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INFORMATION

January 4, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Dominica - Staff Report for the 1990 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1990 Article IV consultation with Dominica, which will be brought to the agenda for discussion on a date to be announced.

Mr. Kavar (ext. 7685) or Mr. Quin (ext. 7686) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads



INTERNATIONAL MONETARY FUND

DOMINICA

Staff Report for the 1990 Article IV Consultation

Prepared by the Staff Representatives for the  
1990 Consultation with Dominica

Approved by S. T. Beza and S. Kanesa-Thasan

January 3, 1991

The 1990 Article IV consultation discussions with Dominica were held in Roseau during the period November 5-14, 1990. The representatives of Dominica included the Acting Prime Minister, the Financial Secretary, the Development Coordinator, and other senior officials. The staff representatives were Messrs. Kavar (Head), Quin, Shah, and Thornton (all WHD). Mr. Towe, Assistant to the Executive Director for Dominica, attended the concluding round of meetings. Dominica accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement in December 1979. <sup>1/</sup>

The last Article IV consultation with Dominica was concluded by the Executive Board on December 15, 1989 (EBM/89/164). Dominica is on the standard 12-month consultation cycle.

I. Economic Background and Recent Developments

The economy of Dominica is based primarily on agriculture and agro-processing. In addition, a number of foreign-owned assembly plants began operations in the past decade attracted by fiscal incentives and relatively low labor costs. The principal exports, bananas and soap products, are marketed under preferential arrangements, primarily in the United Kingdom and the Caribbean Community (CARICOM), respectively. In the early 1980s overall economic performance was characterized by the slow growth of output, weak central government finances, and heavy dependence on external assistance. In the second half of the 1980s, which includes the period of the Structural Adjustment Facility (November 1986-November 1989), there was a considerable acceleration in the growth of output and a substantial increase in public savings.

Real GDP increased at an average annual rate of 7 percent in 1986-88, under the stimulus of rising production of bananas and the spillover effects on other sectors, but declined by 1 percent in 1989

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<sup>1/</sup> Relations with the Fund are presented in Appendix I.

because of damage to the agricultural sector by Hurricane Hugo in September of that year. However, agricultural production recovered much faster than expected and the growth of output is estimated at 7 percent in 1990, even though manufacturing operations were affected adversely by the closure of one plant and lower production by two of the largest firms. Private sector wages increased on average by 6 percent a year in 1987-90, and in late 1989 the minimum wage was increased by 50 percent. <sup>1/</sup> The relatively strong growth of the economy since the mid-1980s led to a reduction in the unemployment rate from about 20 percent at the start of the decade to less than 10 percent recently and labor shortages are now reported in some sectors.

The rate of increase of consumer prices rose from about 3 percent a year in 1986-88 to nearly 6 percent in 1989. A major contributing factor was the increase in the price of foodstuffs because of the disruption caused by the hurricane and the continued shift from production of foodstuffs to bananas. In the first ten months of 1990 the increase in prices slowed to less than 3 percent a year and food prices declined as production recovered.

The public finances strengthened in the second half of the 1980s with the current account surplus of the consolidated public sector increasing from the equivalent of 2 percent of GDP in 1984/85 <sup>2/</sup> to an annual average of more than 7 percent in the three fiscal years 1986/87-1988/89 (Table 1). During the same period the overall balance (after grants) moved from a deficit equivalent to 4 percent of GDP to surpluses averaging 3 percent a year. This improvement occurred notwithstanding reductions in tax rates on individual income and corporate profits and was the result of the buoyant economic activity, restraints on current expenditure, the expansion of coverage by the Social Security Scheme, and the substantial surpluses of the Dominica Banana Marketing Corporation (the largest public sector enterprise) in 1986-88. The improvement of public savings together with the availability of concessional external assistance for the public investment program permitted the public sector to reduce sharply its indebtedness to domestic banks in the second half of the 1980s.

In 1989/90 the hurricane-induced decline in economic activity slowed the growth of tax revenues and these were further affected by the Government's decision to waive temporarily the export tax on bananas. Current expenditure increased because of hurricane-related outlays which included Government payments to farmers in advance of anticipated STABEX

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<sup>1/</sup> This was the first increase in the minimum wage since 1980. From 1980 to 1989, consumer prices increased by 60 percent and wages in the public sector and the private sector increased by 70 percent and 203 percent, respectively.

<sup>2/</sup> Fiscal year beginning July 1.

Table 1. Dominica: Summary Finances of the Consolidated Public Sector <sup>1/</sup>

	1985/86	1986/87	1987/88	1988/89	1989/90	Projected		
						1990/91	1991/92	1992/93
(In millions of Eastern Caribbean dollars)								
<u>Total revenue and grants</u>	139.6	137.0	162.4	170.6	172.0	180.7	195.8	209.7
Current revenue	101.1	115.9	128.5	140.5	141.3	153.8	168.2	176.3
Central Government	(84.0)	(92.2)	(105.4)	(119.9)	(123.1)	(129.9)	(141.5)	(148.4)
Rest of general government	(12.6)	(13.7)	(15.0)	(16.6)	(17.8)	(19.8)	(21.4)	(23.0)
Saving by NFPEs (net)	(4.5)	(10.0)	(8.1)	(4.0)	(0.4)	(4.1)	(6.0)	(4.9)
Capital revenue	0.1	2.0	4.9	6.6	0.4	3.0	3.0	3.0
Foreign grants	38.4	19.1	29.0	23.5	30.3	23.9	23.9	30.4
<u>Total expenditure</u>	135.5	126.6	149.5	161.9	211.2	223.8	200.6	211.6
Current expenditure	87.8	91.9	101.7	108.9	118.0	132.4	137.3	144.0
Central Government	(81.6)	(85.0)	(93.3)	(98.5)	(106.0)	(119.0)	(122.6)	(127.9)
Rest of general government	(6.2)	(6.9)	(8.4)	(10.4)	(12.0)	(13.4)	(14.7)	(16.1)
Capital expenditure	47.7	34.7	47.8	53.0	93.2	91.4	63.3	67.6
Central Government	(45.8)	(31.2)	(40.0)	(37.9)	(55.1)	(47.8)	(52.7)	(58.0)
Onlending to DOMLEC 2/	(—)	(—)	(2.3)	(5.4)	(14.0)	(18.3)	(5.6)	(4.6)
Rest of general government	(—)	(0.9)	(0.1)	(0.3)	(0.3)	(1.0)	(0.5)	(0.5)
Nonfinancial public enterprises	(1.9)	(2.6)	(5.4)	(9.4)	(23.8)	(24.3)	(4.5)	(4.5)
Current account balance	13.3	24.0	26.8	31.6	23.3	21.4	31.6	32.3
<u>Overall balance after grants</u>	4.1	10.4	12.9	8.7	-39.2	-43.1	-4.8	-1.9
<u>Financing</u>	-4.1	-10.4	-12.9	-8.7	39.2	43.1	4.8	1.9
Concessional foreign financing (net)	-8.2	-10.1	-16.2	-15.7	20.6	28.3	10.1	7.9
Nonconcessional financing (net)	-12.3	-20.5	-29.1	-24.4	18.0	14.8	-5.3	-6.0
Foreign	(-6.9)	(-5.6)	(-8.1)	(-8.8)	(-6.1)	(-3.1)	(-2.0)	(-1.0)
Domestic	(-5.4)	(-14.9)	(-21.0)	(-15.6)	(24.7)	(17.9)	(-3.3)	(-5.0)
(In percent of GDP)								
Total revenue and grants	48.7	42.2	44.1	42.3	39.3	37.3	37.2	36.7
Current revenue	(35.3)	(35.7)	(34.9)	(34.8)	(32.3)	(31.7)	(32.1)	(30.9)
Capital revenue	(—)	(0.6)	(1.3)	(1.6)	(0.1)	(0.6)	(0.6)	(0.5)
Foreign grants	(13.4)	(5.9)	(7.9)	(5.8)	(6.9)	(4.9)	(4.5)	(5.3)
Total expenditure	47.3	39.0	40.6	40.1	48.2	46.2	38.1	37.1
Current expenditure	30.6	28.3	27.6	27.0	26.9	27.3	26.1	25.2
Capital expenditure	16.6	10.7	13.0	13.1	21.3	18.9	12.0	11.8
Current account balance	4.6	7.4	7.3	7.8	5.3	4.4	6.0	5.7
Overall balance after grants	1.4	3.2	3.5	2.2	-9.0	-8.9	-0.9	-0.3
Nonconcessional borrowing	-4.3	-6.3	-7.9	-6.0	4.2	3.1	-1.0	-1.1
(In millions of Eastern Caribbean dollars)								
<u>Memorandum items</u>								
GDP at market prices (CY)	267.0	306.4	342.2	394.5	412.7	463.2	505.9	547.9
GDP at market prices (FY)	286.7	324.3	368.4	403.6	438.0	484.6	526.9	570.8

Source: Ministry of Finance.

<sup>1/</sup> Fiscal years beginning July 1.

<sup>2/</sup> Dominica Electricity Services, Ltd., in which the Government holds a 40 percent share.

receipts from the European Community. <sup>1/</sup> As a result, public sector savings declined from nearly 8 percent of GDP in 1988/89 to 5 percent of GDP in 1989/90. Capital expenditures also increased with the launching of two large projects. The overall balance (after grants) moved from a surplus of more than 2 percent of GDP in 1988/89 to a deficit equivalent to 9 percent of GDP in 1989/90. This development led the public sector to borrow the equivalent of 4 percent of GDP from the domestic banking system in 1989/90 after several years of net repayment.

Private sector deposits with commercial banks more than doubled from mid-1985 to mid-1990. In the first two years of this period, bank lending declined as the public sector reduced its net indebtedness and banks acquired external assets. Since 1988, however, bank lending has increased sharply, reflecting initially an increase of loans to the private sector for residential construction and more recently the resumption of net borrowing by the public sector. To satisfy the demand for credit in 1989 and 1990, the commercial banks reduced their accumulated net balances abroad. Interest rates are market determined, with one minor exception relating to the existence of a minimum rate for savings deposits, and the differential between the average lending and deposit rates has been in excess of 6 percentage points reflecting the relatively high operating costs of banks. On average, real interest rates for savings and time deposits have been positive during the last five years.

The deficit in the current account of the balance of payments rose from about 4 percent of GDP a year in 1986-87 to nearly 20 percent of GDP a year in 1988-89. This reflected a rise in imports of both consumer and capital goods in line with the growth of personal income and of public investment and a fall in exports in 1989 because of the effects of the hurricane. The external current account deficit is estimated to have declined to 16 percent of GDP in 1990 as banana export volume recovered, prices increased in the U.K. market, and the growth of consumer goods imports slowed. Concessionary external assistance and private capital inflows, including the reduction of the commercial banks' net foreign assets in 1989 and 1990, have on balance covered the external current account deficit since 1985 (Table 2).

External debt has risen from US\$48 million in 1985 to US\$73 million in 1990 (Table 3). However, in relation to GDP, the debt has declined from about 48 percent in 1985-86 to about 44 percent in 1989-90. Moreover, during this period the share of concessional borrowing has increased from about 73 percent in 1985 to 97 percent in 1990, and this has served to reduce the annual debt service from 8 percent of exports of goods, nonfactor services, and net private transfers to less than 5 percent.

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<sup>1/</sup> The advance payment amounted to EC\$5.1 million whereas the subsequent compensation under the STABEX came to EC\$1.6 million.

Table 2 . Dominica: Summary Balance of Payments

	1985	1986	1987	1988	1989	Prel. 1990	Projections		
							1991	1992	1993
(In millions of U.S. dollars)									
<u>Current account balance</u> 1/	-23.9	-2.2	-7.1	-14.3	-41.9	-27.4	-25.1	-24.3	-24.6
Trade balance	-28.8	-12.4	-18.4	-32.0	-62.0	-56.4	-53.7	-56.3	-60.1
Exports, f.o.b.	(28.4)	(43.4)	(48.0)	(55.6)	(45.1)	(58.6)	(65.9)	(69.5)	(73.2)
Imports, c.i.f.	(-57.2)	(-55.8)	(-66.4)	(-87.5)	(-107.1)	(-115.0)	(-120.0)	(-125.8)	(-133.3)
Services (net)	-1.6	1.0	0.6	6.0	1.3	6.4	6.4	7.4	8.5
Travel (net)	(7.3)	(8.0)	(9.1)	(11.9)	(10.5)	(15.8)	(16.4)	(17.4)	(18.4)
Interest (net)	(-1.9)	(-1.1)	(-0.3)	(0.7)	(-0.1)	(-0.7)	(-0.7)	(-0.5)	(--)
Other services (net)	(-7.0)	(-6.0)	(-8.2)	(-6.6)	(-9.1)	(-8.8)	(-9.3)	(-9.5)	(-9.9)
Private transfers (net)	6.5	9.3	10.7	11.7	18.8	22.7	22.5	24.7	26.9
<u>Capital account balance</u>	20.9	14.8	10.6	9.8	34.9	30.3	28.2	27.2	31.6
Official transfers (net)	14.3	10.8	9.4	9.2	7.6	9.9	8.6	8.7	9.8
Official borrowing (net)	4.4	4.2	5.3	3.5	8.9	7.6	7.1	3.9	4.1
Commercial banks (net)	-0.8	-2.9	-12.7	-9.8	9.5	2.9	--	-2.5	-2.9
Inward private investment	3.0	2.7	8.6	6.9	8.9	10.0	12.5	17.0	20.6
Errors and Omissions	2.3	-6.6	5.1	1.2	6.4	0.8	--	--	--
<u>Overall balance</u>	<u>-0.7</u>	<u>6.1</u>	<u>8.6</u>	<u>-3.3</u>	<u>-0.6</u>	<u>3.7</u>	<u>3.1</u>	<u>2.9</u>	<u>2.8</u>
<u>Financing</u>	<u>0.7</u>	<u>6.1</u>	<u>-8.6</u>	<u>3.3</u>	<u>0.6</u>	<u>3.7</u>	<u>-3.1</u>	<u>-2.9</u>	<u>-2.8</u>
Change in imputed reserves 2/	2.7	-4.2	-8.1	5.4	2.4	-1.8	-1.7	-1.6	-1.6
Foreign assets	-0.5	-1.3	--	--	0.3	-0.6	-0.6	-0.6	-0.6
Borrowing from IMF	-1.5	-0.6	-0.4	-2.1	-2.1	-1.3	-0.9	-0.7	-0.7
(In percent of GDP)									
<u>Current account balance</u> 1/	-24.1	-1.9	-5.6	-9.8	-27.4	-16.0	-13.5	-12.1	-11.3
Trade balance	-29.0	-10.9	-14.5	-21.9	-40.5	-33.0	-29.0	-28.0	-27.5
Exports	(28.6)	(38.3)	(37.8)	(38.0)	(29.5)	(34.4)	(35.4)	(34.5)	(33.5)
Imports	(-57.7)	(-49.2)	(-52.4)	(-59.9)	(-70.1)	(-67.4)	(-64.4)	(-62.5)	(-61.1)
Travel (net)	7.4	7.1	7.2	8.2	6.9	9.3	8.8	8.6	8.4
Private transfers (net)	6.6	8.2	8.5	8.0	12.3	13.3	12.1	12.2	12.5
Official grants	14.4	9.5	7.4	6.3	5.8	6.6	5.4	5.2	5.4
Net official borrowing	4.5	3.7	4.2	2.4	5.8	4.4	3.8	1.9	1.9
Overall balance	-0.7	5.4	6.8	-2.3	-0.4	2.1	1.7	1.4	1.3

Sources: Statistical Office, Ministry of Finance; Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Excluding official transfers.

2/ Refers to changes in Dominica's imputed share in the international reserves of the Eastern Caribbean Central Bank. These reserves are not freely available to Dominica.

Table 3. Dominica: External Public Debt and Debt Service

	1985	1986	1987	1988	1989	Prel. 1990	Projections		
							1991	1992	1993
<u>Total external debt at end of period</u>	<u>47.7</u>	<u>54.0</u>	<u>64.9</u>	<u>64.4</u>	<u>69.6</u>	<u>73.3</u>	<u>79.5</u>	<u>82.8</u>	<u>82.2</u>
IMF credit at end of period	10.1	10.6	11.8	8.9	6.5	5.5	4.6	3.9	3.2
Other debt (beginning of period)	32.2	37.6	43.5	53.2	55.5	63.1	67.8	74.9	78.8
Drawings	5.2	5.3	7.7	5.6	9.8	5.4	9.2	6.0	6.4
Amortization (-)	0.7	1.2	2.3	1.9	1.8	2.0	2.0	2.0	2.3
Valuation adjustment	1.0	1.7	4.4	-1.4	-0.4	1.2	--	--	--
Other debt (end of period)	37.6	43.5	52.2	55.5	63.1	67.8	74.9	78.8	78.9
<u>Debt service on total debt</u>	<u>4.1</u>	<u>4.6</u>	<u>6.2</u>	<u>6.5</u>	<u>6.0</u>	<u>5.1</u>	<u>4.7</u>	<u>4.7</u>	<u>4.9</u>
Amortization	2.2	2.7	4.4	4.7	4.2	3.3	2.9	2.7	3.0
Interest	1.9	1.9	1.8	1.8	1.8	1.8	1.9	2.0	1.9
Debt service on debt to IMF	2.4	2.5	2.8	3.2	2.8	1.6	1.1	0.8	0.8
Repurchases	(1.5)	(1.6)	(2.1)	(2.8)	(2.4)	(1.3)	(0.9)	(0.7)	(0.7)
Charges	(0.9)	(0.9)	(0.7)	(0.4)	(0.4)	(0.3)	(0.2)	(0.1)	(0.1)
Debt service on other debt	1.7	2.2	3.5	3.2	3.2	3.5	3.7	3.9	4.1
Amortization	(0.7)	(1.2)	(2.3)	(1.9)	(1.8)	(2.0)	(2.0)	(2.0)	(2.3)
Interest	(1.0)	(1.0)	(1.2)	(1.3)	(1.3)	(1.5)	(1.7)	(1.8)	(1.8)
(In percent of exports of goods and services and net private transfers)									
<u>Total external debt outstanding</u>	<u>96.0</u>	<u>80.1</u>	<u>84.9</u>	<u>72.4</u>	<u>81.8</u>	<u>67.5</u>	<u>67.9</u>	<u>66.4</u>	<u>61.9</u>
<u>Debt service on total debt</u>	<u>8.4</u>	<u>6.9</u>	<u>8.2</u>	<u>7.2</u>	<u>7.0</u>	<u>4.7</u>	<u>4.1</u>	<u>3.8</u>	<u>3.7</u>
Amortization	4.5	4.1	5.8	5.2	4.9	3.0	2.5	2.2	2.2
Interest	3.9	2.8	2.4	2.0	2.1	1.7	1.6	1.6	1.4
<u>Debt service on total debt excluding IMF</u>	<u>3.5</u>	<u>3.2</u>	<u>4.6</u>	<u>3.6</u>	<u>3.7</u>	<u>3.2</u>	<u>3.1</u>	<u>3.1</u>	<u>3.1</u>
Amortization	1.5	1.7	3.1	2.1	2.2	1.8	1.7	1.6	1.7
Interest	2.0	1.5	1.5	1.5	1.5	1.4	1.4	1.5	1.3
(In percent of GDP)									
Total external debt outstanding	48.1	47.6	51.2	44.1	45.5	42.7	42.5	40.8	37.4
(In percent of total external debt outstanding)									
Concessional debt	73.3	77.8	83.3	89.5	94.3	96.5	98.1	98.9	99.4

Sources: Ministry of Finance; and Fund staff estimates.



The exchange rate of Dominica's currency, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of E.C. dollar 2.70 per U.S. dollar since July 1976. In real effective terms there was a depreciation of about 24 percent from early 1985 through mid-1988 as the Eastern Caribbean dollar depreciated along with the U.S. dollar against other currencies and inflation was lower in Dominica than in trading partner countries; this reversed a large part of the appreciation that took place from 1980 to 1984. In real effective terms the exchange rate of the Eastern Caribbean dollar for Dominica has shown no trend from mid-1988 to mid-1990 (Chart 1).

Dominica is a member of the CARICOM which is endeavoring to establish a common market among its 12 member states and to standardize external trade tariffs with respect to third countries. Implementation of the agreement abolishing internal tariffs began on October 1, 1988 and the common external tariff on imports from third countries is expected to enter into effect in the first quarter of 1991.

## II. Economic Prospects and Policies

At the conclusion of the 1989 Article IV consultation discussions with Dominica, Executive Directors observed that the country's production and export base remained narrow and very dependent on bananas. They voiced support for the authorities' efforts to stimulate private sector savings and investment and encouraged them to concentrate public sector involvement in areas that would enhance private sector activity outside the banana industry. Directors praised the authorities' cautious fiscal policy and noted that wage restraint and productivity gains would help maintain competitiveness and promote the expansion of nontraditional export activities.

### 1. Growth of output and development strategy

With the nearly complete recovery of the agricultural sector from the 1989 hurricane, and taking account of the recent setback of the manufacturing sector, the annual growth of real GDP is projected to be in the range of 5-6 percent a year in 1991-93. This is based on the assumption that the preferential access to the U.K. market for banana exports will not be altered significantly by the coming of the single European market in 1992, <sup>1/</sup> and that new domestic and foreign investment will encourage a resumption of growth in manufacturing and stimulate construction and tourism activities.

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<sup>1/</sup> In the 1990/91 Budget Speech, Prime Minister Charles indicated that Caribbean producers have received a commitment from the European Community that "in the creation of the new rules to govern trade in bananas after 1992, traditional ACP (African, Caribbean, and Pacific) suppliers shall not be in a less favorable situation than in the past or the present."

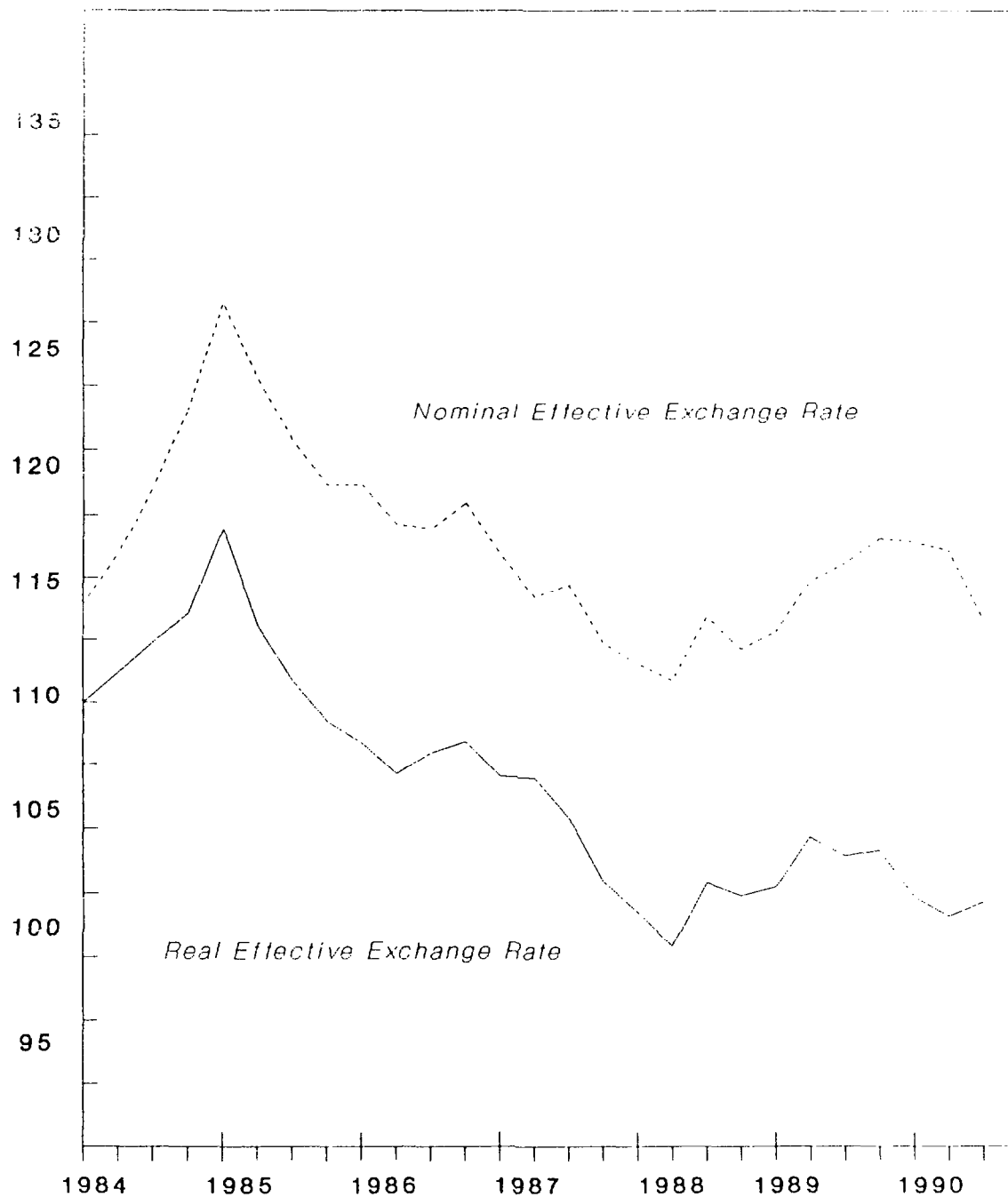
The authorities were satisfied with the overall prospects for the growth of output but expressed concern about the slow progress of diversifying the production base as well as recent declines in the quality of bananas produced in Dominica. They indicated that public sector operations would continue to focus on improving the country's infrastructure and pursuing appropriate macroeconomic policies. To promote the growth of exports and increase earnings from tourism, public sector investment has been raised from an average of 13 percent of GDP in 1987/88-1988/89 to 20 percent of GDP in 1989/90-1990/91 with investment concentrated on improving the transport system (road network and port capacity), expanding hydroelectric generating capacity, building a cruiseship berth facility, and completing a project to export water. Projects still at the planning stage include developing tourist reception and shopping facilities in the capital city, construction of an international airport, and upgrading and expanding the water delivery system to households and businesses.

The diversification of the agricultural production base has been hampered by the relative profitability of bananas which has diverted land and labor away from other crops and resulted in the expansion of banana cultivation to less productive areas. This has contributed to soil erosion on sloping land and, because of the lower yields from the marginal land, has raised the unit cost of the common agricultural operations (such as aerial spraying services).

To encourage farmers to shift production to other crops, the authorities were contemplating a proposal to establish price support mechanisms for crops identified as having good export potential and to assist with their marketing. The mission pointed out that interference in the pricing of bananas and other agricultural products risked increasing rigidities in the production structure by discouraging quick adaptation to market changes and creating new expenditure commitments for the Central Government. To increase the quality of banana production, the Dominica Banana Marketing Corporation has launched a program to replant about 1,000 acres of bananas a year with improved strains, has adopted new packing techniques to reduce damage in transport, and has imposed penalties in pricing arrangements on farmers who consistently produce lower grade fruit.

The difficulties experienced recently by a few manufacturers were attributed to the rising cost of labor and the less developed transport system (compared with neighboring states), as well as the loss of markets, which in the case of soap products was due to competition from synthetic substitutes. The authorities expected that some of these problems would be dealt with by investment in new production techniques, increased emphasis on labor training to raise productivity, and the adoption of CARICOM's Common External Tariff (CET) which would strengthen the position of Dominica's exporters within the region.

**Chart 1. Dominica**  
**Effective Exchange Rate Indices 1/**  
(1980 = 100)



Source: IMF, Information Notice System  
1/ Decline represents depreciation of Dominica's currency



Moreover, investment in hydroelectricity, water delivery, and communications would provide adequate infrastructure. The authorities indicated that new activities in garment manufacturing, coir <sup>1/</sup> production, and data processing are expected to commence in 1991.

A further broadening of the production structure is expected to occur with the growth of tourism, including a potentially significant component of vacation and retirement community housing. The cruiseship berth together with the restoration of historic sites and the expansion of nature trails are scheduled for completion in 1991 and are expected to be followed by the construction of new hotels and vacation rental units. The hotel projects, which are being financed by private foreign investors, would increase overall tourist accommodation capacity by about 50 percent by 1993 and would more than double the availability of first class accommodations from the present level.

## 2. The public finances

The central government budget for 1990/91, which accounts for about 85 percent of the public sector's current revenues and about 75 percent of the public sector's expenditures, was introduced in June 1990. Its major proposals included reinstating the export tax on bananas (following the recovery from the hurricane damage) with an expected yield equivalent to 1 percent of GDP; increasing various post and travel expenditure allowances with an estimated cost of about 0.6 percent of GDP; raising the ceiling on government employment by 2 percent; and increasing wages by 3 percent retroactive to the beginning of the previous fiscal year since no increase had been given at the time.

In the following months a number of modifications were adopted. Duties on various commodities were increased with effect from the first quarter of 1991 as a result of the the agreement among CARICOM members on raising and harmonizing import duties on products manufactured within the CARICOM region. At the same time, in order to mitigate the price effects of this tax increase, consumption duties on a number of other products were reduced with a consequent net increase in revenues estimated at about 0.5 percent of GDP on an annual basis. Also, in December 1990, after strong opposition from the civil service union to the wage increases provided for in the original budget, the Central Government revised the planned increases to 7 percent in 1990/91 and 7.5 percent in the previous year and awarded an additional 0.5 percent to the 5 percent increase of 1988/89.

Notwithstanding revenue measures equivalent to 1.5 percent of GDP in 1990/91, Government revenues are projected to decline to 27 percent of GDP in this year, from 28 percent in the previous year. The main contributing factors are a fall in income tax receipts (discussed below) and the projected slower growth of imports. With current expenditures

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<sup>1/</sup> A coarse fiber produced from the husks of coconuts.

projected to increase from about 24 percent of GDP in 1989/90 to 25 percent in the present fiscal year, the current account surplus is expected to decline to 2 percent of GDP in 1990/91 from 4 percent of GDP in the previous year.

This decline in central government saving in 1990/91 is expected to be offset in part by a strengthening of the financial position of the nonfinancial public enterprises; in particular, the water authority increased water rates by 50 percent in October 1990, and the finances of the Dominica Banana Marketing Corporation have been strengthened as a result of the recovery of banana production. Altogether, the current account surplus of the consolidated public sector is expected to decline by about 1 percentage point of GDP, to 4 percent. With capital expenditure and external grants also declining somewhat in relation to GDP, the overall deficit is projected to remain at about 9 percent of GDP. For the second consecutive year the deficit is likely to exceed the availability of concessional external financing and thus to require domestic financing equivalent to 3 percent of GDP.

The authorities explained that the fall in the ratio of public sector savings to GDP results in part from the decline in the proportion of the Central Government's tax collections to GDP following the income tax reductions implemented in January 1990. These changes, which increased the threshold levels of the individual income tax and the bands for tax rates, and reduced the rate for corporation income tax, were considered by the Government to be an essential ingredient of its efforts to encourage personal saving and investment, reduce administrative costs, and restrain demands for wage increases. Thus, the authorities were not inclined to mobilize revenue through tax increases. Instead, they preferred to maintain a stable tax system and seek to offset the cost of wage increases by limiting the growth of employment in the public sector.

The authorities indicated that recourse to domestic bank borrowing in 1989/90 and 1990/91 was an exceptional circumstance associated primarily with public investment in the cruiseship berth and the port expansion. They had regarded these projects as critical for expanding tourism and facilitating foreign trade and decided to move ahead with their implementation rather than wait until concessional external financing was secured. The authorities emphasized that their policy was not to "crowd out" the private sector, and they noted that the availability of credit did not appear to have been affected adversely since the commercial banks met the increased borrowing demands by reducing their balances abroad.

Projections of the finances of the consolidated public sector for 1991/92 and 1992/93 were prepared on the assumption that no new discretionary revenue measures would be implemented, that wage and salary expenditure would increase by 6 percent a year (comprising a 6 percent increase in pay rates and no increase in staffing), and that public investment would decline following the completion of the two major

projects referred to above. On this basis, current revenues would remain in the range of 31-32 percent of GDP and current expenditures would decline from 27 percent of GDP to 25 percent as the growth of wage outlays would be held below the growth of nominal GDP (expected to be in the range of 9-10 percent a year). With a current account surplus of some 6 percent of GDP, capital revenue and grants of around 5 percent of GDP, and capital expenditure declining from about 18 percent of GDP in 1990/91 to an average of 12 percent of GDP in the following two years, the overall deficit would be reduced from about 9 percent of GDP in 1990/91 to less than 1 percent a year in 1991/92 and 1992/93. Taking account of the existing commitments of external concessionary assistance, a deficit of such magnitude would enable the public sector to reduce its outstanding domestic indebtedness.

### 3. Monetary and exchange rate policies

Traditionally, domestic lending by Dominica's banks was effected primarily against collateral in the form of goods, real estate, and government instruments. In the absence of opportunities for such lending banks preferred to expand their balances abroad. The sharp expansion in domestic lending since 1988 to finance private sector imports and construction activity and public sector borrowing reduced the liquidity of banks and resulted in a drawdown of external assets and an increase in both deposit and lending rates by about 1 percentage point (with almost no change in the spread). With the expected reduction in public sector indebtedness in 1991/92 and the likely moderation in the growth of imports, domestic lending is projected to increase by less than the increase of bank resources and to result in a resumption of the accumulation of balances abroad.

The authorities were satisfied with the increased availability of credit for real estate mortgages since they viewed home ownership as contributing to social stability. They expressed the view that the availability of bank credit was adequate for financing new private sector activity since established bank customers encountered little difficulty, in general, in obtaining financing for investment while small new investors would usually have access to credits from the publicly-owned Agricultural and Industrial Development Bank.

As noted earlier, the change in the index of the real effective exchange rate (based on relative consumer prices) has resulted in a small appreciation of the Eastern Caribbean dollar for Dominica since mid-1988. The authorities noted that although real wages had risen, on average, for a number of years, the rise had in most instances been matched by productivity increases and thus had not resulted in an erosion of competitiveness from this standpoint. They also pointed to the increase of exports since 1985, except for the effect of the hurricane of 1989, and were particularly encouraged by the sharp rise of earnings from tourism in 1990. They expected that exports of soap products would grow at their past rates after investment in new technology is effected and expressed confidence that foreign manufacturers

would be attracted by the environment of political stability, harmonious labor relations, and reasonably priced factory space, water, and electricity services.

The exchange system of Dominica continues to be free of restrictions on payments and transfers for current international transactions.

### III. Medium-term Balance of Payments Outlook

Projections for the balance of payments outturn in the period 1991-93 were prepared on the basis of the following assumptions: (i) the export price for bananas would remain at its average 1990 level while annual export volumes would increase at lower rates than in the recent past as marginal producers withdraw from production; (ii) export volumes of other agricultural and of manufactured commodities would increase as some farmers switched from bananas to other crops and new manufacturing production began, while export prices would move in line with world prices; (iii) imports would increase more slowly than in the recent past because of the decline of public investment--the adverse effects of the recent increases in world oil prices will be tempered by the large share of hydro sources in electricity generation; (iv) earnings from tourism would increase further as facilities are developed; (v) inflows of official grants and loans would be based on existing commitments while debt servicing would take place according to scheduled maturities; (vi) inflows of private remittances would increase at a slower pace to take account of the return of expatriates from the United Kingdom to retire in Dominica; (vii) inflows of direct private investment would increase considerably throughout the period because of the expected expenditure on hotel and vacation home construction and new investment in manufacturing; and (viii) commercial banks would undertake a small amount of external investment as the public sector ends its recourse to domestic bank borrowing.

On these assumptions, the external current account deficit (before official grants) would fall to about 11 percent of GDP by 1993. However, receipts of external grants and concessional loans, as well as rising private direct investment would be more than sufficient to cover the current account deficit throughout the period.

The ratio of external public debt to GDP is projected to decline from 43 percent in 1990 to 37 percent in 1993 and debt service as a proportion of exports of goods and nonfactor services and private transfers is estimated to decline from 5 percent to about 4 percent a year over the same period.



#### IV. Staff Appraisal

In the course of 1990 economic activity recovered from the damage caused by Hurricane Hugo in September 1989. The growth of real GDP is estimated at 7 percent, inflation has abated, and the unemployment rate has declined. Public sector savings fell in the wake of the hurricane while capital expenditures increased, and the public sector engaged in net borrowing from commercial banks after several years of net repayment.

The growth of real GDP is projected at 5-6 percent a year in 1991-93, with the overall balance of the public sector moving close to equilibrium and the external current account deficit covered by inflows of official grants and concessional loans and private investment. These prospects are based on the assumption that banana exports will not be affected adversely by the European integration of 1992, that tourism earnings will grow in response to investments in accommodation and recreation facilities, and that manufacturing exports will recover from recent setbacks.

To promote economic growth in a framework of stability, the authorities have pursued policies aimed at improving the infrastructure and promoting private sector initiatives. However, they have become concerned about the increased concentration of resources in banana production and have been contemplating the introduction of price support mechanisms to encourage farmers to expand production of other crops. Also they have been investing in a water export project.

The staff believes the overall development strategy is sound but that interference with the pricing of agricultural products risks creating rigidities in the production structure and a drain on the public finances. The preferred alternative from the point of the staff would be to continue to invest in expanding storage facilities and improving domestic and international transport links which would increase the profitability of agricultural exports other than bananas. In addition, the authorities might assist with the provision of information about market demand and prices. Justification of the public investment in the water project has to be based on a demonstration of adequate return to capital, and it may be advisable to undertake to privatize the project after a reasonable period of operation.

The increased tightness of the labor market has resulted in upward pressures on wages and the Government has recently granted wage increases averaging nearly 7 percent a year. If relatively large wage settlements are not accompanied by significant productivity increases, the country's competitiveness and external position could be affected adversely. To reduce the risks of such developments the Government will need to continue its efforts to restrain the growth of public sector wages and the wage bill and contain other current expenditures. Also, investment in labor training programs could contribute to a reduction in the present shortages of skills and increase labor productivity.

Dominica's public finances have been managed satisfactorily for several years. The recent decline of public savings and the weakening of the overall balance has resulted from the policy of reducing the burden of taxation and from a bulge in capital spending. However, with the completion of the major tourist and power projects, it is expected to be possible to revert to a position of not borrowing from the domestic banking system. This presumes a strict limitation on capital expenditure that is not funded from external sources and the avoidance of wage increases of a size that would affect domestic saving adversely.

With regard to the exchange rate, the common currency system for the Eastern Caribbean in which Dominica is a member has served the country well. Dominica's external competitiveness continues to be satisfactory as evidenced by the generally favorable development of the economy and the growth of exports of goods and services. However, the authorities should continue to be vigilant in implementing a cautious fiscal policy and in monitoring developments in costs and productivity.

Dominica does not engage in trade with Iraq and Kuwait but has nevertheless restricted trade and payments to these countries.

In November 1990 the authorities communicated their acceptance of the proposed Third Amendment to the Articles of Agreement and earlier had consented to the quota increase.

The authorities of Dominica expressed a strong preference for remaining on the standard 12-month consultation cycle. They indicated that the reviews by the Executive Board contributed to improved policy formulation. It is recommended that the Article IV consultation with Dominica remain on the 12-month cycle.

Dominica--Fund Relations  
(As of November 30, 1990)

I. Membership Status

- (a) Date of membership: December 12, 1978
- (b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

- (a) Quota: SDR 4.0 million
- (b) Total Fund holdings: SDR 5.22 million (130.5 percent of quota)
- (c) Fund credit: SDR 1.23 million (30.7 percent of quota)  
Of which:

	<u>Millions of SDR</u>	<u>Percent of quota</u>
Credit tranche:	--	--
Extended Fund Facility:	1.17	29.3
Supplementary Financing Facility:	0.06	1.41

- (d) Reserve tranche position: SDR 9,044

III. Financial Arrangements and Special Facilities

(a) Stand-by arrangement

- Duration: July 18, 1984 to July 17, 1985
- Amount: SDR 1.40 million (35 percent of quota)
- Utilization: SDR 0.97 million
- Undrawn balance: SDR 0.43 million

(b) Extended arrangement

- Duration: February 6, 1981 to February 5, 1984
- Amount: SDR 8.55 million (294.8 percent of quota)
- Undrawn balance: None

(c) Compensatory Financing Facility:

Approval was given on February 6, 1981 for additional purchase of SDR 1.95 million (67 percent of quota).

(d) Structural Adjustment Facility:

- Duration: November 26, 1986 to November 25, 1989
- Amount: SDR 2.80 million (70.0 percent of quota)
- Undrawn balance: None

IV. SDR Department

- (a) Net cumulative allocation: SDR 0.59 million
- (b) Holdings: SDR 0.02 million (3.4 percent of net cumulative allocation.
- (c) Current designation plan: None

V. Administered Account:

Dominica has received SDR 0.61 million in subsidy payments under the Supplementary Financing Facility.

VI. Financial Obligations due to the Fund (in millions of SDRs)

	Overdue Obligations	Scheduled Payments				
		1991	1992	1993	1994	1995
<u>Principal</u>	--	0.67	0.54	0.54	0.54	0.56
<u>Repurchases</u>	--	0.67	0.38	0.14	--	--
<u>SAF repayments</u>	--	--	0.16	0.40	0.53	0.56
<u>Charges and interest</u>	--	0.16	0.10	0.07	0.06	0.06
<u>Total</u>	--	0.83	0.64	0.61	0.60	0.62

B. Nonfinancial Relations

VII. Exchange rate arrangement:

Since July 1976, the Eastern Caribbean dollar (EC\$) has been pegged to the U.S. dollar at the rate of EC\$2.70 per U.S. dollar.

VIII. Consultation with the Fund:

The last Article IV consultation was concluded by the Executive Board on December 15, 1989 (EBM/89/164 and SM/89/248). Dominica is on the standard 12-month consultation cycle.

IX. Technical assistance: (all from FAD)

Mr. Lent visited Roseau in April 1983 to review the proposed reform of Dominica's consumption tax. Mr. Latham visited Roseau in July 1987, to discuss certain aspects of the tax reform that was introduced in the FY 1987/88 budget. Messrs. Muten and Dubroof (member of the Panel of fiscal experts) visited Roseau in November 1987 to provide assistance in the area of taxation.

Dominica--Basic Data

<u>Area</u>	750 sq. kilometers
Arable land	213 sq. kilometers
<u>Population and related vital statistics</u>	
Population (thousand)	81.3
Annual growth in population in 1981-88 (percent)	
Crude birth rate	2.2
Population increase net of emmigration	0.6
Density	
Total (per sq. kilometer)	103.4
Arable land (per sq. kilometer)	381.8
Life expectancy at birth in 1985 (years)	75
Infant mortality rate in 1986 (per thousand)	11
<u>Nutrition (1981)</u>	
Caloric intake as percent of requirement	87.0
Per capita protein intake (grams per day)	63
<u>Health (1981)</u>	
Population per physician	4,560
Population per hospital bed	230
<u>Distribution of land ownership</u>	
Percent owned by top 10 percent of owners	...
Percent owned by smallest 10 percent of owners	...
<u>Access to electricity (1990)</u>	
Percent of population	85-90
<u>Education (1981)</u>	
Adult literacy rate (percent)	94.4
Primary school enrollment (percent)	...
<u>GDP (1989)</u>	
	SDR 104.6 million
GDP at market prices (millions of U.S. dollars)	154.9
GDP per capita (U.S. dollars)	1,905
<u>Origin of GDP (1989)</u>	
	(In percent)
Agriculture and mining	22.5
Manufacturing	5.8
Construction and utilities	7.0
Transport and communications	12.4
Government services	15.8
Other	36.4
<u>Ratios to GDP (1989)</u>	
Exports of goods and services	45.7
Imports of goods and services	85.4
Central government current revenue (FY 1989/90)	29.6
Central government current expenditure (FY 1989/90)	25.3
External public and publicly guaranteed debt, inclusive of use of Fund credit (end of year)	45.5

Annual changes in selected economic indicators	1986	1987	1988	Prel. 1989
		(In percent)		
Real GDP per capita	6.8	6.8	8.0	-1.5
Real GDP (at factor cost)	6.2	6.3	7.8	-1.7
GDP at current market prices	14.3	11.7	15.2	4.6
GDP deflator	6.2	4.2	6.6	6.4
Consumer prices (annual averages)	2.6	4.6	2.2	5.9
Money and quasi-money <u>1/</u>	12.9	24.8	14.0	14.3
Money	(16.1)	(44.4)	(5.6)	(-9.2)
Quasi-money	(11.7)	(16.7)	(18.3)	(24.9)
Net domestic assets <u>2/</u>	-6.0	-24.8	1.1	34.1
Credit to public sector (net) <u>2/</u>	(-0.6)	(-23.4)	(-11.3)	(15.9)
Credit to private sector <u>2/</u>	(2.3)	(1.9)	(24.8)	(26.5)
Merchandise exports, f.o.b.	52.8	10.6	15.8	-18.9
Merchandise imports, c.i.f.	-2.4	19.0	31.8	22.4
Travel receipts (gross)	6.1	10.6	23.5	-0.7
Central government current revenue <u>3/</u>	9.7	14.4	13.4	2.7
Central government current expenditure <u>3/</u>	4.2	9.8	5.6	7.6
Central government finances <u>3/</u>	1986/87	1987/88	1988/89	1989/90
	(In millions of Eastern Caribbean dollars)			
Domestic revenue	94.9	111.2	127.1	124.2
Total expenditure	116.1	135.6	149.7	188.1
Current account balance	7.9	13.0	22.0	17.8
Foreign grants	17.5	28.2	20.8	25.7
Overall balance	-3.7	3.7	-1.8	-38.3
Foreign concessional borrowing	9.9	17.6	17.2	22.0
Of which: Structural Adjustment Facility	(2.6)	(4.5)	(2.9)	(--)
Change in Government's foreign assets	-0.9	-0.7	-0.7	-1.1
IMF (net purchases)	-4.7	-7.4	-7.7	-5.0
Domestic financing (net) and residual	-0.6	-13.2	-6.9	22.4
Of which: ECCB	(-2.7)	(0.4)	(-0.6)	(5.0)
Balance of payments	1986	1987	1988	Prel. 1989
	(In millions of U.S. dollars)			
Merchandise exports (f.o.b.)	43.4	48.0	55.6	45.1
Merchandise imports (c.i.f.)	55.8	66.4	87.5	107.1
Travel (net)	8.1	9.1	12.0	10.5
Other services	-7.1	-8.5	-6.0	-9.2
Private transfers (net)	9.3	10.7	11.7	18.8
Balance on current account <u>4/</u>	-2.2	-7.1	-14.3	-41.9
Official transfers	10.8	9.4	9.2	7.6
Official borrowing (net)	4.2	5.3	3.5	8.9
Private capital (net) <u>5/</u>	-6.8	1.0	-1.7	24.8
Overall balance	6.1	8.6	-3.3	-0.6

- 1/ Refers to commercial banks' liabilities to the private sector.  
2/ Refers to domestic commercial banks' operations. Changes are in relation to liabilities to the private sector at the beginning of the year.  
3/ Refers to fiscal years beginning July 1.  
4/ Before foreign official transfers.  
5/ Includes errors and omissions.

Dominica--Statistical Issues

1. Outstanding Statistical Issues

a. Real sector

Data reported to the Bureau of Statistics are uncurrent and limited in coverage. No report forms are received at present but CPI data are cabled by the Eastern Caribbean Central Bank (ECCB) from its head office in St. Kitts.

b. Government finance

The latest data in the Bureau of Statistics' data base on the operations of the consolidated Central Government relate only to the fiscal year 1979. Thus no data have been published in the Government Finance Statistics Yearbook since the 1988 issue.

c. Monetary accounts

There are gaps in the reported data for the deposit money banks.<sup>2</sup>  
Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the January 1991 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the ECCB which have been provided on an infrequent basis during the past year.



Status of IFS Data

Latest Data in  
January 1991 IFS

Real Sector	- National Accounts: current prices	1986
	- Prices: CPI	December 1989
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	June 1990
	- Deposit Money Banks	August 1990
	- Other Banking Institutions	n.a.
Interest Rates	- Treasury Bill Rate	March 1989
	- Bank Lending/Deposit Rates	August 1990
	- Bond Yields	July 1990
External Sector	- Merchandise Trade: values	1989
	volumes	n.a.
	prices	n.a.
	- Balance of Payments	1988
	- International Reserves	September 1990
	- Exchange Rates	November 1990

Dominica: Financial Relations of the World Bank Group with Dominica  
As of June 30, 1990

(In millions of U.S. dollars)

	Outstanding as of June 30, 1990			Repayments
	Disbursed	Undisbursed	Total	
Total IDA	7.8	2.9	10.7	--
Road rehabilitation and maintenance project	4.4	--	4.4	--
Power project	1.5	1.7	3.2	--
Structural Adjustment Credit	2.2	1.0	3.2	--

	Net Disbursements during Fiscal Year 1/									
	Actual					Projections				
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94
Net disbursement IDA 2/	1.5	0.3	--	1.4	1.4	1.0	1.6	0.5	0.3	0.1
Road rehabilitation and maintenance project	1.5	0.3	--	--	--	--	--	--	--	--
Power	--	--	--	0.4	0.4	0.8	0.6	0.5	0.3	0.1
Structural Adjustment Credit	--	--	--	1.0	1.0	0.2	1.0	--	--	--
Memorandum item										
Interest and commitment fees	--	--	--	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Source: World Bank.

1/ World Bank fiscal year beginning July 1.

2/ No repayments were made, or expected, in the period covered in this table.