and external borrowing by all public sector entitites is being centralized. The Government has launched a comprehensive effort to improve the financial situation of the enterprises, through improvements in administration, expenditure control and streamlining of operations, and supplemented by further tariff and price increases when necessary.

The State Sugar Company (CEA) is implementing a program aimed at raising efficiency and controlling costs, under which each of the 12 mills will be given detailed operation plans that are to be tested monthly. The program employs specific guidelines to contain the excessive growth of CEA's wage bill. Negotiations are under way to reactivate a World Bank-financed project to rehabilitate the mills and improve management. The CEA will also benefit from the foreign exchange incentives that were granted recently for exports of sugar and other traditional products (see Section II. 3 below). As a result of the monthly tariff increases that were applied from March 1981 through June 1982, the electricity corporation (CDE) should have an operating surplus in 1983. New administrative procedures are being introduced to improve collection of revenues and reduce costs, some of them in fulfillment of conditions in a loan agreement with the IDB for a hydroelectric project. Over a somewhat longer term, efficiency in electricity generation and transmission will be increased through overhaul of existing facilities and new investments. As was noted above, INESPRE's food marketing operations are being streamlined and a series of measures to reduce costs is being implemented; receipts will be raised by charging purchasers for the interest payments on import financing loans. Financial planning in CORDE will be improved through the implementation of detailed operation plans for each firm that are to be tested quarterly; special efforts are being made to restore profitability in the cement company, which has been incurring heavy losses, through plant modernization and employment cuts.

Projections for 1983 point to a substantial reduction in CEA's operating deficit, and a shift to surplus for the CDE. The combined operating deficit of the four principal enterprises is projected to decline by more than RD$110 million in 1983, and their total deficit by a similar amount.

The reduction in the overall public sector deficit during the program period will be reflected in a sizable reduction in public sector borrowing from the domestic banking system. An additional objective of monetary policy is to promote the growth of domestic financial savings (and discourage capital outflows) and improve their allocation. In the past, there has been disintermediation due, inter alia, to the maintenance of interest rates on financial instruments below the levels prevailing in international markets or negative in real terms, and to large spreads between loan and deposit rates. To reverse this trend, the program calls for the adoption of a more realistic interest rate policy.

Effective December 1, 1982, maximum interest rates payable on a range of financial instruments were raised by 1-2 percentage points and financial institutions were authorized to issue a new, high-yield financial instrument (certificate) subject to the following characteristics: (a) initial minimum denominations were set at RD$250,000 for commercial banks and mortgage construction banks, RD$150,000 for savings and loan associations, and RD$100,000 for financial development companies; (b) these minimum denominations will be reduced in five steps every six months; (c) maturities are one, two, and three years; and (d) the maximum payable interest rates range from 10 per cent to 15 per cent and will be raised as required to ensure that they are no less than comparable international rates. The adequacy of the scheduled reductions in the minimum denominations of the new certificates and that of the entire interest rate structure will be the specific subject of review under the periodic consultation clauses. Supplementing this action, the interest rate paid by the Central Bank on the reserve deposits of the commercial banks was raised at the same time (from 2 per cent to 6 per cent).

3. External sector policies

Adjustment of the effective exchange rate of the peso and reform of the exchange system will be key instruments in the effort to achieve a viable balance of payments position while promoting economic efficiency and growth. The authorities have opted not to adjust the official exchange rate at this time because of the legal difficulties involved, but they will attain the same objective by continuing the policy of widening the scope of the parallel foreign exchange market. Such a policy will facilitate the unification of the exchange market at a realistic exchange rate. To promote further institutionalization of the parallel exchange market, banks were given permission to operate in that market starting in October 1982.

Under the Export Incentives Law of 1979, qualified nontraditional exports receive an exchange incentive in the form of partial exemption from the requirement of surrender at the official rate.1/ Implementation of this law did not effectively get under way until well into 1981. Approval for eligibility tended to be slow initially, but it has been speeded up since. As was noted above, the new Administration is taking action to ensure that the law's provisions be used to the fullest extent possible. It has also recognized the need to extend an exchange incentive to traditional exports, and to that end a system of exchange certificates has been devised under which exporters of the principal traditional exports (raw sugar and molasses, coffee, cacao, and tobacco) will receive--effective November 11, 1982--freely negotiable exchange certificates equivalent to a predetermined share of exports receipts (20 per cent for raw sugar and 10 per cent for the other products). Such an exchange certificate will entitle the bearer to buy foreign exchange at the official exchange rate for purposes of making any payments abroad for which the Central Bank made foreign exchange available as of December 31, 1981. At the same time, the foreign exchange quotas for imports of raw materials and consumer goods in 1983 were reduced from the 1982 levels by an amount of some US$75 million--equivalent to the estimated issue of certificates in 1983--to avoid increasing demand pressures in the official market. Subsequently, the foreign exchange quota for food imports by INESPRE in 1983 was reduced by US$28 million from the 1982 level. In addition, import payments for certain raw materials and other goods will be transfered to the parallel market in 1983.

The Dominican Republic representatives acknowledged that the exchange certificate system was complex, but they explained that a direct transfer of export proceeds to the parallel market was not a viable option at this time. Once the system was in operation, it would be easier for the Central Bank to make it less complex and comparable to

1/ In practice all the foreign exchange is surrendered to the Central Bank, which subsequently returns part of it in accordance with a predetermined formula.

the system used for nontraditional exports. The operation of the system will be reviewed regularly, with a view to enhancing its effectiveness and scope.

Apart from the dual exchange market, the Dominican Republic maintains two other multiple currency practices, resulting from (1) the requirement of a fully prepaid letter of credit for certain imports (in so far as it increases the spread between the effective exchange rates beyond 2 per cent); and (2) the levying of a tax on remittances of profits from foreign investments, including a surtax on the amount of this tax. In addition, the Dominican Republic has been incurring external payments arrears. These arrears have risen sharply in the past two years, reaching US$136 million at the end of October 1982, with a maximum delay of 16 calendar months. These aspects of the Dominican Republic's exchange system are subject to Article VIII jurisdiction and are described in detail in the section on the Exchange and Trade System of the Recent Economic Developments paper (SM/83/1). The delay incurred by the Central Bank in providing foreign exchange due to local commercial banks for letters of credit also has increased; the backlog on such operations reached US$210 million at the end of October 1982, with a maximum lag of 14 calendar months; the banks refinance these obligations (with the parent bank in the case of local branches of foreign banks) and pass on the added interest cost to the importer.

The authorities intend to enhance the Dominican Republic's standing in international credit markets by eliminating all external payments arrears and delays during the program period and by making prudent use of external credit to supplement domestic savings. Elimination of payments arrears will be a priority objective under the extended arrangement, and the authorities have indicated that they will seek to negotiate with the creditor banks the conversion into a medium-term loan or deposit of the delays in the delivery of foreign exchange under letters of credit. They will also seek to refinance the short-term debt of the State Sugar Company with a medium-term loan. To increase its long-term borrowing for development projects, the Government intends to rely on concessional resources from international development agencies and friendly foreign governments. On the basis of external debt outstanding as of the end of 1981 and including new borrowing envisaged under the three-year program (including borrowing from the Fund), both disbursed debt as a per cent of GDP and debt service in relation to exports of goods and nonfactor services will increase gradually over the program period (Table 7). Disbursed debt, which stood at 19.7 per cent of GDP at the end of 1981, is expected to reach 28.3 per cent by end of 1985. At the same time, however, the net foreign liabilities of the Central Bank (excluding liabilities to the Fund but including arrears and delays in the delivery of foreign exchange under letters of credit) are projected to decline from 7-1/2 per cent of GDP in 1982 to 1/2 of 1 per cent in 1985. The debt service ratio is projected to jump from 17.2 per cent in 1981 to 29 per cent in 1982, and then rise to 34.4 per cent by 1985.

Table 7. Dominican Republic: External Public Debt Operations, 1978-86 1/

	1978	1979	1980	1981	1982	Projected 1983	1984	1985	1986
	(In millions of U.S. dollars)								
Net disbursements	110.2	282.0	211.7	187.0	237.7	498.4	422.3	441.5	302.2
Gross disbursements	148.3	414.6	338.5	314.7	405.1	675.8 2/	632.5	659.5	518.0
Amortization	38.1	132.6	126.8	127.7	167.4	177.4	210.2	218.0	215.8
Debt service payments	83.4	211.1	236.2	259.7	330.9	359.0	424.1	463.3	492.6
Amortization	38.1	132.6	126.8	127.7	167.4	177.4	210.2	218.0	215.8
Interest	45.3	78.5	109.4	132.0	163.5	181.6	213.9	245.3	276.8
Disbursed debt outstanding at end of year 3/	807.3	1,091.3	1,300.6	1,483.7	1,718.7	2,217.1	2,639.4	3,080.9	3,383.1
	(In per cent)								
Gross disbursements/GDP	3.1	7.5	5.1	4.2	5.0	7.6	6.5	6.1	4.3
Net disbursements/GDP	2.3	5.1	3.2	2.5	3.0	5.6	4.3	4.1	2.5
Debt service/exports of goods and nonfactor services	9.8	18.6	18.6	17.2	29.0	30.1	32.6	34.4	33.9
Interest/exports of goods and nonfactor services	5.2	6.9	8.6	8.7	14.3	15.2	16.5	18.2	19.1
Average interest rate 4/	6.0	8.3	9.1	9.5	10.2	9.2	8.8	8.6	8.6
Debt/GDP	17.1	19.8	19.6	19.7	21.4	24.9	27.0	28.3	28.3

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

1/ External public and publicly guaranteed debt with an original maturity of at least one year, including use of Fund resources.
2/ Includes US$100 million for the refinancing of short-term debt of the state sugar enterprises and US$178 million of use of Fund resources.
3/ Changes in disbursed debt outstanding at end of year are not equal to net disbursements because of changes in the SDR/U.S. dollar exchange rate.
4/ Interest payments divided by average amount of disbursed debt outstanding during the year.

III. Program for the First Year of the EFF Arrangement

Quantitative performance clauses for the period through December 31, 1983 are set out in Table 8. In addition, enactment of a 6 per cent general sales tax before April 1, 1983 has been made a performance criterion at the specific request of the authorities. There is also a performance clause that pertains to the authorities' intentions in respect of multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements, and restrictions on imports for balance of payments purposes. Under another performance clause, the authorities will consult with the Fund before June 30, 1983 to assess progress achieved in the implementation of the program. This review will cover, inter alia, fiscal performance (including the status of the general sales tax), interest rate and exchange rate policies, and the results obtained with respect to refinancing the short-term foreign debt of the State Sugar Company and the Central Bank's delays in the delivery of foreign exchange under letters of credit. Criteria relating to purchases and the phasing of purchases for the remainder of the arrangement will be established in subsequent consultations with the Fund which are scheduled to take place before January 1, 1984 and January 1, 1985.

Many of the measures on which the success of the medium-term program depends have already been taken by the authorities. They include: the introduction of several tax measures; the raising of interest rates to more realistic levels; and the provision of a foreign exchange incentive to nontraditional exports. The authorities will review regularly the adequacy of the interest rate structure and the operation of the exchange certificate system and they have indicated their intention to make modifications as required. They also intend to adjust the prices and tariffs charged by public enterprises as needed to minimize subsidies. With these key policies in place and with a strict adherence to their fiscal policy targets, the authorities expect to limit the loss of net official international reserves in 1983 to US$20 million.

To ensure the achievement of these objectives, certain key parameters of the authorities' program are subject to performance criteria. For the period through December 31, 1983 quarterly limits have been set for the net credit extended to the nonfinancial public sector by the Central Bank and Banco de Reservas, which will be verified at the end of each calendar quarter.

The limits on the net bank credit to the nonfinancial public sector have been designed to permit the domestic banking system to expand credit to the private sector at a rate consistent with the projected growth of the economy and with the balance of payments objective. In turn, to ensure that these credit plans do not conflict with the Government's balance of payments and inflation objectives, a set of limits has been placed on the net domestic assets of the Central Bank, which is consistent with the set of quarterly targets on its net international reserve position.

Table 8. Dominican Republic: Extended Arrangement Quantitative Performance Criteria for 1983

	Stocks on 1982		Targets and limits for 1983			
	Aug. 31	Dec. 31	March 31	June 30	Sept. 30	Dec. 31
	(In millions of Dominican pesos)					
Net domestic assets of the Central Bank 1/	924	1,113	1,103	1,114	1,135	1,197
Net credit of the Central Bank and Banco de Reservas to the nonfinancial public sector 2/	1,235	1,466	1,505	1,535	1,585	1,666
	(In millions of U.S. dollars)					
Net international reserves of the Central Bank 3/	-562	-673	-698	-709	-725	
External payments arrears of the Central Bank 4/	365	453	439	414	394	353
Cumulative disbursements of foreign loans to the public sector with maturity of less than: 5/6/						
1 year	...	...	200	200	200	200
3 years	...	...	220	220	220	220
10 years	...	...	370	370	370	370
Transfers of import payments from the official to the parallel foreign exchange market 7/	...	...	40	15	15	15

Sources: Central Bank of the Dominican Republic; and Memorandum on the Economic Policy of the Dominican Republic.

1/ Defined as the difference between the currency issue and the net international reserves.
2/ As defined in Table 1 annexed to the Memorandum on the Economic Policies of the Dominican Republic.
3/ As defined in Table 4 annexed to the Economic Policies Memorandum.
4/ As defined in Table 3 annexed to the Economic Policies Memorandum.
5/ Excluding loans to the Central Bank.
6/ These limits are applied throughout the period.
7/ These targets refer to the quarters ending on the dates indicated.

A fourth performance criterion is a schedule for the quarterly reduction in the Central Bank's external payments arrears and delays in the delivery of foreign exchange on overdue letters of credit. A fifth performance criterion is the transfer in each of the four quarters of 1983 of specified amounts of import transactions from the official to the parallel foreign exchange market.

In their Policy Memorandum the authorities have reiterated the importance they attach to limiting recourse to external borrowing, especially in the one-to-ten-year maturity range, in order to bring about an improvement in the Dominican Republic's external debt structure. A sixth performance criterion for the period through December 31, 1983, therefore, is a limit on disbursements of public and publicly guaranteed external debt with an original maturity of at least one year and up to and including ten years. Sublimits have been set to control such debt with original maturities of less than one year and of at least one year and up to and including three years.

IV. Staff Appraisal and Proposed Decision

In the last two years the Dominican Republic economy has experienced a pronounced slowdown at the same time that the country's financial performance has deteriorated sharply. While the deficit in the current account of the balance of payments was reduced from the record level recorded in 1980, the overall payments deficit widened from an average of US$100 million in 1978-80 to more than US$300 million in 1982 and the premium for the U.S. dollar in the parallel foreign exchange market has risen. External payments arrears (including delays in letters of credit) more than doubled between the end of 1980 and the end of October 1982. Reflecting not only the contraction of foreign trade but also a weakening in the control of public spending, the fiscal deficit of the nonfinancial public sector--which had widened from 1-1/2 per cent of GDP in 1977 to 6 per cent in 1980--is expected to reach 7 per cent of GDP in 1982.

To deal with these problems, the Government which took office on August 16, 1982 has designed a medium-term economic program aimed at raising the Dominican Republic's rate of economic growth and employment, achieving a viable balance of payments position, and maintaining a low inflation rate. In the attached letter and Economic Policy Memorandum, the Dominican Republic authorities describe the policies they intend to follow to achieve these aims and request an extended arrangement for a period of three years in an amount of SDR 371.25 million in support of their program.

In the view of the staff, the program correctly places major emphasis on a strengthening of the public sector finances. A substantial increase in public sector savings is needed in order to finance a stepped-up investment program and reduce the overall public sector deficit to a manageable level. The staff welcomes the new revenue measures that have already been taken, but because of the erosion of the

Dominican Republic's revenue base in recent years, it considers enactment of the general sales tax to be of critical importance for the success of the program and welcomes the authorities' commitment in this regard. In the view of the staff it is precisely this tax which should make a major contribution toward broadening the tax base and strengthening the revenue system. While further tax increases will be needed in the later years of the arrangement, it must be acknowledged that the scope for raising taxes in the present recessionary environment is limited; therefore, in the short run, an important part of the increase in public sector savings has to be obtained through expenditure restraint. Accordingly, the Government plans to reduce its current outlays in 1983, and it has launched a comprehensive program to improve the financial position of the principal state enterprises. Also, steps are being taken to strengthen the expenditure control machinery and to centralize the system for approving the internal and external borrowing operations of the entire public sector. Effective implementation of these expenditure plans will be crucial to the success of the program, but it is also important that the authorities be prepared to raise public sector tariffs and prices as promptly as required to minimize subsidies.

Achievement of the fiscal objective will permit a larger flow of bank credit to the private sector and also greatly reduce the pressures on the balance of payments. The recent action to raise interest rates and introduce a new, high-yield financial instrument will serve toward these same ends by bolstering the growth of private financial savings. The authorities recognize that further steps may be needed during the program period to ensure prompt adjustment of interest rates when dictated by changes in interest rates abroad or in domestic inflation, and to that end they will carefully monitor and review the adequacy of the new certificates and that of the entire interest rate structure.

In the pursuit of a viable balance of payments over the medium term, demand policies have been combined with a policy of transferring more and more foreign exchange transactions to the parallel market so as to ensure the attainment of a realistic exchange rate. If this goal is to be achieved, these transfers must include receipts from traditional exports. The introduction of the exchange certificates is an important step in that direction, but the authorities should act as quickly as possible to remove the restrictions which the certificates entail so as to reduce the size of the official market and ensure adequate incentives for exporters. The authorities should also be prepared to transfer import payments to the parallel market in 1983 over and above the quarterly amounts that have been targeted. The policy of broadening the scope of the parallel market will contribute to the achievement of equilibrium in the official market and thus facilitate an effective unification of the two exchange rates at a realistic level.

By promoting a more efficient allocation of resources, the exchange rate adjustment and accompanying reform of the exchange system, the adoption of a more flexible interest rate policy, and the reform of the state enterprises will all contribute to the achievement of the medium-term program's objectives as regards economic growth and employment. At the same time, specific steps are being taken to facilitate and encourage private investment in such key sectors as agriculture, export-oriented manufacturing, and tourism. The authorities also intend to strengthen the public investment program, but they have made this objective conditional upon the required improvement in the public sector finances. They expect to have the program ready for review by the World Bank in early 1983 and subsequently to submit it to the Caribbean Consultative Group for additional lending support.

Summing up, in the view of the staff the Dominican Republic's medium-term program--and the financial program for 1983--are appropriate to meet the objectives of achieving a sustainable balance of payments position while promoting faster growth of output and employment. Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

I. Extended Arrangement

1. The Government of the Dominican Republic has requested an extended arrangement for a period of three years in an amount equivalent to SDR 371.25 million.

2. The Fund approves the extended arrangement attached to EBS/82/239.

3. The Fund waives the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement.

II. Approval of Exchange Restrictions

1. The Fund takes this decision relating to the Dominican Republic's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article VIII Consultation with the Dominican Republic, in the light of the 1982 Article IV Consultation with the Dominican Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. The Dominican Republic maintains restrictions on the making of payments and transfers for current international transactions, and multiple currency practices, as described in EBS/82/239. The Fund encourages the Dominican Republic to continue the simplification of its multiple currency practices with a view to the early unification of its exchange rate, and approves the restrictions and multiple currency practices until the end of the first year of the extended arrangement, or the next Article VIII consultation, whichever is the earlier.

Fund Relations with the Dominican Republic
(As of November 31, 1982)

Date of membership:	December 28, 1945.		
Status:	Article VIII.		
Quota:	SDR 82.5 million.		
Fund holdings of Dominican pesos:	As of November 31, 1982	Millions of SDRs	Per Cent of Quota
	Total	146.57	177.66
	Under tranche policies	96.27	116.69
	Under compensatory financing facility	39.75	48.18
	Under buffer stock	10.55	12.79
SDR Department:	As of November 31, 1982	Millions of SDRs	Per Cent of Allocation
	Net cumulative allocation	31.59	100.00
	Holdings	0.53	1.67
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$1.50 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).

Last Article IV consultation: The 1981 Article IV consultation discussions were held in April-May 1981 (SM/81/144) and the consultation procedure was concluded at EBM/81/107 (July 22, 1981).

Dominican Republic: Summary of the Financial Program for 1983 1/

I. Major Assumptions

1. Real GDP is expected to grow by 2 per cent. Agricultural production will expand considerably faster than in 1982, but output growth in most other sectors will decelerate.

2. The ratio of money and quasi-money to GDP, estimated at 20 per cent for 1982, is projected to remain constant. The ratio of money to GDP is projected to remain unchanged, at about 8.8 per cent of GDP.

3. Export prices are estimated to fall by 26-1/2 per cent in 1982 and by 3 per cent in 1983, while import prices are estimated to increase by about 1-1/2 per cent in 1982 and by 2-3/4 per cent in 1983. The assumptions for the major export products are as follows:

	1982	1983
Raw sugar		
Value (US$ million)	284	248
Volume (thousand metric tons)	875	910
Unit value (US$ per metric ton)	324	273
(US$ per 100 lbs.)	14.7	12.4
Unprocessed coffee		
Value (US$ million)	85	79
Volume (thousand metric tons)	32	30
Unit value (US$ per metric ton)	2,670	2,645
(US$ per 100 lbs.)	121.1	120.0
Raw cocoa		
Value (US$ million)	49	52
Volume (thousand metric tons)	35	34
Unit value (US$ per metric ton)	1,400	1,543
(US$ per 100 lbs.)	63.5	70.0
Gold		
Value (US$ million)	136	148
Volume (thousand troy ounces)	378	371
Unit value (US$ per troy ounce)	360	400
Other traditional products		
Value (US$ million)	138	188
Other products (nontraditional)		
Value (US$ million)	92	105

1/ Actual and projected data on selected economic and financial indicators for the period 1980-83 are shown in Table 9.

Table 9. Dominican Republic: Selected Economic and Financial Indicators

	1980	1981	Est. 1982	Proj. 1983
(Annual per cent changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	5.7	3.5	1.6	2.0
GDP deflator	13.8	9.7	4.5	9.0
Consumer prices (average)	16.8	7.5	7.5	9.0
External sector (on the basis of U.S. dollars)				
Exports, f.o.b.	10.8	23.5	-34.0	4.6
Imports, f.o.b.	33.6	-4.4	-17.7	-6.3
Export volume	-19.1	5.0	-10.2	7.8
Import volume	21.7	-12.0	-18.8	-8.8
Terms of trade (deterioration -)	24.7	8.3	-27.4	-5.5
Nominal effective exchange rate (depreciation -)	--	0.7	-1.3	...
Real effective exchange rate (depreciation -)	1.1	-1.3	1.0	...
Central Government				
Revenue	29.0	4.0	-26.6	18.5
Expenditure	8.4	0.3	-8.4	1.3
Money and credit 1/				
Domestic credit (net) 2/	20.3	29.1	43.7	19.9
Public sector 2/	(7.8)	(26.2)	(31.9)	(12.4)
Private sector 2/	(11.8)	(-1.9)	(5.8)	(7.5)
Money and quasi-money (M2)	2.1	11.1	11.0	11.4
Velocity (GDP relative to M2)	18.1	2.0	-4.2	-0.2
Interest rate 3/	7.5	8.5	8.5	9.5
(In per cent of GDP)				
Central government savings	2.5	2.0	-1.4	0.8
Overall public sector deficit	-6.0	-5.9	-7.0	-3.9
Domestic financing	(1.5)	(4.5)	(5.8)	(2.2)
Foreign financing	(4.5)	(1.4)	(1.2)	(1.7)
Gross domestic investment	25.7	23.7	20.8	22.1
Gross national savings	15.6	18.3	15.4	19.1
BOP-current account deficit	-10.1	-5.4	-5.4	-3.0
External public debt 4/	19.6	19.7	21.4	24.9
(In per cent of exports of goods and nonfactor services)				
Debt service 5/	18.6	17.2	29.0	30.1
Interest payments 5/	8.6	8.7	14.3	15.2
(In billions of U.S. dollars)				
Overall balance of payments	-117.8	-150.9	-335.0	-20.0
Gross official reserves (months of imports)	2.2	2.3	2.2	2.4
External payments arrears	149.6	316.4	454.0	354.0

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

1/ Excluding nonbank financial intermediaries.
2/ Changes in relation to broad money outstanding at the beginning of period.
3/ Term deposits exceeding 180 days.
4/ Medium- and long term external debt, including use of Fund credit.
5/ On medium- and long-term external public debt, including use of Fund credit.

4. Net official capital inflows are estimated at US$189 million in 1982 and projected at US$249 million in 1983, as detailed below.

	1982	1983
(In millions of U.S. dollars)		
Total	189	249
Gross disbursements	385	511
International institutions	(76)	(166)
Mexico and Venezuela, under San Jose agreement	(78)	(96)
Other governments	(194)	(129)
Private sources	(37)	(120)
Amortization	-196	-262

II. Targets

1. Domestic inflation of 9 per cent is projected, following an estimated increase in prices of 7.5 per cent in 1982.

2. The net international reserves of the Central Bank are projected to decline by US$20 million, compared with an estimated decline of US$350 million in 1982. The current account deficit is projected to decline to the equivalent of 3.0 per cent of GDP, from 5.4 per cent estimated for 1982.

3. Domestic investment level equivalent to 22.1 per cent of GDP.

III. Principal Elements of the Program

1. Fiscal policy

The overall deficit of the nonfinancial public sector is to be reduced to 3.9 per cent of GDP, from an estimated 7 per cent in 1982. This reduction is to originate from an improvement in the savings performance of the consolidated nonfinancial public sector equivalent to 3.7 per cent of GDP. Public investment is to be increased by 0.5 per cent of GDP.

The expected improvement in the operations of the nonfinancial public sector in 1983, amounting to the equivalent of 3.7 per cent of GDP, reflects the following:

	Impact as Per Cent of GDP
Total current account	3.7
Central Government	2.2
Revenue measures	1.2
Import surcharge	(0.4)
Sales tax	(0.3)
Other tax measures	(0.5)
Other revenue	-0.7
Current expenditure	1.7
Rest of public sector	1.5
Revenue	0.1
Current expenditure	1.4

2. Money and credit

a. The expansion of the net domestic credit of the Central Bank will be limited to RD$84 million (the equivalent of 19 per cent of the stock of its liabilities to the private sector at the beginning of the year), with quarterly ceilings as performance criteria.

b. The maximum permissible expansion of net domestic credit to the nonfinancial public sector by the Central Bank and Banco de Reservas taken together is RD$200 million; quarterly ceilings on the use of such net domestic credit have been established as performance criteria.

c. Interest rates on domestic financial instruments will be maintained at levels broadly competitive with foreign rates. The minimum denomination of the newly created financial certificates will be reduced in two steps from a range of RD$100,000 to RD$250,000 to a range of RD$75,000 to RD$150,000. The adequacy of these reductions, and of the entire interest rate structure, will be the subject of review under the periodic consultations with the Fund about the progress being made in the implementation of the program.

d. The reserve deficiency of the Banco de Reservas will be reduced.

3. External sector

a. During the first quarter of 1983, US$40 million worth of import payments will be transferred to the parallel market and additional transfers of US$15 million will be made in each of the subsequent quarters.

b. External payments arrears will be reduced by at least US$100 million. External arrears are defined to include delays in the delivery of foreign exchange by the Central Bank to domestic commercial banks under letters of credit. In the event that the Central Bank negotiates a refinancing of these latter obligations, the external liability acquired by the Central Bank under such a refinancing will be considered a reserve liability if it is of less than five years maturity, and as such it will be subject to the balance of payments test.

c. Disbursements of new foreign loans with maturities of less than ten years to the public sector (excluding the Central Bank) will be limited to US$370 million, with sublimits of US$220 million and US$200 million for maturities of less than three years and less than one year, respectively. These limits, which are performance criteria, were designed to take into account a possible US$120 million loan for the State Sugar Company (CEA), to refinance its short-term external debt, and they will be reduced in accordance with the maturity of the financing obtained by the CEA.

d. As a performance criterion, the authorities will not intensify or introduce restrictions on payments and transfers for current international transactions, will not conclude bilateral payments agreements which are inconsistent with Article VIII of the Articles of Agreement, and will not impose import restrictions for balance of payments reasons.

Dominican Republic: Extended Arrangement

Attached hereto is a letter, with annexed memorandum, dated -------, 1983 from the Technical Secretary of the Presidency, the Secretary of Finance, and the Governor of the Central Bank of the Dominican Republic requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of the Dominican Republic intend to pursue for the period of the extended arrangement;

(b) the policies and measures that the authorities of the Dominican Republic intend to pursue for the first year of this extended arrangement; and

(c) understandings of the Dominican Republic with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of the Dominican Republic will pursue for the second and third years of this extended arrangement.

To support these objectives and policies the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from ----------, 1983, the Dominican Republic will have the right to make purchases from the Fund in an amount equivalent to SDR 371.25 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Until -------- -, 1984, purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 123.75 million, provided that purchases shall not exceed the equivalent of SDR 45 million until April 25, 1983, the equivalent of SDR 74.25 million until July 25, 1983, and the equivalent of SDR 94.50 million until October 25, 1983.

(b) Until ------- --, 1985, purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 247.50 million.

(c) The right of the Dominican Republic to make purchases during the second and third years shall be subject to such phasing as shall be determined.

3. Purchases under this extended arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1 until purchases under this extended arrangement reach the equivalent of SDR 231 million, and then purchases shall be made from borrowed resources, provided that any modification by the Fund of the proportion of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. The Dominican Republic will not make purchases under this extended arrangement:

(a) after March 31, 1983, if the 6 per cent general sales tax referred to in paragraph 6 of the memorandum annexed to the attached letter has not been approved by the Congress and promulgated into law in accordance with the legislative process of the Dominican Republic; or

(b) throughout the first year, during any period in which the data for the end of the preceding quarter indicate that

(i) the ceiling on the combined net credit of the Central Bank and the Banco de Reservas to the public sector referred to in paragraph 6 and Table 1 of the memorandum annexed to the attached letter, or

(ii) the ceiling on the net domestic assets of the Central Bank referred to in paragraph 7 and Table 2 of the memorandum annexed to the attached letter, or

(iii) the schedule of quarterly transfers of imports to the parallel foreign exchange market referred to in paragraph 8 of the memorandum annexed to the attached letter, or

(iv) the target for the reduction of external payments arrears set forth in the schedule referred to in paragraph 9 and Table 3 of the memorandum annexed to the attached letter, or

(v) the target for the net international reserves of the Central Bank referred to in paragraph 9 and Table 4 of the memorandum annexed to the attached letter, or

(vi) the ceiling on the foreign borrowing by the public sector referred to in paragraph 10 and Table 5 of the memorandum annexed to the attached letter

is not observed; or

(c) between July 1, 1983 and the end of the first year of the arrangement, if the review referred to in paragraph 3 of the attached letter has not been completed; or

(d) throughout the second and third years, if before the beginning of the second year and the beginning of the third year of the extended arrangement suitable performance clauses for these periods have not been established in consultation with the Fund as contemplated in paragraph 3 of the attached letter, or if such clauses, having been established, are not being observed; or

(e) throughout the duration of the extended arrangement, if the Dominican Republic:

(i) imposes new or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, except to add categories of transactions to the parallel market, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When the Dominican Republic is prevented from purchasing under this extended arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and the Dominican Republic and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. The Dominican Republic's right to engage in the transactions covered by this extended arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of the Dominican Republic. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and the Dominican Republic and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this extended arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of the Dominican Republic, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this extended arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. The Dominican Republic will consult the Fund on the timing of purchases involving borrowed resources.

8. The Dominican Republic shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

9. (a) The Dominican Republic shall repurchase the amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund including those relating to repurchase as the Dominican Republic's balance of payments and reserve position improves.

(b) Any reductions in the Dominican Republic's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this extended arrangement will be normally either the sixth day or the twenty-second day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the extended arrangement the Dominican Republic shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to the Dominican Republic or of representatives of the Dominican Republic to the Fund. The Dominican Republic shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of the Dominican Republic in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 3 of the attached letter the Dominican Republic will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria under paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the extended arrangement and while the Dominican Republic has outstanding purchases under this extended arrangement, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning the Dominican Republic's balance of payments policies.

Santo Domingo, Dominican Republic
January , 1983

Mr. Jacques de Larosiere
Managing Director
700 19th Street, N.W.
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. In the last several years the Dominican Republic economy has been beset by financial difficulties stemming from a combination of external and domestic factors, with adverse effects on domestic investment and economic growth. In the course of 1982 these financial imbalances have become critical. The Central Bank's foreign reserves have been virtually depleted and external payments arrears have reached an unsustainable level. The Government's savings have turned negative and the financial performance of the major state enterprises has deteriorated sharply. As a result, economic growth has come to a standstill.

2. The newly elected, democratic Government that took office on August 16, 1982, committed itself to an improvement of the Dominican Republic's growth performance through sound financial management and the implementation of an adequate public investment program. A series of measures designed to deal with the present financial crisis has been put into effect, and additional measures will be required in the period ahead to redress the prevailing imbalances and lay the basis for the resumption of sustained economic growth. Because the adjustment process will take at least three years, the Government has cast its policies into a medium-term program which is described in the attached Memorandum on the Economic Policies of the Dominican Republic. The Government of the Dominican Republic wishes to count on the support of the International Monetary Fund during this period of adjustment and structural changes. Accordingly, it hereby request a three-year extended arrangement from the Fund in an amount of SDR 371.25 million.

3. During the period of the requested extended arrangement, the authorities of the Dominican Republic will periodically consult with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in the implementation of the program described in the attached memorandum and any policy adaptations judged to be appropriate for the achievement of its objectives. With respect to the program for the first year the Government will review with the Fund, before June 30, 1983, the progress made in implementing the program. Also, before January 1, 1984 and January 1, 1985, the authorities

of the Dominican Republic will consult with the Fund in order to reach understandings on the policies and measures for the second and third year, respectively, of the extended arrangement.

Yours sincerely,

Ramon Alburquerque
Technical Secretary
of the Presidency

Jose Rafael Abinader
Secretary of Finance

Bernardo Vega
Governor of the
Central Bank of the
Dominican Republic

Memorandum on the Economic Policies of the Dominican Republic

1. In recent years the Dominican Republic has experienced growing balance of payments deficits and accumulation of external payments arrears, a marked weakening of the public sector finances, and a slowdown in the pace of economic activity. The pressures on the external position and the domestic financial imbalances have intensified in 1982 under the impact of declines in the prices of most of the Dominican Republic's export products and a significant deterioration in the fiscal accounts. Moreover, domestic savings and investment have declined sharply, and little or no increase in output occurred in 1982.

2. The Government intends to attack these problems in the framework of a medium-term economic program aimed at achieving high and stable rates of growth and a substantial increase in employment opportunities. The Government, moreover, is committed under its program of Democracia Economica y Concentracion Nacional to policies designed to meet basic human needs and to enhance opportunities for progress to the most disadvantaged segments of society. The Government believes that the pursuit of these ultimate objectives can best be served in the long run through policies geared to a more efficient allocation of resources and an improvement of the investment performance of the economy.

3. In line with these objectives, the Government's economic program for 1983-85 aims at a significant increase in the level of investment, from 21 per cent of GDP in 1982 to almost 25 per cent by 1985. This increase is to be achieved through the public sector investment program, which will be presented for possible additional support to the World Bank sponsored Caribbean Group, and by encouraging private investment--particularly in the agricultural, export-oriented manufacturing, and tourism sectors. In this context, steps are being taken to promote a substantial expansion of export manufacturing acitivites in the so-called free-trade zones. The public investment effort will be concentrated on the provision of infrastructure, particularly in the construction, energy, and agricultural sectors.

4. In order to support the increase in investment, the level of gross national savings will be raised through the pursuit of appropriate fiscal and monetary policies and a more efficient allocation of resources. These policies will result in a reduction of the deficit of the current account of the balance of payments from 5-1/2 per cent of GDP in 1982 to 3 per cent of GDP in 1983 and to 2-1/2 per cent in 1985. The Government of the Dominican Republic is counting on the continued support of international development agencies and friendly foreign governments to increase its long-term borrowing for development projects, but recourse to short-term foreign financing will be reduced sharply.

5. Fiscal policy has been assigned a major role in controlling the expansion of aggregate demand. Large wage increases for public sector employees granted in 1979 and rapid employment growth contributed to

the weakening of public sector savings and a substantial increase in the overall public sector deficit. Moreover, tax revenue in relation to GDP has dropped sharply, a consequence of a reduction in export and import taxes, a rise in tax exemptions and an erosion of the tax base because of excessive reliance on specific taxes. There has also been a marked deterioration in the financial performance of the major state enterprises, due to production and management inefficiencies, adverse world market conditions, and inadequate price adjustments. To strengthen the balance of payments and to prevent an acceleration of inflation, the public sector deficit must be brought back under control. To achieve this without adverse effects on the Dominican Republic's development effort calls for a major increase in public sector savings, which virtually disappeared in 1982. Accordingly, the Government intends to limit the overall public sector deficit to 4 per cent of GDP in 1983 and to 3 per cent of GDP by 1985, while public sector savings will be raised to 1/2 of 1 per cent of GDP in 1983 and to 2-1/2 per cent by 1985.

6. This improvement in public sector savings will require a major fiscal reform. In order to quickly raise additional government revenues, a package of tax measures has been implemented, including a temporary ad valorem surcharge of 10 per cent on imports, increases in the progressivity of the personal income tax, a tax on capital gains from the sale of real estate, abolition of provisional import duty payments, etc. The Government has also submitted to Congress a proposal for a 6 per cent sales tax which is expected to be signed into law before April 1, 1983. Over the longer term, the economy's reliance on foreign trade taxes is to be reduced and the general sales tax will increase in relative importance. Furthermore, tax exemptions--primarily from income taxes and import duties--will be reduced, and the entire system of exemptions and incentives is being examined with a view toward its rationalization. The Government has also begun a strong effort to improve tax administration, particularly in the area of income taxes and customs duties. Another major part of the reform is the overhaul of the expenditure structure. Investment spending will be limited strictly to the available resources, and current spending will be kept under tight control and will be smaller in 1983 than in 1982. Wages of government employees above a certain level have been reduced according to a progressive scale, and working hours have been extended. Nonwage outlays will be reduced to the minimum consistent with operational efficiency in the public administration. To monitor the public sector deficit, the Government is improving the expenditure control mechanisms, including control over the state enterprises and the decentralized agencies. Raising the operational efficiency of these enterprises is another important element of the fiscal reform. Negotiations are under way with the World Bank on a plan to modernize the mills of the State Sugar Company (CEA) and improve management. Efficiency in electricity generation and transmission will be increased through overhaul of existing facilities and new investments; tariffs have been adjusted and indexed to petroleum prices, and further adjustments will be made when needed to ensure an adequate operating surplus. It is the position of the Government that the operations of the Price Stabilization Institute

(INESPRE) should be limited to those prescribed in its charter and that support prices should permit adequate production incentives. Accordingly, measures are being taken to reduce operating costs and eliminate the deficit. More generally, the Government has committed itself to maintaining public sector tariffs and prices in line with costs. The pursuit of this firm fiscal policy, entailing a sizable reduction in the public sector borrowing requirement during the three-year period, is intended to maximize the amount of financial resources available to the rest of the economy. To ensure the achievement of this objective in 1983, quarterly ceilings have been established on the combined net credit of the Central Bank and Banco de Reservas to the public sector. These ceilings are shown in the annexed Table 1.

7. To promote the flow of private financial savings and ensure an efficient allocation of financial resources, the Government has undertaken to strengthen the financial system. In the past, there has been widespread disintermediation due to, inter alia, the maintenance of interest rates on financial instruments below the levels prevailing in international markets or negative in real terms. To reverse this trend, a more realistic interest rate policy is being adopted. Interest rates on a range of financial instruments were increased by amounts of 1 to 2 percentage points, and a new, high-yield financial certificate was created. The yields on these new instruments are linked to those on comparable instruments in the United States. Also, commercial banks have been allowed to accept deposits denominated in U.S. dollars at a rate linked to the six-month deposit rate in the United States, and it has been proposed to Congress that savings and loan associations and mortgage banks be allowed to accept dollar deposits from Dominican residents abroad at freely determined interest rates. During the program period, the authorities will regularly review the effects of these measures and take further steps needed to ensure prompt adjustment of interest rates when dictated by changes in interest rates abroad or in domestic inflation. Moreover, interest rates paid by the Central Bank on the reserve deposits of the commercial banks were increased and the legal reserve deficiencies of the Banco de Reservas will be gradually eliminated. To ensure the consistency of these monetary policies with the required adjustment of the balance of payments, quarterly ceilings have been established on the net domestic assets of the Central Bank for the period through December 31, 1983. These ceilings are shown in the annexed Table 2.

8. Adjustment of the effective exchange rate and reform of the exchange system are key elements in the three-year program designed to redress the balance of payments while promoting economic efficiency and growth. Because of present legal impediments, the official exchange rate cannot be changed, but the monetary authorities will continue the policy of transferring payments from the official to the parallel market in order to achieve equilibrium in the official market by the end of the program period, with a view to reaching unification of the exchange markets. To promote further institutionalization of the parallel

market, commercial banks were given permission to operate in the parallel exchange market starting in October 1982. Also, for the first time, certain traditional exports were given an exchange incentive through a system of exchange certificates so that at least the import requirements can be covered at the official exchange rate, in order to offset cost distortions and enhance the profitability of production in these sectors. Exporters of the four principal, traditional agricultural exports (sugar, coffee, cacao, and tobacco) will be receiving freely negotiable exchange certificates equivalent to 20 per cent of sugar export receipts and 10 per cent of the other traditional exports. The effectiveness and scope of the exchange certificates will be subject to review under the periodic consultations with the Fund about the progress being made in the implementation of the program. At the same time, other imports including raw materials and supplies for an equivalent value of the exchange certificates are being transferred to the parallel market. During the first quarter of 1983 US$40 million worth of import payments will be transferred to the parallel market, and US$15 million of additional import payments in each of the remaining three quarters, to reduce the demand pressures on the official exchange market. After 1983 other payments will be transferred to the parallel market in coordination with the issue of exchange certificates, while maintaining the policy objective of expanding the parallel market. As was stated earlier in this memorandum, a temporary ad valorem surcharge of 10 per cent on imports (other than petroleum and certain other essential items) was put into effect. Also, in order to provide quick balance of payments relief, the importation of certain products was prohibited for a period of one year effective August 16, 1982. It is the intention of the Government not to rely on additional import restrictions in the future, and to lift present prohibitions as soon as feasible.

9. The financial support from the International Monetary Fund would be directed primarily to restoring the net international reserve position of the Central Bank of the Dominican Republic. The gross foreign reserves of the Central Bank can be expected to be at a level equivalent to 2.5 months of imports by the end of 1983 and show further improvement by the end of 1985. External payments arrears will be reduced by US$100 million in 1983 in accordance with the schedule shown in the annexed Table 3, and will be eliminated within the program period. Targets for the net official reserve position for the period through December 31, 1983 are set out in the annexed Table 4.

10. The external public debt of the Dominican Republic has risen by considerable amounts in the last several years. In order to prevent the servicing of this debt from exercising undue pressure on the balance of payments, the Government plans to constrain the contracting of external public debt with maturities of less than ten years. The ceilings that will apply to disbursemnts (including refinancing) of external public debt with maturities of less than ten years for the period through Decemeber 31, 1983 are shown in the annexed Table 5. In this context, the Government of the Dominican Republic would like to count

on the assistance of the International Monetary Fund with the international financial community in its efforts to renegotiate the country's short-term external debt.

11. The Government of the Dominican Republic does not intend to introduce any new multiple currency practices, impose or intensify restrictions on payments and transfers for current international transactions during the period of the extended arrangement.

Table 1. Dominican Republic: Combined Net Credit of the Central Bank and the Banco de Reservas to the Public Sector 1/

	Level of Net Credit at the End of the Month
1982	
August (actual)	1,235.1
1983	
March	1,505.2
June	1,535.2
September	1,585.2
December	1,665.7

1/ Defined as the sum of (a) all forms of credit, net of deposits, from the Central Bank and the Reserve Bank to the Central Government, the decentralized and autonomous agencies (to the exclusion of the Housing Bank), the CORDE enterprises for which the Government is a majority shareholder, Rosario Dominicana, and the oil refinery; (b) deposits under the San Jose agreement and of the Venezuelan Investment Fund transferred to the Government and converted into long-term loans; (c) Central Bank loans for housing through Central Bank deposits with the National Housing Bank and the mortgage banks; and (d) Central Bank compensation to the financial intermediaries for the effects of interest rate adjustments.

Table 2. Dominican Republic: Net Domestic Assets of the Central Bank 1/

(In millions of Dominican pesos)

	Level at the End of the Month
1982	
August (actual)	923.5
1983	
March	1,103.2
June	1,114.2
September	1,135.2
December	1,196.7

1/ Defined as the difference between the currency issue and the net international reserves of the Central Bank.

Table 3. Dominican Republic: Schedule of Net Reduction in External Payments Arrears 1/

(In millions of U.S. dollars)

	Level of External Payments Arrears
March 31, 1983	438.9
June 30, 1983	413.9
September 30, 1983	393.9
December 31, 1983	353.4

1/ For purposes of the use of Fund resources under the extended Fund facility, external payments arrears consist of payments arrears and delays on drafts and transfers, collections, letters of credit in the portfolios of commercial banks for which the Central Bank has not made foreign exchange available for their payment and arrears on other concepts of external payments. In the event that the Central Bank negotiates with commercial banks a refinancing of the obligations in connection with letters of credit, if the external liability acquired by the Central Bank under such refinancing is of less than five years, that liability will be considered a reserve liability of the Central Bank, and as such it is subject to the balance of payments test.

Table 4. Dominican Republic: Net International Reserves of the Central Bank 1/

(In millions of U.S. dollars)

	Level at the End of the Month
1982	
August (actual)	-562.3
1983	
March	-698.2
June	-709.2
September	-725.2
December	-692.7

1/ Defined as the difference between the gross international reserves and the international reserve liabilities of the Central Bank. The international reserve liabilities are defined as the Central Bank use of credit from the International Monetary Fund and all other Central Bank foreign liabilities of less than three years, including arrears and delays in the delivery of foreign exchange to local banks for the payment of overdue letters of credit. However, for the purpose of the definition of net international reserves, if the Central Bank negotiates a refinancing of the letters of credit due to commercial banks, and this refinancing results in a Central Bank liability with maturity of less than five years, this liability will continue to be considered as part of the international reserve liabilities of the Central Bank. Excluded from the definition of reserve liabilities are: (a) deposits of Venezuela and Mexico under the San Jose Agreement; (b) Venezuelan Investment Fund deposits eligible for conversion into long-term loans to the Government; and (c) a loan from Venezuela under the Venezuelan Oil Facility that is being amortized.

Table 5. Dominican Republic: Cumulative Ceilings on Foreign Borrowing by the Public Sector, Excluding the Central Bank During 1983

(In millions of U.S. dollars)

Maturity Ranges	Ceilings on Disbursements 1/
a. Less than one year	200 2/
b. Less than three years	220 2/
c. Less than ten years	370 2/

1/ These disbursement ceilings include any advances to La Rosario Dominicana against its gold and silver sales.

2/ These cumulative ceilings include disbursements of external loans of the Consejo Estatal del Azucar (CEA). To the extent that CEA obtains financing of more than one year and less than three years, ceiling a will be reduced accordingly; to the extent that CEA obtains financing of more than three years and less than ten years, ceilings a and b will be reduced accordingly; and to the extent that CEA obtains financing of more than ten years all three ceilings will be adjusted accordingly.