FOR AGENDA

SM/87/73
Supplement 1

CONTAINS CONFIDENTIAL INFORMATION

August 19, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Dominican Republic - Staff Report for the 1987 Article IV Consultation

The attached supplement to the staff report for the 1987 Article IV consultation with the Dominican Republic has been prepared on the basis of additional information.

Mr. Ewart Williams (ext. 8624) is available to answer technical or factual questions relating to this paper prior to the Board discussion, which has been scheduled for Monday, August 24, 1987.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

Dominican Republic

Staff Report for the 1987 Article IV Consultation
Supplementary Information

Prepared by the Staff Representatives for the 1987 Article IV Consultation with the Dominican Republic

Approved by S. T. Beza and W. A. Beveridge

August 18, 1987

I. Introduction

At the time of the consultation discussions in January 1987, the Government was still in the process of formulating its economic program. A draft program was finalized in early April and, at the request of the authorities, staff missions visited Santo Domingo in the period May 1-21 and June 9-12 to discuss the proposed program. 1/ Meetings were held with the Secretary of Finance, the Technical Secretary to the Presidency, the Governor of the Central Bank, and other senior officials. Staff representatives in one or both of the missions were Messrs. Williams (Head), Incer, Cardemil (all WHD), de Schaetzen (ETR) and Ms. Kriegsmann (WHD-Secretary). 2/ This supplement outlines the economic program recently adopted by the Government and briefly discusses economic developments in the first half of 1987.

II. The Economic Program for 1987-88

1. Targets and objectives

The principal objectives of the Government's economic program for 1987-88 are the same as those outlined in the Staff Report (SM/87/73): stabilization of the exchange rate, strengthening of the balance of payments, and recovery from the economic stagnation of 1985-86. The program is based on a projected growth in real GDP of about 3 percent in 1987 and 5 percent in 1988. The depreciation of the peso in the first half of the year and corrective price adjustments are expected to raise

---

1/ A quantified economic program for 1987 supported by a Fund stand-by or extended arrangement or an enhanced surveillance agreement as well as a rescheduling agreement with the Paris Club are conditions for the continuation of the commercial bank MYRA.

2/ A technical assistance mission comprising Messrs. Quirk (ETR) and Williams (WHD) also visited the Dominican Republic July 7-10 to discuss with the authorities the operation of the foreign exchange market.

the 12-month rate of inflation from 6 percent at the end of 1986 to 20 percent by the end of 1987; the rate of price increase is, however, projected to decline to 10 percent by end-1988 (Table 1). The authorities have programmed no change in net international reserves in 1987 as a whole (instead of an increase of US$84 million originally envisaged), implying a year-end level of gross official reserves equivalent to about two months' imports; the target is for an increase in net international reserves of US$88 million in 1988.

2. Policies for 1987

a. Financial policies

The authorities' program aims at reducing the overall cash deficit of the nonfinancial public sector (including central bank losses) from 4.5 percent of GDP in 1986 to around 2 percent of GDP in 1987 (Table 2). Revised official projections put net external financing (including a possible Paris Club rescheduling) of the deficit at about 1.3 percent of GDP (instead of 2 percent of GDP projected originally), leaving a balance of approximately 0.8 percent of GDP to be covered by credit from the domestic banking system. The authorities feel that this level of bank credit expansion to the public sector is consistent with the new balance of payments target without crowding out of private investment.

The reduction of the fiscal deficit in 1987 was expected to be achieved through a cutback in total central government expenditure from 16 percent of GDP to 14 percent of GDP, reflecting a sharp cut in current spending, and a projected increase in central government revenue from 14 percent of GDP to 15 percent of GDP. The expenditure plan has been based on no increase in wages in 1987 and payment of the end-of-year bonus on the same terms as in 1986. The revenue performance has been predicated on the collection of outstanding arrears, certain tax measures which have already been implemented 1/, and the introduction of a comprehensive tax package which has been projected by the authorities to yield close to 1.3 percent of GDP in 1987 and about 2.5 percent of GDP in 1988.

The tax package includes:

(i) a reform of income tax legislation to provide for the inclusion in personal taxable income, of interest, dividends paid by financial intermediaries, and capital gains, for limitations on personal and business deductions, and for a reduction in deductions for the reinvestment of profits;

1/ These measures were a substantial increase in automobile license fees with effect from January 1987, and an increase in mid-May from 2 percent to 5 percent in the tax on the purchase of foreign exchange for certain imports.

Table 1. Dominican Republic: Selected Economic and Financial Indicators, 1984-88

	1984	1985	Prel. 1986	Orig.1/ Proj. 1987	Prog. 1987	Proj. 1988
(Annual percentage changes, unless otherwise specified)						
National income and prices						
GDP at constant prices	0.4	-2.2	1.0	2.4	2.4	5.0
GDP at current market prices	24.8	35.6	11.0	17.7	17.7	20.8
GDP deflator	24.4	38.6	9.9	15.0	15.0	15.0
Consumer prices (average)	24.6	37.5	9.7	15.0	15.0	15.0
Consumer price (end of year)	38.1	28.3	6.5	20.0	20.0	10.0
External sector (on the basis of U.S. dollars)						
Exports, f.o.b.	10.6	-14.9	-2.3	1.3	5.3	2.8
Imports, f.o.b.	-2.0	2.3	-1.5	8.1	8.2	2.7
Export volume	5.3	-11.4	-6.7	-1.5	-2.3	2.2
Import volume	-6.6	-1.5	12.4	-6.1	-1.2	1.0
Terms of trade (deterioration -)	--	-7.5	19.5	-2.3	0.8	-0.2
Effective exchange rate 2/						
Nominal	-43.3	-1.3	-17.1	...	...	...
Real	-24.6	12.6	-15.0	...	...	...
Central Government						
Revenue	30.2	85.6	2.3	0.4	26.8	16.5
Expenditure	12.5	85.0	6.6	-10.9	1.0	14.8
Money and credit 3/						
Net domestic assets 4/	22.4	-3.8	45.0	3.9	15.0	14.3
Of which:						
Public sector credit (net) 4/	18.7	-15.9	20.3	--	3.3	...
Private sector credit 4/	7.8	13.6	31.5	6.5	8.2	14.3
Liabilities of the private sector	22.7	22.0	55.1	11.4	15.0	20.6
Of which:						
Money and quasi-money (M2)	22.9	19.0	50.7	11.4	16.1	18.5
Velocity (GDP relative to year average M2)	6.3	7.6	5.6	6.2	6.2	6.2
(In percent of GDP)						
Public sector deficit including the operating losses of the Central Bank						
Commitment basis	-6.5	-2.7	-5.0	-2.4	-0.7	-1.4
Cash basis	-6.5	-4.6	-4.5	-3.8	-2.1	-1.4
Gross domestic investment	20.6	19.8	16.4	16.4	18.7	16.8
Gross national savings	15.7	14.7	13.0	14.0	16.5	15.4
BOP-current account deficit	-4.9	-5.1	-3.4	-2.4	-2.2	-1.4
External public debt 5/	63.6	77.8	69.4	61.4	61.4	61.2
(In percent of exports of goods and services)						
Debt service 6/						
Before rescheduling	47.1	52.3	47.9	39.0	43.8	25.2
After rescheduling	47.1	30.9	36.7	23.0	25.9	24.0
(In million of U.S. dollars)						
Changes in net foreign assets (increase -)	-108.4	-198.6	-121.0	-84.1	--	-88.0
Change in arrears (decrease -) 7/	246.9	-347.0	93.3	-175.9	-169.0	...
Gross official reserves (weeks of imports)	11.1	14.4	15.9	11.7	10.0	11.5

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

1/ As in SM/87/73.
2/ Based on a composite exchange rate which reflects non-oil transactions as used in the Information Notice System (end of the year rate).
3/ Banking system.
4/ Changes in relation to the liabilities of the private sector outstanding at the beginning of the period.
5/ Debt of all maturities (including use of Fund credit, but excluding other reserve liabilities of the Central Bank) in relation to GDP in U.S. dollars. The implicit exchange rates applied to convert GDP to U.S. dollars are RD$1.16 in 1982, RD$1.25 in 1983, RD$2 in 1984, RD$3.1 in 1985, RD$3.0 in 1986 and RD$3.4 in 1987 and 3.9 in 1988.
6/ Repayments of medium- and long-term loans and interest payments on debt of all maturities. Includes net repayments of public sector short-term debt.
7/ Outside the Central Bank.

Table 2. Dominican Republic: Public Sector Operations, 1984-88

	1984	1985	1986	Orig. Proj. 1/ 1987	Prog. 1987	Proj. 1988
	(In millions of Dominican pesos)					
Total revenue	1,292.9	2,351.6	2,370.9	2,364.5	2,984.2	3,419.8
Central Government	1,204.4	2,235.5	2,286.2	2,296.1 2/	2,899.4	3,262.4
Current	1,186.2	2,197.2	2,274.8	2,281.3	2,889.4	3,250.4
Of which: new measures				...	253.0	...
Capital	18.2	38.3	11.4	8.8	10.0	12.0
Public enterprises 3/	88.5	116.1	84.7	68.4	84.8	157.4
Operating surplus	76.0	56.6	27.7	--	16.4	89.0
Capital revenue	12.5	59.5	57.0	68.4	68.4	68.4
Total expenditure	1,446.7	2,755.1	2,906.0	2,807.8	3,060.6	3,718.6
Central government	1,281.6	2,370.4	2,526.4	2,251.8	2,553.1	3,040.6
Current	1,007.7	1,913.9	1,896.9	1,591.8	1,576.1	1,641.4
Capital	273.9	456.5	629.5	660.0	977.0	1,399.2
Public enterprises 3/	165.1	384.7	379.6	556.0	507.5	678.0
Operating losses	...	--	--	26.1	...	...
Interest payments	36.5	55.6	143.1	180.5	155.2	178.0
Capital expenditure	128.6	329.1	236.5	349.4	352.3	500.0
Deficit of the consolidated public sector	-153.8	-403.5	-535.1	-443.3	-76.4	-298.8
Residual 4/	-260.5	79.9	100.5	91.8	91.8	91.8
Central bank operating losses	-282.7	-69.7	-365.3	-110.3	-146.7	-112.0
Overall deficit commitment basis)	-697.0	-393.3	-799.9	-461.8	-131.3	-319.0
Arrears 5/						
Domestic	...	...	69.6	100.0	100.0	--
Foreign interest payments	...	269.4	-142.8	153.8	168.7	--
Overall deficit (cash basis)	-697.0	-662.7	-726.7	-715.6	-400.0	-319.0
Financing	697.0	662.7	726.7	715.6	400.0	319.0
Foreign	331.9	1,066.6 6/	172.2	286.0	250.0 7/	319.0
Domestic	365.1	-403.9	554.5	...	150.0	--
Banking system 8/	400.4	-378.7	561.7	...	150.0	--
Other	-35.3	-25.2	-7.2	...	--	--
Financing gap	--	--	--	429.6	--	--
	(In percent of GDP)					
Memorandum items						
Overall deficit of the public sector (cash basis)	-6.5	-4.6	-4.5	-3.8	-2.1	-1.4
Of which: Central Bank	-2.6	-0.5	-2.3	-0.6	-0.8	-0.5
Commitment basis	-6.5	-2.7	-5.0	-2.4	-0.7	-1.4

Sources: Data provided by the Dominican authorities; and Fund staff estimates.

1/ As in SM/87/73.
2/ Excluding measures amounting to RD$319 million identified by the staff.
3/ Refers to CDE, INESPRE, CEA, and CORDE.
4/ Includes the rest of the General Government, public enterprises other than those referred to in footnote 3, CORDE's affililates, the oil refinery, and Rosario Mining Company.
5/ Minus sign represents increase.
6/ Includes a loan for US$50 millions in 1984 and grants for US$85 millions in 1985.
7/ Includes possible rescheduling with Paris Club creditors for US$ 168.8 millions.
8/ Includes deposits and withdrawals of counterpart deposits in the Central Bank of Plan Reagan funds. It excludes transfers from these accounts to FIDE equity accounts in the Central Bank.

(ii) a new ad-valorem tax of 10 percent on the sales of oil derivatives;

(iii) a tax of 3 percent on net worth of individuals and corporations as of end-1987 and of 5 percent on the annual increase in net worth after 1987;

(iv) a 6 percent tax on gross interest received by financial intermediaries; and

(v) a tax amnesty for partial payment of tax liabilities now subject to litigation, and increases in fines for failure to file returns or delays in payment of tax liabilities.

The program assumes the tax package will be in place as from mid-August. However, the package is now expected to be presented to Congress in the second half of August and it is not certain whether it will be approved in its entirety or when the measures would actually take effect. Also, there are questions as to the likely yield of the measures being proposed, particularly because enforcement of the new income tax provisions will require improvements in tax administration that may be feasible only over time.

Consistent with the new balance of payments target of no change in net international reserves, net domestic assets of the banking system are programmed to increase by about 15 percent in 1987, in relation to the liabilities to the private sector (compared with 45 percent in 1986); after allowance for the programmed credit expansion to the public sector mentioned above, there is room for an increase in bank credit to the private sector of 8 percent (Table 3).

To facilitate achievement of the monetary targets, at the end of May the authorities raised effective marginal reserve requirements and began to offer government bonds for sale at attractive interest rates. In addition, reserve requirements on the state-owned Reserve Bank were brought more in line with those of the private commercial banks, and the bank's freedom to extend credit to public enterprises was curtailed. The tightening of monetary policy as well as the sharp decline in private capital inflows have forced up interest rates on certificates of deposit by 2 percentage points (to 18 percent) for commercial banks (notwithstanding nominal ceilings of 16 percent) and 22 percent for institutions in the informal financial sector.

b. External policies

The program envisages a reduction in the external current account deficit from 3.4 percent of GDP in 1986 to about 2.2 percent of GDP in 1987 (Table 4), based on a compression of non-oil imports and an expansion in tourism earnings. The capital account is expected to worsen in

Table 3. Dominican Republic: Summary Accounts of the Consolidated Banking System

(In millions of Dominican pesos)

	1984	1985	1986	First Quarter 1986	First Quarter 1987	Prog. 1987	Proj. 1988
Stocks at the end of period							
Net foreign assets	-363	-485	-190	-718	-483	-210	102
Net domestic assets	2,752	3,390	4,709	3,850	5,207	5,407	6,170
Net credit to public sector	2,157	1,664	2,385	2,145	2,512	2,532	2,532
Nonfinancial	1,780	1,218	1,574	1,607	1,641	1,574	1,574
Central Bank losses	377	446	812	538	872	958	958
Credit to the private sector	1,413	1,739	2,657	1,761	2,694	3,026	3,808
Other	-441	-13	-333	-56	1	-151	-170
Liabilities to the private sector	2,389	2,914	4,519	3,132	4,724	5,197	6,272
Money	1,141	1,296	1,837	1,345	1,920	2,133	2,572
Quasi-money 1/	1,066	1,364	2,301	1,513	2,388	2,531	3,056
Capital and surplus	182	254	381	274	416	533	644
Period flows							
Net foreign assets 2/		615	295	-269	-398	--	334
Net domestic assets		-90	1,310	487	603	678	741
Net credit to public sector		-380	592	448	127	147	--
Nonfinancial		-449	227	357	67	...	...
Central Bank losses		70	365	91	60	...	...
Credit to the private sector		326	918	21	36	369	741
Other		-36	-200	18	440	162	--
Liabilities to the private sector		525	1,605	218	205	678	1,075
Money		155	541	50	83	297	439
Quasi-money 1/		299	937	149	87	230	525
Capital and surplus		71	127	19	35	151	111
Changes as a percent of the liabilities to the private sector at the beginning of the period							
Net foreign assets		25.7	10.1	-9.2	-8.8	--	6.4
Net domestic assets		-3.8	45.0	16.7	13.3	15.0	14.3
Credit to the public sector (net)		-15.9	20.3	15.4	2.8	3.3	--
Credit to the private sector		13.6	31.5	0.7	0.8	8.2	14.3
Liabilities to the private sector		22.0	55.1	7.5	4.5	15.0	20.6

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

1/ Includes time and saving and other deposits.
2/ Dollar flows converted at the average exchange rate of the period.

Table 4. Dominican Republic: Summary Balance of Payments

(In millions of U.S. dollars)

	1984	1985	Prel. 1986	Orig.Prog.1/ 1987	Prog. 1987	Proj. 1988
Current account balance	-259.7	-237.7	-189.0	-152.0	-125.0	-94.0
Trade balance	-389.0	-547.4	-544.3	-629.0	-610.0	-626.0
Exports	868.1	738.5	721.9	731.0	760.0	781.0
Imports	-1,257.1	-1,285.9	-1,266.2	-1,360.0	-1,370.0	-1,407.0
Services (net)	-135.7	-46.6	84.3	165.0	172.8	233.0
Receipts	507.3	605.9	703.0	784.0	784.0	868.0
Of which: tourism	370.6	451.0	506.4	587.0	587.4	676.0
Payments	-643.0	-652.5	-618.7	-619.0	-611.2	-635.0
Of which: interest	-274.7	-293.4	-267.4	-238.0	-215.3	-240.0
Transfers (net)	265.0	356.3	271.0	312.0	312.0	299.0
Private	205.0	242.0	242.0	242.0	242.0	259.0
Public	60.0	114.3	29.0	70.0	70.0	40.0
Capital account	128.6	185.7	66.8	-44.0	-120.7	23.0
Public sector capital	18.8	-107.0	-180.8	-134.0	-260.7	-21.0
Medium-and long-term loans	69.1	-104.6	-133.0	-119.0	-195.9	-21.0
Short-term loans	-50.3	-2.4	-47.8	-15.0	-64.8	--
Private sector capital	109.8	292.7	247.6	90.0	140.0	44.0
Direct investment	68.5	36.6	40.0	40.0	40.0	44.0
Short term (including errors and omissions)	41.3	256.1	207.6	50.0	100.0	--
Other (SDR allocations, and counterpart items)	-7.4	-32.0	-30.0	-7.0	-7.0	--
Overall balance	-138.5	-84.0	-152.2	-196.0	-252.9	-71.0
Extraordinary finance	246.9	282.6	254.0	158.0	253.0	159.0
Rescheduled debt	--	629.6	160.7	334.0	422.0 2/	159.0 2/
Arrears (outside Central Bank)	246.9	-347.0	93.3	-176.0	-169.0	--
Net foreign assets (increase -)	-108.4	-198.6	-101.8	-84.0	--	-88.0
Central Bank	-92.2	-87.9	-94.5	-84.0	--	-88.0
Gross reserves	-63.7	-87.4	-28.1	80.0	127.1	-40.0
Use of Fund credit	-25.0	75.8	7.3	55.0	-54.5	-48.0
Arrears	34.3	-46.3	-25.8	-40.0	-40.4	--
Other liabilities	-37.8	-30.0	-47.9	-69.0	-32.2	--
Commercial banks (net)	-16.2	-110.7	-7.3	--	--	--
Financing gap	--	--	--	-122.0	--	--
Memorandum item						
Current account (as percent of GDP)	-4.9	-5.1	-3.4	-2.4	-2.2	-1.4

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

1/ As in SM/87/73.
2/ Includes possible Paris Club rescheduling on the same terms as the 1985 agreement.

1987, reflecting an increase in amortization payments and a reduction in net private capital inflows related to the uncertainties that have existed in the exchange markets.

The authorities' balance of payments projection for 1987 assumes debt relief of about US$420 million including US$140 million under the commercial bank MYRA, US$96 million under the oil facility with Venezuela, and US$190 million from Paris Club creditors. As noted, after allowance for the reduction in arrears, no change in net international reserves is envisaged in 1987.

3. Policies for 1988

The program aims at a further reduction in the external current account deficit in 1988 (to 1.4 percent of GDP) through a reduction in the overall fiscal deficit to a level (1.4 percent of GDP) that is to be financed entirely from external concessional loans, including expected debt relief from official creditors. The tax package to be submitted to Congress is expected to make an important contribution to the reduction in the fiscal deficit in 1988. In addition, the authorities are in the process of finalizing, in conjunction with the World Bank, programs to improve the viability of the electricity corporation (CDE) and the state sugar company (CEA). The plan for CEA involves a scaling down of the company's operations in line with the reduced demand for sugar in the preferential U.S. market and the intensification of diversification efforts. The World Bank is considering a Sugar Subsector Loan in support of the diversification program. The authorities and the World Bank are also discussing a program of measures that would form the basis for technical and financial assistance to the CDE.

To facilitate the conduct of monetary policy in 1988, the authorities are planning to implement monetary reforms that involve the simplification of liquidity requirements, the relaxation of portfolio credit restrictions, and the liberalization of existing controls on interest rates. These measures would increase competition between the official and unofficial financial sector.

4. Developments in 1987

Economic activity expanded strongly in early 1987 and on that basis real GDP growth is now expected to reach about 4 1/2 percent in 1987 against 3 percent originally projected. The strong recovery in economic activity is being led by a larger than anticipated increase in rice and sugar production and the stimulation to construction activity resulting from the expansion in public works projects. The 12-month rate of increase in the consumer price index rose to 18 percent in June 1987 from 6 percent in December 1986, largely reflecting the depreciation of the peso.

Central government operations in the first half of 1987 showed a marked improvement over the corresponding period of 1986 (Table 5). Revenue collections in January-June were about 14 percent higher than in the corresponding period of 1986, even though tax collections in the first half of 1986 included RD$120 million from the export surcharge which was eliminated in mid-1986. The revenue growth in 1987 reflected (i) the increase in motor vehicle license fees referred to above; (ii) a strong expansion in imports and the large depreciation of the peso; (iii) the sharp rise in international gold prices, which facilitated an increase in dividend payments by the state-owned Rosario Gold Mining Company; and (iv) collection of corporate income tax arrears. Central government expenditure rose marginally in January-June 1987 compared with the same period of 1986 as a contraction in current spending was more than offset by a near doubling of capital outlays. It may be noted that the level of capital outlays in the first half of the year was nearly three-fourths of the amount budgeted for the year as a whole.

The recent acceleration in inflation has prompted strong demands for wage increases in both the public and private sectors. The Government has responded by imposing, in early August, a price freeze on 21 essential consumer items and has indicated that it would submit to Congress a proposal to increase the legal minimum wage by 10 percent with effect from August 1987 and a further 10 percent from January 1988.

In the first quarter of 1987 net domestic assets of the banking system rose by about 13 percent in relation to the stock of liabilities to the private sector at the beginning of the period (see Table 3), a rate which, if maintained, would result in overshooting of the target for the year as a whole. The targeted reduction in the fiscal deficit and the measures to restrain credit expansion taken at the end of May (described earlier) were expected to lead to a sharp deceleration in the growth of net domestic assets for the balance of the year. During the first half of 1987 net official reserves fell by US$15 million and there was an increase of US$65 million in external debt service arrears of which about two thirds represented interest payments.

Exchange rate management was subject to frequent changes in the first half of 1987 and the peso depreciated from an average of RD$3.07 per U.S. dollar in January to RD$3.85 per U.S. dollar in the first two weeks of June. 1/ The depreciation of the peso (which was particularly sharp from early May through mid-June) was associated with the large

---

1/ The standard index developed in connection with the information notice system indicates that by April 1987 the peso had depreciated in real effective terms by 11.3 percent since the last occasion on which the exchange rate policy of the Dominican Republic was brought to the attention of the Board in an information notice (EBS/86/141, 7/1/86). Preliminary information indicate that in May 1987 the real effective exchange rate was 13 percent lower than in January 1985 when the exchange markets were unified.

Table 5. Dominican Republic: Operations of the Central Government

	1984	1985	1986	1987 Orig. 1/ Proj.	1987 Prog.	Jan.-June 1986	Jan.-June 1987
	(In millions of Dominican pesos)						
Total revenue	1,204.4	2,235.4	2,286.2	2,296.1	2,899.4	1,149.0	1,306.5
Current revenue	1,186.2	2,197.1	2,274.8	2,287.3	2,889.4 2/	1,144.8	1,300.9
Tax revenue	1,084.8	2,096.6	2,146.3	2,127.1	2,657.1	1,084.8	1,184.8
Taxes on income and profits	263.0	341.7	420.0	413.5	508.0	201.0	225.5
Taxes on property	12.0	14.1	18.7	18.7	50.7	15.6	48.0
Taxes on goods and services	497.6	702.6	948.5	856.5	845.5	469.3	442.4
Taxes on international trade	295.5	434.2	601.7	698.4	1,053.2	250.4	442.3
Exchange surcharge	--	587.8	125.9	108.5	148.5	122.4	--
Other taxes	16.7	16.2	31.5	31.5	51.2	26.1	26.6
Nontax revenue	101.4	100.5	128.5	160.2	232.5	60.0	116.1
Capital revenue	18.2	38.3	11.4	8.8	10.0	4.2	5.6
Total expenditure	1,281.6	2,370.4	2,526.4	2,251.8	2,553.1	1,354.4	1,392.7
Current expenditure	1,007.7	1,913.9	1,896.9	1,591.8	1,576.1	1,035.3	678.1
Wages and salaries	499.9	609.7	720.5	725.9	672.2	343.4	321.1
Goods and services	192.3	282.3	331.9	228.1	229.2	149.9	123.3
Transfers	269.3	886.7	649.4	380.5	465.0	500.3	223.8
Interest payments	46.2	135.2	195.1	257.3	209.7	41.7	9.9
Other	--	--	--	--	--	--	--
Capital expenditure	273.9	456.5	629.5	660.0	977.0	319.1	714.6
Capital formation	106.3	178.8	234.1	365.1	...	...	...
Capital transfers to rest of public sector	147.6	258.5	347.6	283.1	...	...	...
Other	20.0	19.2	47.8	11.8	...	...	...
Current account surplus or deficit (-)	178.5	283.2	377.9	695.5	1,313.3	109.5	622.8
Overall surplus or deficit (-) (commitment basis)	-77.2	-135.0	-240.2	44.3	346.3	-205.4	-86.2
Arrears 3/							
Domestic	...	...	-100.0	100.0	100.0	--	--
Foreign interest payments	...	...	-53.3	57.4	63.0	--	--
Overall surplus or deficit (-) (cash basis)	-77.2	-135.0	-86.9	-113.1	183.3	-205.4	-86.2
	(In percent of GDP)						
Total revenue	11.3	15.4	14.2	12.1	15.3		
Current revenue	11.1	15.2	14.1	12.1	15.2		
Tax revenue	10.1	14.5	13.3	11.2	14.0		
Nontax revenue	0.9	0.7	0.8	0.8	1.2		
Capital revenue	0.2	0.3	0.1	--	0.1		
Total expenditure	12.0	16.3	15.7	11.9	13.5		
Current expenditure	9.4	13.2	11.8	8.4	8.3		
Capital expenditure	2.6	3.1	3.9	3.5	5.2		
Current account surplus or deficit (-)	1.8	2.2	2.4	3.7	7.0		
Overall surplus or deficit (-) (commitment basis)	-0.7	-0.9	-1.5	0.2	1.0		

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

1/ As in SM/87/73.
2/ Includes estimated effect of new revenue measures submitted for congressional approval in mid-August.
3/ Minus sign represents increase.

liquidity overhang from 1986, the weakness of off-season tourism, lower foreign remittances, and an accumulation of inventories of imported goods (perhaps in response to official indications that exchange controls might be imposed). In addition, the authorities believe that there was some manipulation of the rate by a few large exchange houses.

In response to the sharp depreciation, on June 17, 1986, the free market was suspended, the authorization for commercial and exchange banks to sell foreign exchange was rescinded, and all foreign exchange was required to be surrendered to the Central Bank at an exchange rate fixed by the Bank. Payments for all imports were made subject to prior central bank approval based on a priority list, under which applications for nonessential imports were not to receive foreign exchange or customs certification. Strict limits were put on the provision of foreign exchange for invisibles and capital, with private debt servicing given low priority. Through weekly adjustments, the official exchange rate, which had been fixed at RD$3.85 per U.S. dollar on June 17, was moved to RD$3.20 per U.S. dollar by the end of July.

It is estimated that under the new arrangements only about one fourth of the foreign exchange bought by the exchange banks was actually being surrendered to the Central Bank, with the remainder being sold in the unofficial parallel market. In this situation, the Central Bank in mid-July relaxed the operation of the system, even though the legal provisions remained unchanged. In practice, receipts from merchandise exports are now being sold to the Central Bank while those from tourism, private remittances, and private capital are allowed to remain with the exchange banks. The Central Bank is now providing foreign exchange mainly for basic foods, raw materials, and capital goods imports at the official rate while foreign exchange for all other imports and payments for invisibles can be obtained from the secondary market. Despite this relaxation of the exchange system, the availability of foreign exchange has been reduced as the inward remittances have declined and there is evidence of increased private capital outflow. At the end of July the exchange rate in the secondary market was around RD$3.60 per U.S. dollar compared to the official rate of RD$3.20 per U.S. dollar. The authorities have indicated that the dual exchange rate system is temporary but have not yet determined the timing or the modalities for the unification of the exchange markets.

III. Staff Appraisal

The Government has formulated an econommic program geared toward reducing financial imbalances and setting the stage for sustained economic growth. The outcome of the program will depend critically on the Government's success in achieving the planned reduction in the fiscal deficit and on the pace at which the return to a unified free exchange market is carried out.

As regards fiscal policy it is very important that the new revenue package be implemented without delay. Also, it may be noted that the yield of the revenue package is based on improvements in tax administration that may not be feasible in the short run and recent trends point to an overshooting of the total expenditure budget; in this connection, the authorities should be prepared to take additional action to ensure that the desired reduction in the deficit is achieved.

The recent relaxation of the import and exchange controls introduced in mid-June is a step in the right direction. The staff believes that to facilitate the attainment of the Government's economic objectives, a market-oriented exchange rate policy should be an integral part of the overall economic strategy. Such a policy would re-establish incentives to the export sector, which is now being taxed by the dual exchange rate system, ensure that external competitiveness is maintained, and restore the incentives for the inflow of capital. The staff would note that exchange rate stability essentially will depend on the pursuit of appropriate demand policies.

In addition to the restrictive practices described in SM/87/73, the legal provisions for exchange controls introduced on June 17, 1987 would constitute exchange restrictions if implemented. Also the dual exchange rate system, involving an official exchange rate for some imports and a free rate for other transactions and the 5 percent tax on foreign exchange purchases for the payment of imports, gives rise to multiple currency practices subject to Fund jurisdiction. The staff urges the authorities to adopt policies that will make it possible to eliminate reliance on such restrictive practices. In the meantime, because policies do not offer assurance that the these practices are temporary, the staff does not recommend their approval at this time.

Dominican Republic - Fund Relations
(As of June 30, 1987)

I. Membership Status

(a) Date of membership: December 28, 1945
(b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

	Millions of SDRs	Percent of Quota
(a) Quota	112.10	
(b) Fund holdings of Dominican pesos	333.51	297.51
(c) Fund credit	221.41	197.51
Of which: CFF	31.53	28.13
Credit tranche	78.50	70.02
EFF	61.88	55.20
Enlarged access under EFF	49.50	44.16
(d) Reserve tranche position	--	--

III. Latest Stand-By and Special Facilities

(a) Stand-by arrangement

(i) Duration: From April 15, 1985 to April 14, 1986
(ii) Amount: SDR 78.5 million
(iii) Utilization: Fully disbursed

(b) Special facilities since 1974:

Facility	Date of purchase	Amount
CFF	December 3, 1985	SDR 15.50 million
BSFF	August 1983	SDR 12.64 million
CFF	January 1983	SDR 42.75 million
BSFF	July 1982	SDR 10.55 million
CFF	May 1982	SDR 36.00 million
CFF	September 1979	SDR 27.50 million
CFF	January 1979	SDR 6.00 million
BSFF	January 1979	SDR 11.51 million
CFF	September 1976	SDR 21.50 million

IV. SDR Department

(a) Net cumulative allocation: SDR 31.59 million

(b) Holdings: SDR 0.03 million (0.09 percent of net cumulative allocation)

V. Financial obligations due to the Fund

	Overdue Financial Obligations 5/31/87	Principal and Interest Due June-Dec. 1987	1988	1989	1990
Principal					
- Repurchases	--	21.52	38.13	68.51	61.13
- T.F. Repayments	--	--	--	--	--
Charges and interest including SDR and TF (provisional)	--	8.02	13.98	10.90	6.43
Total	--	29.53	52.11	79.41	67.56

B. Nonfinancial Relations

VI. Exchange Rate Arrangement

From January 23, 1985 until June 16, 1987 the Dominican peso floated freely. On June 17, 1987 the Central Bank suspended the free market and required commercial and exchange banks to surrender all foreign exchange to the Central Bank. Central Bank resolutions issued in early August provide for the establishment of an official market for imports of basic foods, raw materials and capital goods, and a secondary market for other imports and service payments. As of July 31, 1987, the exchange rate in the official market was RD$3.20 per U.S. dollar and in the secondary market around RD$3.60 per U.S. dollar.

Existing restrictions on payments and transfers for current international transactions stem from a tax on profit remittances, external payments arrears, and the requirement of Central Bank approval for all foreign exchange transactions. Also, the dual exchange rate system and the 5 percent tax on purchases of foreign exchange for imports constitute a multiple currency practice. The exchange restrictions and the multiple currency practices of the Dominican Republic are not approved by the Fund.

VII. Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on November 27, 1985 (EBM/85/172). The relevant staff report was SM/85/291. For consultation purposes, the Dominican Republic is on the 12-month cycle.

VIII. Technical Assistance

Technical assistance was provided by the Bureau of Statistics in April/May 1985 in the area of monetary statistics and by the Central Banking Department in October 1985 in the area of unregulated financial markets. In June 1986 a staff member of the CBD traveled to Santo Domingo to review the possible adoption of a deposit insurance scheme; the draft report was completed in October 1986. A staff member of the Bureau traveled to Santo Domingo in May-June 1987 to work on monetary statistics and a mission visited Santo Domingo in early July to advise the authorities on the operation of the foreign exchange market.

Dominican Republic

Area and population				
Area				48,400 kilometers
Population (mid-1986)				6.5 million
Annual rate of population increase (1981-86)				2.9 percent
GDP (1986)				RD$16.1 billion
GDP per capita (1986)				RD$2,492

	1983	1984	1985	1986
Origin of GDP		(percent)		
Agriculture and fishing	21.0	20.6	20.0	19.2
Mining and manufacturing	20.1	19.7	19.4	18.9
Construction	7.0	7.1	6.5	7.3
Commerce, transportation, and communications	21.8	21.1	20.6	21.5
Government	8.8	8.9	9.2	9.0
Other	21.4	22.7	24.2	24.1
Ratios to GDP 1/				
Exports of goods and nonfactor services 1/	18.1	25.6	28.3	25.2
Imports of goods and nonfactor services 1/	-23.0	-29.1	-33.8	-27.8
Current account of the balance of payments 1/	-6.1	-4.9	-5.1	-3.4
Central government revenues	10.8	11.3	15.4	14.2
Central government expenditures	13.3	12.0	16.3	15.4
Central government savings	0.6	1.8	2.2	2.7
Public sector overall surplus or deficit (-)2/	-5.0	-6.5	-4.6	-4.5
External debt (end of year) 1/	36.9	52.3	64.9	59.3
Gross national savings	15.7	15.7	14.7	13.0
Gross domestic investment	21.8	20.6	19.8	16.4
Banking system liabilities to private sector (end of year) 3/	20.8	20.6	18.3	25.7
Annual percentage changes in selected economic indicators				
Real GDP per capita	1.0	-2.2	-5.0	-1.8
Real GDP	3.9	0.4	-2.2	1.0
GDP at current prices	7.4	24.8	35.5	11.0
Domestic expenditures (at current prices)	6.7	23.1	38.1	7.9
Investment	9.6	17.6	30.3	--
Consumption	5.9	24.6	40.0	--
GDP deflator	3.4	24.4	38.6	9.9
Consumer prices (annual average)	7.0	24.4	37.5	9.8
Central government revenues	22.4	30.2	85.6	2.3
Central government expenditures	17.6	12.5	85.0	4.4
Money and quasi-money	7.9	30.3	15.2	68.4
Money	7.3	51.0	13.6	41.8
Quasi-money 4/	8.5	8.4	17.5	106.1
Domestic credit 5/	38.4	37.4	-8.7	74.1
Credit to public sector (net)	27.6	27.2	-25.6	32.6
Credit to private sector	10.8	10.2	17.0	41.5
Merchandise exports (f.o.b. in U.S. dollars)	2.3	10.6	-14.9	-2.3
Merchandise imports (f.o.b. in U.S. dollars)	2.0	-2.0	2.3	-1.5

	1983	1984	1985	1986
Central government finances	(millions of Dominican pesos)			
Revenues	924.9	1,204.4	2,235.4	2,286.2
Expenditures	1,139.1	1,281.6	2,370.4	2,526.4
Current account surplus or deficit (-)	45.3	178.5	283.3	377.9
Overall surplus or deficit (-)	-214.2	-77.2	-135.0	-240.2
External financing (net)	40.5	101.3	495.2	152.3
Internal financing (net)	173.7	-24.1	-360.2	87.9
Balance of payments	(in millions of U.S. dollars)			
Merchandise exports (f.o.b.)	785.2	868.1	738.5	721.9
Merchandise imports (f.o.b.)	-1,282.2	-1,257.1	-1,285.9	-1,266.2
Investment income (net)	-297.1	-337.7	-336.8	-317.7
Travel	320.5	370.6	451.0	506.4
Other services and transfers (net)	52.5	96.4	195.5	166.6
Balance on current account and transfer accounts	-421.1	-259.7	-237.7	-189.0
Official capital (net)	71.8	18.8	-107.0	-133.0
Private capital and errors and omissions (net) 6/	-16.4	102.4	260.6	189.1
Extraordinary finance	596.6	246.9	282.6	254.0
Change in banking system net reserves (increase -)	-230.9	-108.4	-198.6	-101.8

	December 31			
	1983	1984	1985	1986
International reserve position				
Central Bank (gross)	204.3	268.5	355.4	383.5
Central Bank (net)	-428.1	-335.9	-248.0	-153.5
Rest of banking system (net)	-42.8	-26.7	84.0	92.3

Social and Demographic Indicators

	1965	1985
Population characteristics and health		
Life expectancy at birth (in years)	59.0	63.6
Infant mortality (per thousand)	111.0	71.0
Population per physician (in thousand)	1.7	1.4
Education		
Enrollment rates (percent)		
Primary	87.0	94.0
Secondary	12.0	45.0
Nutrition		
Daily calories per capita (percent of requirement)	82.7	105.0

1/ Ratio to GDP expressed in U.S. dollars. The implicit effective exchange rates used are RD$1.07 in 1981, RD$1.16 in 1982, RD$1.25 in 1983, RD$2.0 in 1984, RD$3.1 in 1985, RD$2.9 in 1986, and RD$3.1 in 1987 per U.S. dollar.
2/ On a commitment basis and includes central bank operating losses.
3/ Excluding private capital and surplus.
4/ Includes time and savings deposits.
5/ Changes in relation to liabilities to private sector (excluding private capital and surplus) at the beginning of the period.
6/ Residual.