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September 4, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Dominica - Staff Report for the 1987 Article IV Consultation,  
Review of First Annual Arrangement and Request for Second  
Annual Arrangement Under Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Dominica, a review of its first annual arrangement and a request for the second annual arrangement under the structural adjustment facility. A draft decision appears on page 21.

This subject is tentatively scheduled for discussion by the Executive Board on Wednesday, October 7, 1987.

Mr. Yadav (ext. 7685) or Mr. Furtado (ext. 7692) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

DOMINICA

Staff Report for the 1987 Article IV Consultation,  
Review of First Annual Arrangement, and Request for  
Second Annual Arrangement Under Structural Adjustment Facility

Prepared by the Western Hemisphere Department

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

Approved by S. T. Beza and S. Kanasa-Thanan

September 2, 1987

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## I. Introduction

The 1987 Article IV consultation discussions with Dominica <sup>1/</sup> were held in Roseau during the period May 26-June 11, 1987 and in Washington on July 31, 1987. At the same time, the staff reviewed the performance during the period of the first annual arrangement under the Structural Adjustment Facility (SAF) and negotiated the program underlying the second annual arrangement. The representatives of Dominica included the Prime Minister, who is also Minister of Finance, Economic Development and External Affairs; the Financial Secretary; and other senior officials. Mr. Hodgson, Advisor to the Executive Director for Dominica, and Mr. Ellis, Advisor in the Eastern Caribbean Central Bank, participated in the principal policy discussions. The staff team consisted of Messrs. Yadav (Head), DaCosta, Furtado (all WHD), Shibuya (EP-WHD), Mrs. Ecevit (INS), and Mrs. Archer (Secretary-WHD). A World Bank team participated in the updating of the Policy Framework Paper (PFP) and in the revision of the medium-term public sector investment program (PSIP). A staff member from the Fiscal Affairs Department provided technical assistance to Dominica in the area of tax reform during July 7-8, 1987.

The last Article IV consultation with Dominica was concluded by the Executive Board on October 17, 1986 (SM/86/242). The Board approved a three-year SAF arrangement in an amount of SDR 1.88 million (47 percent of quota) on November 26, 1986 (EBS/86/248). A disbursement of SDR 0.8 million in support of the first year program was made on December 3, 1986. Recently, the Board increased the disbursement under the second annual arrangement from 13 1/2 percent of quota to 30 percent (EBM/87/93, June 19, 1987). The balance of 13 1/2 percent of quota, plus any augmentation, would be available to Dominica in the third year of the arrangement.

In the attached letter to the Managing Director dated August 4, 1987, the Prime Minister and Minister of Finance of Dominica requests the second annual arrangement under the SAF for SDR 1.2 million (30 percent of quota) in support of an economic program covering Dominica's fiscal year 1987/88. This amount will be available in one disbursement to Dominica upon the Board's approval of the arrangement for the second year. The updated PFP, which is annexed to the Prime Minister's letter, describes the objectives and policies to be pursued by the authorities during FY 1987/88-FY 1989/90. The Memorandum of Economic Policies, also annexed to the Prime Minister's letter, provides a more detailed description of the policies to be implemented during the second annual SAF program.

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<sup>1/</sup> Dominica accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement in December 1979. Dominica does not impose restrictions on payments and transfers for current international transactions. Dominica's relations with the Fund are summarized in Appendix A.

## II. Recent Developments and Performance Under the First Annual SAF Arrangement

The economic objectives of the first annual SAF program were generally achieved, with real GDP growth and the fiscal and balance of payments performance being either as projected or better (Table 1). All quantitative benchmarks were observed. Among other benchmarks, the authorities reorganized the Central Water Authority, strengthened the management of the Co-Operative Citrus Growers Association, and divested the Dominica Electricity Services Limited. However, the following benchmarks were not observed: (i) completion of the Organization and Management exercise for the civil service has been delayed because of difficulties in arranging external assistance (nevertheless, the authorities have continued to hold down the wage bill, as envisaged under the SAF program); (ii) the merger of the Tourist Board and the Industrial Development Corporation (IDC) has been postponed until September 1987 because of administrative difficulties; and (iii) the enactment of legislation setting the framework for wage negotiations in the public sector has been postponed because of delays in arranging the services of foreign consultants. In addition, the authorities have postponed the adjustment of port charges until the completion of a comprehensive review of port charges in the Caribbean region aimed at determining the level of charges that would preserve Dominica's international competitiveness.

The rate of growth of real GDP, which had moderated to less than 2 percent in 1985, picked up to 4 percent in 1986 (as projected under the SAF program) on the strength of a recovery in agriculture (Table 2). Consumer prices rose by 3 percent in 1986, compared with just over 2 percent in 1985, but the rise in the GDP deflator (which is more influenced by wage cost developments) slowed to 5 1/2 percent from 7 1/2 percent.

The current account of the nonfinancial public sector, which had moved from a deficit of 2 percent of GDP in FY 1982/83 to a surplus of 6 percent in FY 1985/86, strengthened further in FY 1986/87 when public sector savings reached 7 1/2 percent of GDP (Table 3). Capital outlays fell from 16 1/2 percent of GDP in FY 1985/86 to 10 1/2 percent in FY 1986/87; to a large extent this reduction had been expected, as it was related to the completion of the major roads project, but also included an unplanned element (particularly the postponement of a water export project). 1/ External grants and concessionary loans (mostly project related) covered the bulk of capital outlays in FY 1986/87, as they had in previous years, and virtually all public sector savings were

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1/ Implementation of the water export project, which was to be financed by nonconcessionary loans of EC\$8.1 million from abroad and EC\$0.5 million from domestic sources, has been postponed from FY 1986/87 to the current fiscal year because of delays in completing transportation and marketing arrangements.

Table 1. Dominica: Selected Economic and Financial Indicators, 1982-89

	1982	1983	1984	1985	Prog. 1/ 1986	Prel. 1986	Program		
							1987	1988	1989
(Percentage changes, unless otherwise specified)									
<u>National income and prices</u>									
GDP at constant prices	2.4	2.1	6.2	1.8	4.0	4.0	4.0	4.0	4.0
GDP deflator	4.5	8.3	5.1	7.7	3.0	5.7	3.5	3.5	3.5
Consumer prices	4.4	4.1	2.2	2.1	2.5	3.0	3.5	3.5	3.5
<u>External sector (on the basis of U.S. dollars)</u>									
Exports, f.o.b.	28.3	12.2	-6.9	10.5	18.1	37.5	8.0	9.0	9.2
Imports, c.i.f.	-4.4	-0.8	18.5	2.5	14.2	-2.6	22.8	14.2	7.4
Export volume	9.6	16.3	-3.9	-2.4	16.7	23.7	13.9	7.4	7.4
Import volume	-2.1	0.8	19.2	3.0	11.2	-8.3	18.1	9.8	3.3
Terms of trade (deterioration -)	14.0	2.8	-2.7	7.9	3.8	1.8	-8.6	-1.9	-1.9
Nominal effective exchange rate (depreciation -)	6.7	8.0	14.2	6.3	...	-5.7	-2.5	--	--
Real effective exchange rate (depreciation -)	3.3	6.2	8.3	1.2	...	-7.0	-2.1	--	--
<u>Money and credit 2/</u>									
Domestic credit (net) 3/	0.2	8.3	6.1	7.2	7.2	-9.5	-0.6	-0.1	3.1
Public sector	(-3.6)	(-0.4)	(-2.3)	(-3.7)	(-8.8)	(-3.5)	(-9.5)	(-12.9)	(-11.3)
Private sector	(11.7)	(9.7)	(9.0)	(9.1)	(16.0)	(2.5)	(10.0)	(13.9)	(15.5)
Money and quasi-money (M-2) 4/	17.3	8.2	11.6	5.9	7.1	17.6	11.2	7.6	7.6
Velocity (GDP relative to M-2)	2.7	2.8	2.8	2.9	2.8	2.8	2.7	2.7	2.7
Interest rate on one-year time deposits	6.0	5 3/4	5 3/4	5 3/4	5.0	5.0	4 3/4	4 3/4	4 3/4
Interest rate on consumer loans	11 1/4	11 1/4	11 1/2	12.0	12.0	12.0	12.0	12.0	12.0
<u>Central government operations 5/</u>									
Domestic revenues	2.5	20.1	6.7	13.7	6.6	10.5	1.7	2.7	7.4
Expenditures and net lending	3.0	17.9	20.8	1.4	0.1	-7.5	19.5	8.8	9.9
(In percent of GDP, unless otherwise specified) 6/									
<u>Central government operations 5/</u>									
Current balance	-2.4	0.1	--	1.1	1.5	1.7	1.0	1.0	1.6
Overall balance (before grants)	-14.6	-14.9	-20.1	-15.1	-11.4	-7.9	-13.7	-15.5	-16.5
Overall balance	-7.6	-6.0	-6.0	-2.1	-3.5	-2.8	-4.1	-6.9	-3.8
Nonconcessionary financing	4.1	1.0	1.3	0.5	-1.1 7/	-1.1	-2.0	-1.7	-1.1
<u>External sector</u>									
Current account deficit (-)	-12.3	-7.6	-4.4	-8.9	-6.6	-3.8	-3.4	-7.3	-5.2
Current account deficit before official transfers (-)	-20.3	-13.0	-20.7	-21.0	-22.4	-8.1	-14.9	-17.6	-16.9
<u>External debt</u>									
Inclusive of use of Fund credit	47.7	51.1	48.9	49.3	52.2	50.4	52.5	56.7	57.5
External debt service as a percent of receipts from exports of goods and services and net private transfers	4.0	6.9	10.1	9.4	9.2	8.6	9.5	10.2	9.4
Overall balance of payments (in millions of SDRs)	-1.4	-4.1	6.0	-1.0	1.1	4.4	3.8	3.5	3.3
Gross official reserves (months of imports) 8/	1.3	0.6	1.8	1.3	1.3	2.3	2.6	2.6	2.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ Structural Adjustment Facility program beginning July 1.

2/ Refers to domestic commercial banks' operations.

3/ In relation to commercial banks' liabilities to private sector at the beginning of the period.

4/ Refers to commercial banks' liabilities to private sector.

5/ Refers to fiscal years beginning July 1.

6/ Based on revised historical data on GDP.

7/ Adjusted to reflect the delay in the implementation of the water export project and use of the temporary borrowing provision related to shortfalls in aid disbursements.

8/ Refers to sinking funds held abroad and Dominica's imputed share in the international reserves of the ECCB. However, these resources are not freely available to Dominica.

Table 2. Dominica: Production and Price Indicators

	1982	1983	1984	1985	Prel. 1986	Proj.	
						1987	1988
<u>(In millions of Eastern Caribbean dollars)</u>							
Nominal GDP at market prices	194.8	216.2	241.7	267.5	298.1	320.9	345.4
Nominal GDP at factor cost	163.6	180.9	201.9	221.4	243.5	262.0	282.1
Real GDP at factor cost	100.5	102.6	108.9	110.9	115.4	120.0	124.8
<u>(Percentage change)</u>							
Nominal GDP at market prices	9.1	11.0	11.8	10.7	11.4	7.6	7.6
Nominal GDP at factor cost	7.0	10.6	11.6	9.7	10.0	7.6	7.6
Real GDP at factor cost	2.4	2.1	6.2	1.8	4.0	4.0	4.0
Agriculture	(2.3)	(0.8)	(5.5)	(-2.5)	(10.8)	(6.7)	(5.6)
Of which: crops	/3.5/	/0.1/	/6.0/	/-7.1/	/14.1/	/8.0/	/6.0/
Manufacturing	(17.4)	(2.0)	(-1.0)	(14.0)	(3.0)	(3.0)	(4.0)
Construction	(-13.2)	(-5.6)	(40.9)	(-10.9)	(-17.0)	(6.0)	(5.5)
Transport and communication	(13.9)	(26.6)	(4.9)	(11.0)	(8.5)	(5.0)	(6.0)
Hotels and restaurants	(10.3)	(14.6)	(2.7)	(-3.5)	(3.0)	(5.0)	(5.0)
GDP deflator at factor cost	4.5	8.3	5.1	7.7	5.7	3.5	3.5
Consumer price index	4.4	4.1	2.2	2.1	3.0	3.5	3.5

Sources: Statistical Division, Ministry of Finance; and Fund staff estimates.

reflected in a reduction of outstanding nonconcessionary debt (including net repurchases to the Fund and a strengthening of the net position with the domestic financial institutions).

Table 3. Dominica: Consolidated Operations of the  
Nonfinancial Public Sector 1/

(In percent of GDP)

	1982/83	1983/84	1984/85	1985/86	Prel. <u>2/</u> 1986/87
Current revenue	30.7	32.9	32.4	34.7	35.6
Current expenditure	32.5	31.3	30.0	28.9	28.0
<u>Current balance</u>	<u>-1.8</u>	<u>1.6</u>	<u>2.4</u>	<u>5.8</u>	<u>7.6</u>
Capital receipts	1.0	0.1	--	--	0.7
Foreign grants	8.4	9.9	15.0	13.6	5.3
Capital expenditure	16.3	16.1	20.7	16.7	10.5
<u>Overall balance</u>	<u>-8.6</u>	<u>-4.5</u>	<u>-3.3</u>	<u>2.8</u>	<u>3.1</u>
Concessionary foreign borrowing	6.3	5.5	4.8	2.0	4.1
Nonconcessionary financing	2.4	-1.1	-1.5	-4.8	-7.2

Sources: Ministry of Finance; nonfinancial public enterprises; Social Security Scheme; and Fund staff estimates.

1/ Fiscal years begin July 1. The public sector comprises the Central Government, nonfinancial public enterprises, the Social Security Scheme, local governments, the Industrial Development Corporation, and the Tourist Board.

2/ Based on part-year data.

The overall deficit (after grants) of the Central Government widened somewhat in FY 1986/87 but not as much as had been provided in the SAF program (Table 4). External grants fell substantially more than anticipated in the program, but this was largely offset by a shortfall in capital outlays. The inflow of external concessionary loans more

Table 4. Dominica: Central Government Operations <sup>1/</sup>

	1982/83	1983/84	1984/85	1985/86	Program 2/ Prel. 1986/87	1986/87	Program 2/ 1987/88	1988/89	1989/90
(In millions of Eastern Caribbean dollars)									
<u>Total revenue</u>	72.6	90.4	110.5	121.5	114.6	109.3	127.4	128.7	153.9
Current revenue	57.7	69.7	74.6	84.7	90.4	91.6	94.1	97.9	105.1
Tax revenue	(49.4)	(60.2)	(65.8)	(76.3)	(81.1)	(84.5)	(85.5)	(88.8)	(95.5)
Nontax revenue	(8.3)	(9.5)	(8.7)	(8.4)	(9.3)	(7.1)	(8.6)	(9.1)	(9.6)
Capital receipts	0.5	0.2	0.1	0.1	--	2.1	1.2	--	--
Foreign grants	14.4	20.5	35.9	36.7	24.2	15.6	32.1	30.8	48.8
Of which: budgetary foreign grants	(1.0)	(--)	(--)	(4.1)	(6.8)	(--)	(9.5)	(5.4)	(5.4)
<u>Total expenditure</u>	88.3	104.1	125.7	127.5	125.5	118.0	141.0	153.4	168.6
Current expenditure	62.6	69.5	74.5	81.6	85.9	86.3	90.7	94.3	99.0
Wages and salaries	(35.8)	(39.6)	(42.3)	(47.1)	(49.4)	(49.3)	(52.8)	(54.4)	(56.0)
Goods and services	(12.0)	(13.4)	(12.9)	(14.0)	(16.2)	(16.4)	(16.5)	(17.5)	(19.5)
Interest	(4.7)	(6.3)	(7.3)	(7.6)	(6.9)	(6.9)	(7.2)	(7.5)	(7.9)
Retirement benefits	(4.3)	(4.3)	(5.0)	(5.0)	(5.0)	(5.3)	(5.5)	(5.8)	(6.1)
Transfers	(5.8)	(5.9)	(7.0)	(7.9)	(8.4)	(8.4)	(8.7)	(9.1)	(9.5)
Capital expenditure and net lending	25.7	34.6	51.2	45.9	39.6	31.7	50.3 <sup>3/</sup>	59.1 <sup>3/</sup>	69.6 <sup>3/</sup>
Of which: locally financed	(4.7)	(2.1)	(2.4)	(7.2)	(9.1)	(5.0)	(8.9)	(8.2)	(5.4)
<u>Current account balance</u>	-4.9	0.2	0.1	3.1	4.5	5.3	3.4	3.6	6.1
<u>Overall balance before grants</u>	-30.1	-34.2	-51.1	-42.7	-35.1	-24.3	-45.7	-55.5	-63.5
<u>Overall balance</u>	-15.7	-13.7	-15.2	-6.0	-10.9	-8.7	-13.6	-24.7	-14.7
Concessionary foreign borrowing (net)	7.2	11.4	11.8	4.6	5.3	9.4	16.1	29.0	19.0
Structural Adjustment Facility	--	--	--	--	2.4	2.6	4.1	1.8	--
<u>Nonconcessionary financing</u>	8.5	2.3	3.4	1.4	3.2	-3.3	-6.6	-6.1	-4.3
Reserve-type transactions	7.5	2.1	-0.2	-0.5	1.9	-7.8	-3.5	-7.9	-5.7
IMF	(7.6)	(0.7)	(-2.1)	(-4.5)	(-4.2)	(-4.7)	(-7.2)	(-7.2)	(-5.0)
Change in government foreign assets (increase -)	(-0.1)	(-0.6)	(-0.4)	(-0.8)	(-0.7)	(-0.9)	(-3.0)	(-0.7)	(-0.7)
Other foreign	(--)	(--)	(0.2)	(--)	(8.1) <sup>4/</sup>	(--)	(9.0) <sup>4/</sup>	(--)	(--)
ECCB	(--)	(2.0)	(2.1)	(4.8)	(-1.3)	(-2.2)	(-2.3)	(--)	(--)
Domestic commercial banks	1.8	--	0.8	-0.5	1.3	-3.3	-3.1	1.8	1.4
Social Security Scheme	-0.1	2.0	2.0	4.2	--	--	--	--	--
Other domestic	-0.6	--	--	0.6	--	7.7	--	--	--
Residual	-0.1	-1.8	0.8	-2.4	--	0.1	--	--	--
<u>Memorandum item</u>									
Nonconcessionary financing (adjusted)	8.5	2.3	3.4	1.4	-3.4 <sup>5/</sup>	-3.3	-6.6	-6.1	-4.3
(In percent of GDP) <sup>6/</sup>									
<u>Total revenue</u>	35.3	39.5	43.4	43.0	37.2	35.3	38.2	35.9	39.9
Current revenue	28.1	30.4	29.3	30.0	29.4	29.6	28.2	27.3	27.2
Foreign grants	7.0	9.0	14.1	13.0	7.9	5.0	9.6	8.6	12.6
Of which: budgetary foreign grants	(0.5)	(--)	(--)	(1.4)	(2.2)	(--)	(2.9)	(1.5)	(1.4)
<u>Total expenditure</u>	43.0	45.5	49.4	45.1	40.8	38.1	42.3	42.8	43.7
Current expenditure	30.5	30.3	29.3	28.9	27.9	27.9	27.2	26.3	25.6
Capital expenditure and net lending	12.5	15.1	20.1	16.2	12.9	10.2	15.1	16.5	18.0
<u>Current account balance</u>	-2.4	0.1	--	1.1	1.5	1.7	1.0	1.0	1.6
<u>Overall balance before grants</u>	-14.6	-14.9	-20.1	-15.1	-11.4	-7.9	-13.7	-15.5	-16.5
<u>Overall balance</u>	-7.6	-6.0	-6.0	-2.1	-3.5	-2.8	-4.1	-6.9	-3.8
Concessionary loans	3.5	5.0	4.7	1.6	2.5	3.9	6.1	8.6	4.9
Nonconcessionary financing (adjusted)	4.1	1.0	1.3	0.5	-1.1 <sup>5/</sup>	-1.1	-2.0	-1.7	-1.1

Sources: Ministry of Finance; and Fund staff estimates.

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

<sup>2/</sup> Structural Adjustment Facility program beginning July 1.

<sup>3/</sup> Includes the on-lending of external concessionary loans to the Dominica Electricity Services Ltd., of EC\$5 million in FY 1987/88 and EC\$17 million each in FY 1988/89 and FY 1989/90 for a hydropower project. This project was previously included in the public sector investment program, but it had been assumed that would be covered by direct external financing to the company.

<sup>4/</sup> Refers to loans for a water export project, the implementation of which has been postponed from FY 1986/87 to FY 1987/88.

<sup>5/</sup> Adjusted to reflect the delay in the implementation of the water export project and use of the temporary borrowing provision in FY 1986/87 due to the shortfall in aid disbursements.

<sup>6/</sup> Based on revised historical data on GDP.

than covered the overall deficit, and the Government reduced its non-concessionary debt by EC\$3.3 million or 1 percent of GDP, compared with a reduction of EC\$3.4 million envisaged in the program. 1/

The overall financial position of the rest of the public sector, which had shifted from a small deficit in FY 1982/83 to a surplus of nearly 5 percent of GDP in FY 1985/86, improved to a surplus of 6 percent of GDP in FY 1986/87. About one half of last year's surplus corresponded to the Social Security Scheme and the other half to the public enterprises. The position of the latter was strengthened last year as a result of a substantial rise in banana production and exports.

The liquidity position of commercial banks improved further in 1986, reflecting the growth of deposits and a strengthening of the public finances. However, the rate of growth of bank credit to the private sector moderated from an annual average of 9 1/2 percent during 1982-85 to 2 1/2 percent in 1986, perhaps owing to loan repayments by banana producers made possible by strong export receipts. Interest rates, which generally reflect market forces, were positive in real terms in 1986.

The current account deficit of the balance of payments (before grants), which averaged 18 percent of GDP in 1982-84 and rose to 21 percent of GDP in 1985, narrowed to 8 percent of GDP in 1986 as the merchandise trade deficit was nearly halved to 15 percent of GDP (Table 5). After moving sluggishly during 1982-84, the value of merchandise exports began to recover in 1985 and surged by more than one third in 1986 as a result of a substantial increase in banana export volumes and prices. The value of imports, in contrast, declined in 1986 in reflection of the reduction of investment activity. Although external grants and capital inflows taken together declined in 1986, they were more than sufficient to cover the reduced deficit on trade, services, and private transfers, and the overall balance shifted to a sizable surplus in 1986 from a small deficit in 1985.

Dominica's public external debt, which is mostly on concessionary terms, rose from 47 1/2 percent of GDP at the end of 1982 to an estimated 50 1/2 percent of GDP at the end of 1986 (Table 6). The ratio of external debt service payments to exports of goods and services and net private transfers increased from 4 percent in 1982 to 10 percent in 1984 but it then declined to 8 1/2 percent in 1986 (compared with a projected 9 percent), reflecting further improvements in debt structure and increased export earnings. In recent years, more than one half of debt service consisted of payments to the Fund.

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1/ After allowing for the delay in respect of a major water export project and the provision of temporary domestic borrowing related to the shortfall in aid disbursements.

Table 5. Dominica: Summary Balance of Payments 1/

	1982	1983	1984	1985	Prel. 1986	Projections 2/				
						1987	1988	1989	1990	1991
(In millions of U.S. dollars)										
Current account balance	-8.8	-6.0	-3.9	-8.8	-4.2	-4.0	-9.3	-7.2	-3.4	-2.3
Trade balance	-23.0	-19.6	-30.2	-28.9	-16.8	-26.4	-32.3	-33.9	-31.3	-30.0
Exports, f.o.b.	(24.5)	(27.5)	(25.6)	(28.3)	(38.9)	(42.0)	(45.8)	(50.0)	(54.5)	(59.5)
Imports, c.i.f.	(-47.5)	(-47.1)	(-55.8)	(-57.2)	(-55.7)	(-68.4)	(-78.1)	(-83.9)	(-85.8)	(-89.5)
Travel (net)	4.3	6.0	8.5	7.3	7.5	8.2	8.9	10.0	10.9	11.9
Interest payments (net)	-0.8	-1.7	-2.0	-2.0	-2.1	-2.1	-2.1	-2.5	-2.7	-2.8
Other services (net)	0.3	-0.1	-1.1	-3.7	-4.3	-4.3	-4.4	-4.5	-4.7	-4.9
Private transfers (net)	4.6	5.0	6.3	6.5	6.8	7.1	7.4	7.7	8.1	8.4
Official transfers	5.8	4.4	14.6	12.0	4.7	13.6	13.2	16.0	16.3	15.1
Capital account	7.3	1.6	10.1	7.8	9.4	8.8	13.7	11.3	6.5	4.9
Public sector borrowing (net)	8.2	5.9	4.7	4.6	5.1	7.2	12.0	9.0	4.2	2.0
Commercial banks (net)	-1.6	-2.4	3.0	-0.8	-2.9	-2.3	-1.6	-0.9	-0.3	-0.1
Direct investment	0.2	0.2	2.3	3.0	6.1	3.9	3.3	3.2	2.6	3.0
Short-term capital (including errors and omissions)	0.5	-2.1	0.1	1.0	1.1	--	--	--	--	--
Overall surplus or deficit (-)	-1.5	-4.4	6.2	-1.0	5.2	4.8	4.4	4.1	3.1	2.6
Financing	1.5	4.4	-6.2	1.0	-5.2	-4.8	-4.4	-4.1	-3.1	-2.6
Change in official reserves 3/	-1.8	3.0	-6.1	2.7	-4.2	-3.2	-2.0	-1.5	-1.5	-1.5
Change in foreign assets	0.2	-0.4	0.2	-0.2	-0.3	-1.1	-0.3	-0.3	-0.3	-0.3
Net credit from IMF 4/	3.1	1.8	-0.3	-1.5	-0.7	-0.5	-2.1	-2.3	-1.3	-0.8
(In percent of GDP)										
Current account balance	-12.3	-7.6	-4.4	-8.9	-3.8	-3.4	-7.3	-5.2	-2.3	-1.4
Trade balance	-31.9	-24.5	-33.7	-29.2	-15.2	-22.3	-25.3	-24.6	-21.1	-18.8
Exports (f.o.b.)	(34.0)	(34.3)	(28.6)	(28.6)	(35.2)	(35.3)	(35.8)	(36.3)	(36.8)	(37.3)
Imports (c.i.f.)	(-65.8)	(-58.8)	(-62.3)	(-57.7)	(-50.4)	(-57.6)	(-61.1)	(-60.9)	(-57.9)	(-56.1)
Travel (net)	5.9	7.4	9.5	7.4	6.8	6.9	7.0	7.2	7.3	7.4
Official transfers	8.0	5.5	16.3	12.1	4.3	11.5	10.3	11.6	11.0	9.5
Current account balance (before official transfers)	-20.3	-13.0	-20.7	-21.0	-8.1	-14.9	-17.6	-16.9	-13.3	-10.9
Overall balance	-2.1	-5.5	6.9	-1.0	4.7	4.0	3.4	3.0	2.1	1.6

Sources: Statistical Division, Ministry of Finance; and Fund staff estimates.

1/ Based on partial information on certain external transactions compiled by Dominica officials. There are no complete official balance of payments estimates.

2/ If the projects for which sources of financing are not yet identified were to be excluded, imports as well as corresponding grants would be lower by an average of 7 percent of GDP per year in 1988-90.

3/ Refers to change in Dominica's imputed share in the international reserves of the ECCB. These reserves are not freely available to Dominica.

4/ Includes actual and projected disbursements under the Structural Adjustment Facility.

Table 6. Dominica: Public and Publicly Guaranteed External Debt and Debt Service

	1982	1983	1984	1985	Prel. 1986	1987	1988	1989	1990	1991
	<u>(In millions of U.S. dollars)</u>									
Debt service on total debt	1.4	2.8	4.4	4.2	4.9	5.8	6.8	6.8	6.2	5.9
Amortization	0.7	1.1	2.4	2.2	2.8	3.7	4.6	4.3	3.6	3.2
Interest	0.8	1.7	2.0	2.0	2.1	2.1	2.1	2.5	2.7	2.8
On debt outstanding as of December 31, 1986	1.4	2.8	4.4	4.2	4.9	5.8	6.4	5.8	4.7	4.1
Amortization	0.7	1.1	2.4	2.2	2.8	3.7	4.6	4.3	3.4	3.0
Interest	0.8	1.7	2.0	2.0	2.1	2.1	1.7	1.5	1.3	1.1
IMF	0.6	1.6	2.8	2.5	2.4	2.8	3.3	2.6	1.4	1.0
Repurchases	--	0.7	1.8	1.5	1.6	2.0	2.8	2.3	1.3	0.8
Charges	0.6	0.8	1.0	0.9	0.9	0.8	0.5	0.3	0.2	0.1
Other	0.8	1.3	1.6	1.8	2.4	3.0	3.1	3.1	3.3	3.2
Amortization	0.7	0.4	0.6	0.7	1.2	1.7	1.9	2.0	2.2	2.2
Interest	0.2	0.9	1.0	1.1	1.2	1.3	1.2	1.1	1.1	1.0
On additional borrowing 1/	--	--	--	--	--	--	0.4	1.0	1.5	1.8
Amortization	--	--	--	--	--	--	--	--	0.1	0.1
Interest	--	--	--	--	--	--	0.4	1.0	1.4	1.7
	<u>(In percent of exports of goods and services and net private transfers)</u>									
Debt service on total debt	4.0	6.9	10.1	9.4	8.6	9.5	10.2	9.4	8.0	7.0
Amortization	1.8	2.7	5.5	4.9	5.0	6.1	7.0	5.9	4.6	3.7
Interest	2.1	4.2	4.6	4.5	3.6	3.5	3.2	3.4	3.4	3.3
Debt service, excluding IMF	2.3	3.1	3.7	4.0	4.3	5.0	5.2	5.7	6.1	5.8
Amortization	1.8	0.9	1.3	1.5	2.2	2.8	2.8	2.7	2.9	2.7
Interest	0.5	2.2	2.4	2.4	2.1	2.2	2.4	3.0	3.2	3.1
	<u>(In millions of U.S. dollars, end of year)</u>									
Total external debt outstanding	34.4	40.9	43.8	48.8	55.6	62.4	72.5	79.2	82.2	83.4
IMF	10.3	11.5	10.5	10.1	10.6	10.1	8.0	5.7	4.4	3.6
Other	24.1	29.4	33.3	38.8	45.1	52.3	64.4	73.5	77.7	79.8
	<u>(In percent of GDP)</u>									
Total external debt outstanding	47.7	51.1	48.9	49.3	50.4	52.5	56.7	57.5	55.4	52.2
	<u>(In percent of total external debt outstanding)</u>									
Concessional debt	64.9	66.4	71.2	75.0	79.5	82.3	84.5	89.0	91.3	92.8

Sources: Ministry of Finance; and Fund staff estimates.

1/ Assumes borrowing (largely on concessional terms) of about US\$9 million per year in 1987-91.

### III. Report on the Article IV Consultation Discussions and the Second Annual SAF Arrangement

The economic program that is supported by the SAF arrangement is aimed at achieving an annual rate of growth of real GDP of about 4 percent in the medium term through policies that would expand domestic savings, strengthen the fiscal and balance of payments positions, contain the public external debt within manageable proportions, and build up a cushion of reserves against external shocks. The broad economic objectives of the first annual SAF program, as noted, were achieved, and the authorities believe that the program's medium-term objectives continue to be generally appropriate.

The program for the next few years provides for further improvements in the country's infrastructure and incentives for the private sector. <sup>1/</sup> In particular, public sector investment is expected to recover from its low level in FY 1986/87, and fiscal incentives to private investment and production would be strengthened through a comprehensive tax reform that would rationalize the tax system and reduce the tax burden. At the same time, government current expenditure would be restrained, particularly through moderation in wage adjustments under the next three-year wage contract with the civil service and the rationalization of the civil service. The government nonconcessionary debt would continue to be reduced over the next few years, which would enhance the domestic commercial banks' capacity to finance the private sector.

The current projections of the main fiscal and balance of payments variables for the rest of the SAF arrangement show a number of differences with respect to the projections presented in the original program (see EBS/86/248), owing to several factors. First, the postponement of the water export project (referred to above) lowered government capital expenditure in FY 1986/87 and would raise it in FY 1987/88; as a result, the overall government deficit was smaller than projected in FY 1986/87 and has been revised upward for FY 1987/88, with corresponding changes in the net use of nonconcessionary financing (since the project is expected to be financed by loans on commercial terms). Second, a technical adjustment was made in the fiscal projections to allow for the financing of a hydro-electricity project through an external loan to the Government, the proceeds of which will be on-lent to the electricity company; this project had been included in the PSIP but it had been assumed that it would be financed by a direct external loan to the company. The effect has been to raise the overall fiscal deficit in FY 1987/88 and even more in FY 1988/89, with a

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<sup>1/</sup> The broad economic parameters and indicators of the program for FY 1987/88-FY 1989/90 are presented in Table 1 (also see Tables 2 through 7, and the Memorandum of Economic Policies annexed to the Prime Minister's letter). The objectives and timing of the main policy actions, which have been taken recently or would be taken during the program period, are summarized in Table 1 of the PFP.

corresponding increase in concessionary borrowing, without affecting the net nonconcessionary financing. Third, the tax reform had been expected to be revenue neutral but in the present form is projected to result in some decline in revenue and a weakening of government savings (relative to the earlier projection). This shortfall is to be offset by an increase in external assistance.

While the combined net effect of the various factors discussed above is to raise the overall fiscal deficit in the three-year period of the SAF arrangement, and specifically in FY 1987/88 and FY 1988/89, the reduction in nonconcessionary debt (the variable subject to benchmark) in the period as a whole would not be affected, although there would be some timing changes within the period. There would also be timing changes in the current and overall balance of payments positions, but the external performance over the period of the SAF arrangement would not be weakened.

1. The public finances

a. The public sector investment program (PSIP)

The pace of implementation of the PSIP, which slowed in FY 1986/87, is expected to pick up in FY 1987/88, ensuring the attainment of total capital outlays previously envisaged for the three years of the SAF arrangement (Table 7). The projections of capital outlays beyond the SAF arrangement period have been tentatively revised upward, reflecting mainly the inclusion of an international airport and new road projects. The World Bank believes that the proposed PSIP for FY 1987/88-FY 1989/90 is within the absorptive capacity of the country and is consistent with the achievement of the program's objectives.

Of the proposed capital outlays averaging 19 percent of GDP in FY 1987/88-FY 1989/90, 19 1/2 percent would be allocated to the provision of agricultural inputs and credit, 62 1/2 percent to infrastructure, and most of the remainder to social services and the public administration. Project-related external grants and concessionary loans are expected to finance some 85 percent of outlays. Sources of financing have been identified for all projects included in the PSIP for FY 1987/88 and for about 70 percent and 40 percent, respectively, of the proposed outlays in the subsequent two years; the authorities expect financing to become available in due course, or else they would curtail the proposed PSIP.

The World Bank, which provided financial assistance to Dominica for the major roads project, has agreed recently to cofinance a hydro-power project with IDA funds of US\$3 million. In addition, the World Bank has concluded recently a Structural Adjustment Credit of US\$3 million with Dominica. The Caribbean Development Bank (CDB), which obtains part of its funding from IDA, has been providing concessionary loans to Dominica.

Table 7. Dominica: Public Sector Investment Program 1/

	Fiscal Year 1986/87			Fiscal Year 1987/88			Fiscal Year 1988/89 2/			Fiscal Year 1989/90 2/		
	Total	Grants	Loans	Total	Grants	Loans	Total	Grants	Loans	Total	Grants	Loans
(In millions of Eastern Caribbean dollars)												
Total	41.8	19.5	16.9	66.4	24.8	31.6	67.4	29.9	28.0	72.1	45.4	20.8
Agriculture	7.6	2.5	2.6	11.2	5.1	2.7	14.8	9.6	3.3	14.4	10.0	3.8
Education	2.9	1.6	1.1	3.0	0.6	2.0	3.2	0.5	2.6	1.1	1.0	--
Energy	4.8	3.9	1.0	5.2	0.1	5.0	17.1	0.1	17.0	17.0	--	17.0
Health and social services	3.5	2.0	1.1	3.4	2.3	0.9	3.0	2.3	0.6	1.2	1.0	--
Housing	3.9	--	3.7	3.0	--	2.4	2.6	2.0	0.1	4.3	4.0	--
Industrial estates	0.1	--	--	0.3	--	--	1.3	1.2	--	0.3	0.3	--
Roads	10.8	4.9	5.0	14.8	7.4	5.6	12.8	8.1	2.7	16.2	15.2	--
Tourism	0.3	0.2	--	0.6	0.6	--	2.3	2.2	--	2.1	2.0	--
Transportation	3.3	3.2	--	2.7	2.5	--	1.2	1.2	--	10.0	9.0	--
Water and sewerage	0.5	0.5	--	12.6	2.5	9.0	3.7	2.4	--	2.5	2.0	--
Other	4.1	0.7	2.4	9.6	3.7	4.0	5.4	0.3	1.7	3.0	0.9	--
(In percent of total public investment)												
Total	100.0	46.7	40.4	100.0	37.3	47.6	100.0	44.4	41.5	100.0	63.0	28.8
Agriculture	18.2	6.0	6.2	16.9	7.7	4.1	22.0	14.2	4.9	20.0	13.9	5.3
Education	6.9	3.8	2.6	4.5	0.9	3.0	4.7	0.7	3.9	1.5	1.4	--
Energy	11.5	9.3	2.4	7.8	0.2	7.5	25.4	0.1	25.2	23.6	--	23.6
Health and social services	8.4	4.8	2.6	5.1	3.5	1.4	4.5	3.4	0.9	1.7	1.4	--
Housing	9.3	--	8.9	4.5	--	3.6	3.9	3.0	0.1	6.0	5.5	--
Industrial estates	0.2	--	--	0.5	--	--	1.9	1.8	--	0.4	0.4	--
Roads	25.8	11.7	12.0	22.3	11.1	8.4	19.0	12.0	4.0	22.5	21.1	--
Tourism	0.7	0.5	--	0.9	0.9	--	3.4	3.3	--	2.9	2.8	--
Transportation	7.9	7.7	--	4.1	3.8	--	1.8	1.8	--	13.9	12.5	--
Water and sewerage	1.2	1.2	--	19.0	3.8	13.6	5.5	3.6	--	3.5	2.8	--
Other	9.8	1.7	5.7	14.5	5.6	6.0	8.0	0.4	2.5	4.2	1.2	--
(In percent)												
Memorandum item												
Total investment/GDP 3/	13.5			19.9			18.8			18.7		
	(19.5)			(16.9)			(18.9)			(12.3)		

Source: Ministry of Finance.

1/ Includes the on-lending of concessionary funds from external sources by the Dominica Agricultural Industrial, and Development Bank. Grants and loans refer to project-related grants and loans only.

2/ The PSIP for FY 1988/89 and FY 1989/90 is preliminary and contains several tentative projects for which the sources of external financing have not yet been identified.

3/ Figures in bracket refer to ratios envisaged earlier.

b. The Central Government

Under the proposed program, the overall deficit of the Central Government (after grants) would widen from 3 percent of GDP in FY 1986/87 to 4 percent in FY 1987/88, as a rise in capital outlays and a decline in the current account surplus (explained above) would be offset only partially by higher external grants (see Table 4). However, net concessionary loans would more than cover the overall deficit, thereby facilitating a reduction of EC\$6.6 million (2 percent of GDP) in the government nonconcessionary debt; at least EC\$4 million of this reduction is to be achieved in the first half of FY 1987/88. As in the first annual arrangement, the target for the reduction in nonconcessionary debt may be lowered by up to EC\$2 million to meet temporary needs arising from unforeseen developments, such as delays in aid disbursements.

The Government will not guarantee loans from foreign sources on nonconcessionary terms in FY 1987/88. During the three-year period of the SAF arrangement, the Government will neither accumulate payments arrears nor borrow from foreign sources on nonconcessionary terms, except for the water export project and such other selected investment projects which would be subject to prior review by the staff of the Fund and the World Bank as regards their financial viability and their consistency with the achievement of the program's objectives. If any project in the agreed PSIP were not undertaken, the Government will not engage in nonconcessionary borrowing related to that project and, therefore, the reduction in nonconcessionary debt will be correspondingly larger.

Under the SAF program, the authorities were expected to implement a revenue-neutral tax reform by mid-1987 with the objective of broadening the tax base and reducing disincentives to investment and production. In the event, the latest budget included a tax reform that reduced the high rates and steep progressivity in the income tax, simplified and consolidated indirect taxes (inter alia, by establishing a 3 percent tax on gross sales), introduced a development levy on banana exports and a tax credit for certain types of investment, and removed the withholding tax on profits retained locally (Appendix D).

The authorities estimated that the tax reform would result in a net revenue loss averaging 1 1/2 percent of GDP through FY 1989/90, followed by net revenue gains as the economy expands in response to the additional incentives furnished by the reform. Aside from the uncertainty about the effects of the reform on economic activity and the tax base, the staff noted that the revenue estimates (particularly as regards the new tax on gross sales) assumed improvements in collection procedures that would require substantial efforts over a period of time. The staff also drew attention to the distortions that could arise from a cascading sales tax such as that being introduced. In this respect, the authorities indicated that they would modify the tax to eliminate its cascading feature, with the Fund's Fiscal Affairs Department being

expected to provide technical assistance for this purpose before the end of this year. As regards the levy on banana exports, the authorities noted that it applies only if export prices exceed a remunerative minimum level and thus is not expected to discourage exports.

Current expenditure, which fell from 30 1/2 percent of GDP in FY 1982/83 to 28 percent in FY 1986/87, is projected to continue declining, albeit somewhat less than previously projected; in FY 1987/88 it would be down to 27 percent of GDP. The authorities would continue to trim through attrition the size of the civil service, although they see the margin for further reductions as being small. Also, the Organization and Management exercise for further rationalizing the civil service is expected to be completed in FY 1987/88 and action would be initiated in mid-1988. The scope for reducing other current expenditures is limited by the statutory or contractual nature of pension and interest payments and the need to maintain infrastructure and social services; nevertheless, they are projected to decline in real terms in FY 1987/88. The authorities intend to introduce wage legislation in October 1987 to improve wage bargaining procedures in the public sector. Also, the authorities are expected to limit the growth of the wage bill to 3 percent a year or less in FY 1988/89-FY 1990/91--the period of the new wage contract with the civil service. These measures would further reduce the ratio of current expenditure to GDP over the medium term.

c. The rest of the public sector

The authorities are committed to pursuing policies that would strengthen the financial position of the public enterprises. The current account surplus of the Banana Marketing Corporation is expected to average 2 percent of GDP over the medium term reflecting mainly growth in banana output. The Central Water Authority was abolished last year, and the authorities intend to strengthen the operations of the new National Water Service with external technical and financial assistance in FY 1987/88 and FY 1988/89. To this effect, water charges will be reviewed to reflect the improvements in water supply. As noted earlier, an examination of port charges in the Caribbean region is to be concluded in FY 1987/88 with a view to determining a rate that would help preserve Dominica's international competitiveness. The Social Security Scheme is expected to broaden its coverage and to continue to accumulate substantial balances with the domestic financial system.

2. Monetary and external policies

The authorities believe that provision of adequate bank credit is essential for sustained growth of private sector activity. The projected improvement in the public finances would enable banks to accommodate a significantly larger expansion in private sector credit than in the past three years, without jeopardizing the banks' liquidity position.

Dominica and seven other member countries of the ECCB share a common currency, the Eastern Caribbean dollar (EC dollar), which since July 1976 has been pegged to the U.S. dollar at the rate of EC\$2.70 per U.S. dollar. The index of the real effective exchange rate for Dominica rose from 100 in 1980 to 140 in February 1985, but fell back to 116 1/2 by May 1987 as the U.S. dollar depreciated against other major currencies (Chart 1 and Table 8). The authorities are of the view that with the recent real effective depreciation of the EC dollar and a number of measures taken to raise productivity, Dominica's international competitive position is no longer a major obstacle to export growth. They pointed out also that exchange rate action was not realistic at this time since the unanimous agreement of the ECCB members required for such action would be difficult to reach, in part because of the differences in the movement of real effective exchange rates among the ECCB members. Nevertheless, the authorities have indicated that in FY 1987/88 they will conduct a review of the country's international competitive position in collaboration with the staff of the Fund and the World Bank.

### 3. Other policies

The authorities regard the development of the private sector as the major vehicle for economic growth, with the public sector focusing on the improvement of infrastructure and rehabilitation of agriculture. Support to the private sector is being provided through the Industrial Development Corporation (IDC), the Agricultural and Industrial Development Bank (AID Bank), the Tourist Board, and the Dominica Export-Import Agency (DEXIA). The IDC and the AID Bank, which were established in 1981, have been involved in the promotion of private (foreign and domestic) investment and in the construction and leasing of factory space. The present shortage of factory space is expected to be alleviated this year with the construction of 47,000 square feet of space, financed by the CDB.

The planned merger of the IDC and the Tourist Board in September 1987 is designed to strengthen the efforts to promote tourism and foreign investment. The DEXIA, which was established in May 1986, is expected to intensify marketing efforts for nontraditional exports. The export-oriented manufacturing industry would benefit also from the recent easing of trade restrictions within CARICOM. Further, export taxes were abolished in FY 1986/87 and the recent tax reform would further reduce disincentives. In addition, labor relations have improved considerably in recent years and it is expected that wage increases will continue to moderate.

### 4. Benchmarks for the second annual program

The benchmarks refer to the indicators contained in Table 2 of the Memorandum of Economic Policies, including: (i) semi-annual reductions in the government nonconcessionary debt; (ii) no government guarantee of external debt on nonconcessionary terms; (iii) no government borrowing

Table 8. Dominica: Comparative Indices of Real Effective Exchange Rates 1/

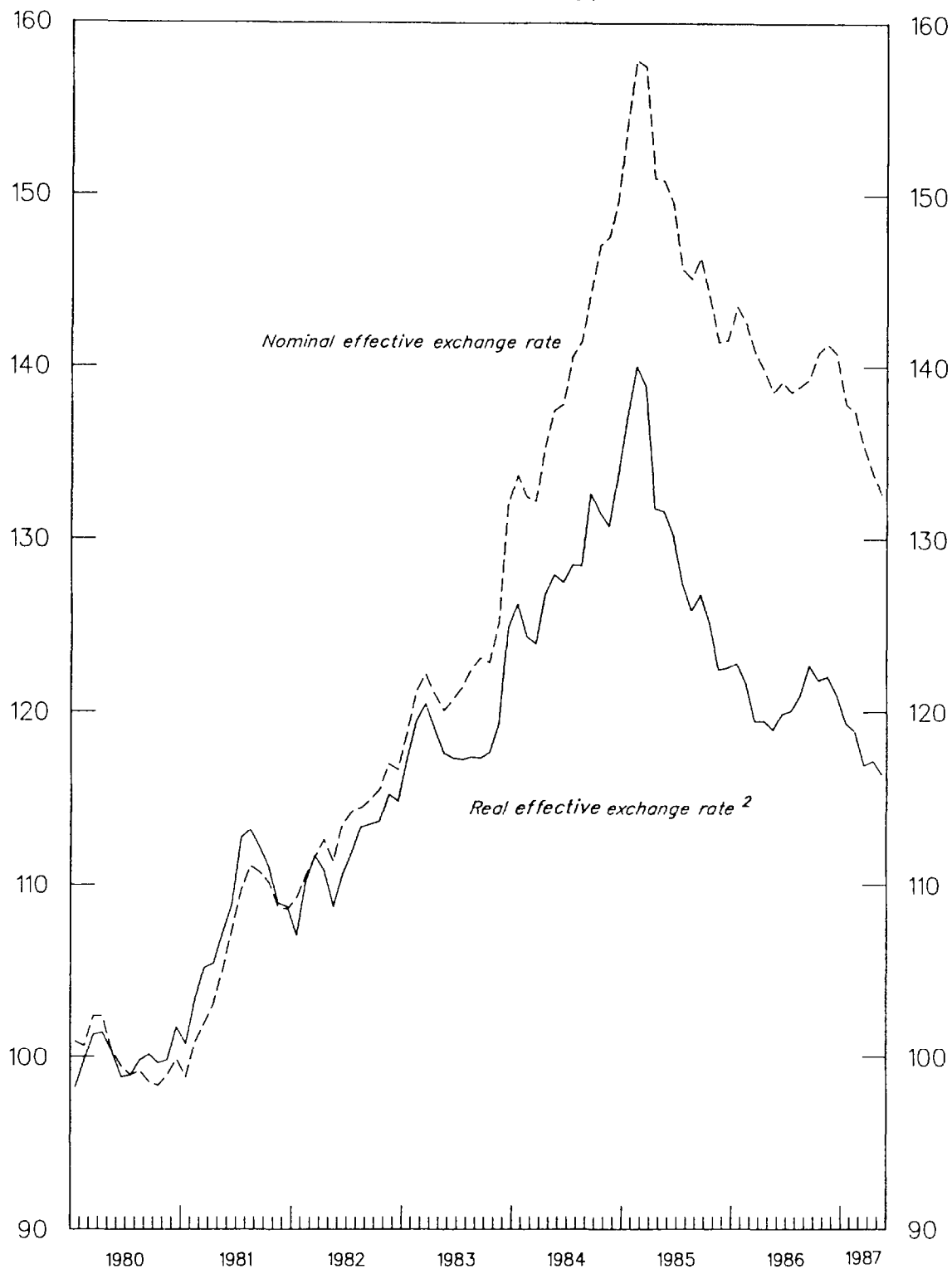
(1980 = 100)

	1982	1983	1984	1985	1986	<u>First Quarter</u>	
						1982	1987
<u>I. End of Period</u>							
Antigua and Barbuda	105.9	108.5	114.0	103.6	103.2	106.5	98.8
Dominica	115.1	125.2	133.9	122.6	121.0	111.7	116.6
Grenada	125.6	134.5	143.2	130.4	123.9	120.9	119.3
St. Kitts and Nevis	106.6	108.0	111.8	104.9	103.0	105.7	99.3
St. Lucia	112.4	116.0	121.1	110.4	111.2	113.0	109.5
St. Vincent and the Grenadines	111.6	115.0	118.1	110.3	110.0	108.4	108.6
<u>II. Period Average</u>							
Antigua and Barbuda	106.2	107.1	110.9	109.4	104.3	105.7	100.1
Dominica	111.8	118.7	128.5	130.0	120.9	109.6	118.3
Grenada	122.8	129.1	137.7	137.9	128.4	119.4	120.1
St. Kitts and Nevis	106.1	107.1	109.2	108.8	105.0	105.3	100.7
St. Lucia	112.6	114.3	117.8	117.0	110.1	112.2	109.6
St. Vincent and the Grenadines	109.5	113.2	115.1	113.9	112.1	107.9	109.1

Source: Fund staff estimates.

1/ An increase means real effective appreciation.

CHART 1  
DOMINICA  
EFFECTIVE EXCHANGE RATE INDICES<sup>1</sup>  
(1980=100; period average)



Sources: Ministry of Finance; and Fund staff estimates.

<sup>1</sup> Average trade and tourism weights of 1980-82. Decline in index represents depreciation of Dominica's currency.

<sup>2</sup> Nominal effective exchange rate adjusted for relative consumer prices.



from external sources on nonconcessionary terms, except as provided in paragraph 35 of the updated PFP; and (iv) no accumulation of external or domestic payments arrears by the Government.

In addition, a number of policy actions are required to be implemented, including implementation of the tax reform; new wage legislation for the public sector; completion of the Organization and Management exercise for the civil service; integration of the IDC and the Tourist Board; extension of the Social Security Scheme's coverage to the self-employed; strengthening of the management of the National Water Service and review of water charges; and completion of the review of port charges. Also, the program includes provisions dealing with the exchange and trade systems.

#### IV. The Medium-Term Scenario (1987-91)

The medium-term objectives, strategy, and policies presented in the preceding section provided a basis for the balance of payments scenario for 1987-91 that the mission discussed with the authorities. The scenario assumes that the medium-term PSIP and the tax reform will be implemented as proposed and that the 1 1/2 percent tax on sales of foreign exchange for invisible trade transactions will be eliminated in the next fiscal year. Restraint on government expenditure will be continued. In particular, the annual rate of growth of the wage bill will be reduced to 3 percent in FY 1988/89-FY 1990/91--the expected period of the new wage contract with the civil service. Further, the public sector is expected to improve its net creditor position with local commercial banks. In the external sector, the authorities would continue to make efforts to promote exports, tourism, and foreign private investment.

The external current account deficit (before official transfers) is projected to average 16 1/2 percent of GDP in 1987-89 (the same as in 1984-86), before declining to 11 percent in 1991. After official transfers, the current account deficit would fluctuate in 1987-89 around 5 1/2 percent of GDP (the average deficit in 1984-86), but would narrow to 1 1/2 percent by 1991. External borrowing (mostly on concessionary terms) by the public sector and private direct investment would more than cover the current account deficit, thereby providing for substantial reductions in debt to the Fund and a buildup of reserves.

Exports are projected to grow at 9 percent a year in 1987-91 led by an increase in banana exports in 1987-89 and a pickup in exports of manufactured goods in 1990-91. The growth of banana exports would slow considerably in 1990-91 as Dominica reaches its maximum access to the preferential U.K. market, while manufactured exports would be boosted by a recovery in processed agricultural goods and bottled water as well as by new exports, such as bulk water and cosmetics. Imports are expected to rise faster than GDP over most of the projection period, reflecting mainly the increase in public sector capital outlays. Net receipts from

tourism are projected to grow at an average annual rate of 9 1/2 percent in 1987-91 because of increased promotional efforts and the reconstruction of two hotels. Net inflows of private transfers and net payments for other services would grow at a moderate pace.

Dominica's public external debt, which is mostly on concessionary terms, is projected to rise from 50 1/2 percent of GDP at the end of 1986 to 52 percent at the end of 1991. The increase would be entirely in the form of concessionary debt, while nonconcessionary debt would continue to decline. In relation to exports of goods, services, and net private transfers, external debt service payments would decline from 8 1/2 percent in 1986 to 7 percent in 1991.

#### V. Staff Appraisal

In the period 1981-85, Dominica made significant economic gains, although the unemployment rate remained high and the public finances and the balance of payments continued to depend heavily on external concessionary assistance. In July 1986, the Government initiated a three-year structural adjustment program aimed at raising the rate of growth of GDP on a sustained basis through policies aimed at raising domestic savings and investment, strengthening the fiscal and balance of payments positions, containing the public external debt within manageable proportions, and building up a cushion of reserves against external shocks.

The broad economic objectives of the first annual SAF program were achieved, with real GDP growth and the fiscal and balance of payments performance being either in line with the program projections or better. In particular, all the quantitative benchmarks as well as a number of other benchmarks were observed. There were delays regarding some measures, but the authorities intend to carry these out during the proposed second annual arrangement.

A key element of the program is the implementation of a medium-term PSIP focused on improvement of infrastructure with a view to providing an appropriate environment for the development of private sector activity. The staff would emphasize that the PSIP should consist of high quality projects and that its financing should not give rise to an undue debt burden in the future. On the former point, it may be noted that, according to the World Bank staff, outlays under the proposed PSIP are within the absorptive capacity of the economy and are consistent with the achievement of the program's objectives. As regards financing, the PSIP is expected to be covered mainly by external grants and concessionary loans. Although the water export project would be financed by borrowing on commercial terms, it was felt that such a borrowing was justified because the project was estimated to generate a cash flow sufficient to meet its own debt service.

The overall deficit of the Central Government would widen in relation to GDP in FY 1987/88 and FY 1988/89, partly as a result of the postponement of the water project from the previous year. However, the deficit would be more than covered by external assistance, and there would be a further significant reduction in government nonconcessionary debt. The estimates of external assistance beyond the current fiscal year are tentative, and it is understood that a shortfall in assistance would be offset by a corresponding cutback in capital expenditure, without affecting the understandings as regard nonconcessionary borrowing. Use and guarantee of external nonconcessionary loans by the Government would be limited under benchmarks for monitoring developments in the fiscal area. Also, the program includes provisions for a limited amount of contingency financing to meet unforeseen developments such as delays in debt disbursements that might impair the implementation of investment projects. The staff would stress that use of this contingency clause, by its own nature, is meant to be temporary.

Achievement of the program's fiscal objectives hinges on restraint over current expenditure, as the program projects a decline in the tax burden reflecting a tax reform aimed at strengthening incentives for private sector investment and production. The staff would stress the need for the authorities to monitor carefully the implementation of the budget to keep outlays within the planned limits and to ensure that future wage adjustments are consistent with the projected wage bill. As regards revenue, the staff is concerned about the revenue loss involved in the tax reform; moreover, there are questions about the revenue estimates, particularly as regards the yield of the new tax on gross sales. In this situation, it is important for the authorities to be ready to take action should a revenue shortfall start to emerge, to ensure that the fiscal objectives of the program are attained. Further, the cascading feature of the sales tax that has been introduced gives rise to distortions; in this respect, the staff takes note of the intention of the authorities to modify this tax to avoid the cascading effect, with technical assistance from the Fiscal Affairs Department. The staff also attaches importance to the need to apply the levy on banana exports in a way that avoids disincentive effects over time.

Under the program, directly productive activities would essentially be the domain of the private sector. Private investment and production is to be stimulated by an expansion of fiscal incentives through the tax reform, the continued improvement in infrastructure, and the intensification of the export and tourism promotion efforts. Moreover, the expected reduction in the Government's net debt with the banking system would make room for a substantial expansion of bank credit to the private sector. The staff also attaches importance to the review of the country's international competitive position that the authorities intend to conduct during the current fiscal year with assistance from the staff of the Fund and the World Bank.

On the basis of the policies contained in the program and recent trends, the current account deficit of the balance of payments is projected to narrow over the medium term, following a temporary widening in 1988 mainly as a result of a rise in investment-related imports. The deficit would be more than covered by concessionary flows and private direct investment from abroad, and the overall balance of payments would be in surplus throughout the projection period.

Despite the projected improvements, Dominica's balance of payments would continue to be weak over the medium-term, requiring substantial external concessionary financing (though less, in relation to GDP, than in the past three years). Also, the projected overall balance of payments surplus is needed to enable Dominica to meet its debt obligations to the Fund and certain other external creditors as well as to build a cushion of reserves against external shocks.

Over the period 1986-91, the ratio of public external debt to GDP is projected to increase moderately because of the rise in concessionary debt. However, nonconcessionary debt would continue to decline reflecting a reduction in debt to the Fund and the limited use of other nonconcessionary borrowing. The projected improvement in the structure of the external public debt would result in a modest decline in the debt service ratio over this period. On this basis, Dominica's debt burden should remain manageable.

The staff believes that implementation of the macroeconomic and structural policies contained in the SAF program will help create the basis for sustained economic growth in Dominica. Also, the program may be expected to help Dominica in its efforts to obtain the external financial assistance required to finance its investment effort.

Dominica's request for the second annual arrangement under the SAF is recommended for approval by the Executive Board.

It is recommended that the next Article IV consultation with Dominica be conducted on the 12-month cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Dominica has requested the second annual arrangement under the Structural Adjustment Facility.
2. The Fund has appraised the progress of Dominica in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated Policy Framework Paper (EBD/87/226).
3. The Fund approves the arrangement set forth in EBS/87/192.

Structural Adjustment Facility:  
Second Annual Arrangement

Attached hereto is a letter, with an annexed Memorandum of Economic Policies, dated August 4, 1987, from the Prime Minister and Minister of Finance, Economic Development and External Affairs of Dominica, requesting from the Fund the second annual arrangement under the three-year structural adjustment arrangement, and setting forth the objectives and policies of the program to be supported by the second annual arrangement.

To support these objectives and policies, the International Monetary Fund grants the requested arrangement in accordance with the following provisions and subject to the Regulations for the administration of the Structural Adjustment Facility:

1. The second loan in the amount equivalent to SDR 1.2 million is available for disbursement at the request of Dominica.
2. Before approving the third annual arrangement, the Fund will appraise the progress of Dominica in implementing the policies and reaching the objectives of the program supported by the second annual arrangement, taking into account primarily:
  - (a) the indicators specified in Table 2 attached to the Memorandum of Economic Policies annexed to the letter dated August 4, 1987,
  - (b) imposition of restrictions on payments and transfers for current international transactions,
  - (c) introduction of multiple currency practices,
  - (d) conclusion of bilateral payments agreements which are inconsistent with Article VIII,
  - (e) imposition or intensification of import restrictions for balance of payments reasons.
3. In accordance with paragraph 3 of the attached letter, Dominica will provide the Fund with such information as the Fund requests in connection with the progress of Dominica in implementing the policies and reaching the objectives supported by the second annual arrangement.
4. In accordance with paragraph 4 of the attached letter, Dominica will consult with the Managing Director on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because of deviations from any of the indicators under paragraph 2 above or because he considers that consultation on the program is desirable. These consultations may include correspondence and visits of officials of the Fund to Dominica or of representatives of Dominica to the Fund.

Dominica - Letter of Transmittal, Request for the Second  
Annual Arrangement Under Structural Adjustment Facility

Roseau, Dominica

August 4, 1987

Mr. Michel Camdessus  
Managing Director  
International Monetary Fund  
700 - 19th Street, N.W.  
Washington, D.C. 20431

Dear Managing Director:

1. The annexed Policy Framework Paper<sup>\*</sup> has been prepared in collaboration with the staffs of the Fund and the World Bank, and updates the Policy Framework Paper of October 31, 1986.

The Government of Dominica will remain in close contact with the staffs of the Fund and the World Bank on developments and progress in implementing these policies, and the Policy Framework Paper will be updated in connection with the third annual arrangement.

2. The annexed Memorandum of Economic Policies sets out the objectives and policies that the Government of Dominica intends to pursue under its program, for which balance of payments assistance is needed. In support of these objectives and policies, Dominica hereby requests from the Fund the second annual arrangement under the three-year structural adjustment arrangement.

3. Dominica will provide the Fund with such information as the Fund requests in connection with its progress in implementing the policies and reaching the objectives of the program.

4. The Government believes that the policies set forth in the annexed Memorandum of Economic Policies are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. Dominica will consult with the

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\* See EBD/87/226 (9/4/87).

Managing Director on the adoption of any measures that may be appropriate, at the initiative of the Government of Dominica or whenever the Managing Director requests such consultation.

Sincerely yours,

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M. Eugenia Charles  
Prime Minister and Minister of Finance  
Economic Development and External Affairs

Annexes: Policy Framework Paper  
Memorandum of Economic Policies

Memorandum of Economic Policies

1. The Policy Framework Paper (PFP), which Government of Dominica updated in collaboration with the staff of the World Bank and the IMF, describes the major economic problems and challenges facing the country, the objectives and priorities of the program for the period FY 1987/88-FY 1989/90 (fiscal years beginning July 1), and the broad thrust of macroeconomic and structural adjustment policies. This memorandum is intended to provide a more detailed description of the policies contained in the economic program, with emphasis on the program for FY 1987/88.

2. As noted in Section II of the PFP, the broad economic objectives of the first annual program under the Structural Adjustment Facility (SAF) were achieved. The policies for the first year were carried out as programmed, with the exception of the proposed merger of the Industrial Development Corporation (IDC) and the Tourist Board, the introduction of legislation for wage negotiations in the public sector, the completion of the Organization and Management exercise for administrative reform of the civil service, and the review of port charges. These policy actions will be taken in FY 1987/88 (the period of the second annual SAF program).

3. Government believes that the medium-term economic program should continue to aim at achieving an annual rate of growth of real GDP of about 4 percent in 1987-89 through policies that would strengthen further the fiscal and balance of payments positions, contain public external debt within manageable proportions, strengthen the potential for increased domestic savings, and build up a cushion of reserves against external shocks. The thrust of economic growth would come from private sector activities, and the public sector would be directed mainly to developing conditions for such activities. Government believes that the continuation of Fund support is crucial for the success of the program (the major indicators and parameters of the three-year economic program are presented in Table 1).

The public sector investment program (PSIP)

4. With assistance from the World Bank and the Caribbean Development Bank (CDB), Government has finalized the PSIP for FY 1987/88 and is reviewing the PSIP for FY 1988/89 and FY 1989/90. The proposed three-year PSIP is consistent with the economic objectives of Government. The links between the PSIP, domestic savings, and economic growth are being strengthened mainly through improvements in the management of public sector enterprises and government departments and appropriate rate structures for public utilities. Of total capital outlays proposed for the three-year period, 19 1/2 percent would be allocated mainly to the provision of agricultural inputs and credits, 62 1/2 percent to economic infrastructure, and the remainder to social services and public administration.

5. PSIP-related capital outlays are projected to rise from about 13 1/2 percent of GDP in FY 1986/87 to 20 percent in FY 1987/88, partly because the delays in making appropriate marketing and transportation arrangements with potential buyers have led to the postponement of the implementation of the bulk water export project from the last fiscal year to the current fiscal year. The PSIP for FY 1987/88 includes projects which are currently in progress or have an identified source of financing. The PSIP for FY 1988/89 and FY 1989/90 envisages tentatively capital outlays of an average of 19 percent of GDP, of which 30 percent and 60 percent, respectively, relate to projects which require additional preparation before implementation and/or have no identified source of financing. About 85 percent of public sector investment in FY 1987/88 is expected to be covered by external grants and loans (mostly on concessionary terms), and Government believes that this proportion will increase to 92 percent by FY 1989/90.

#### The operations of the Central Government

6. With external technical assistance, Government completed its review of the tax system with the objectives of reducing disincentives to investment and production and broadening the tax base. On the basis of this review, the budget for FY 1987/88 introduced a tax package which would reduce revenue by EC\$3.1 million (about 1 percent of GDP) in FY 1987/88 and by EC\$5.8 million (1 1/2 percent of GDP) in FY 1988/89. Government believes that, during the three-year period ending FY 1989/90, the loss of revenue would be less than the projected inflow of external budgetary grants. However, it expects that the accelerated pace of economic activity resulting from the tax reform would assure the recovery of revenue loss over the medium term.

7. The above-mentioned tax package included (estimates of revenue impact for FY 1987/88 are indicated in parentheses): (i) the removal of the 5 percent stamp duty on imports (-EC\$4.9 million); (ii) the establishment of a uniform rate of 1 1/2 percent for the customs service charge on imports (-EC\$2.9 million); (iii) the replacement of the present multiple rates of consumption tax with a uniform rate of 20 percent, except for a few items to which special rates are applied (-EC\$1.2 million); (iv) the replacement of the present 1 percent stamp duty on wholesale and retail sales with a 3 percent gross receipts tax (EC\$6.4 million); (v) the introduction of a 3 percent wholesale tax on petroleum and petroleum products (EC\$0.8 million); (vi) the rationalization of the personal income tax (-EC\$2.2 million); (vii) the unification of the corporate income tax rate at 35 percent (-EC\$0.3 million); (viii) the introduction of a development levy (EC\$2.5 million); (ix) the introduction of a 10 percent tax credit on new capital investment (-EC\$0.1 million); and (x) the removal of withholding tax on profits retained locally (-EC\$0.2 million). In addition, Government will eliminate the 1 1/2 percent levy on the purchase of foreign exchange for invisible trade transactions in FY 1988/89 and will introduce a property tax by FY 1990/91. Also, Government intends to review licenses and

fees. Total current revenue is expected to decline from 29 1/2 percent of GDP in FY 1986/87 to a little over 28 percent of GDP in FY 1987/88 (see Table 1).

8. The ratio of current expenditure to GDP has been declining over the past several years, and room for further restraint is limited by the small size of the civil service, the current wage contract that extends through June 1988, the statutory retiring benefits and interest payments, and the need to provide for the maintenance of infrastructure and a minimum level of social services. However, Government would continue to keep vacant, or abolish, any post which appears to be redundant or wasteful. Also, it intends to complete the Organization and Management exercise for job grading, job analysis, and performance evaluation of the civil service in FY 1987/88 and further action on the size of the civil service, consistent with Government's goals and objectives, will be taken in FY 1988/89. As a prudent wage policy is essential for improving Dominica's fiscal and international competitive positions, Government intends to introduce legislation by October 1987 to make wage bargaining less disruptive and to implement a uniform wage policy in the entire public sector. These policies should strengthen Government's efforts to limit the growth of the wage bill to 3 percent or less in FY 1988/89. In addition, the recent restructuring of Government's domestic debt should help in containing the growth of interest payments over the medium term. These policies are expected to reduce the ratio of current expenditure to GDP from about 28 percent in FY 1986/87 to just over 27 percent in FY 1987/88.

9. On the basis of the above policies, the current account surplus is projected to decline from 1 1/2 percent of GDP in FY 1986/87 to 1 percent in FY 1987/88. Government's capital outlays are expected to rise from around 10 percent of GDP to about 15 percent in the same period, reflecting mainly the delays in the implementation of the water export project mentioned above. In this period, receipts of external grants (including budgetary grants) are projected to rise from 5 percent of GDP to 9 1/2 percent. The overall deficit (after grants) would increase by 1 percentage point of GDP to 4 percent of GDP in FY 1987/88. Projected net inflows of external concessionary loans (project-related loans of EC\$9.8 million; nonproject loans of EC\$12.2 million from the CDB, the World Bank, and the Fund; and amortization payments of EC\$1.8 million) would more than cover the overall deficit, resulting in a decline of EC\$6.6 million in Government's nonconcessionary debt in FY 1987/88. This reduction in nonconcessionary debt would allow for the external borrowing of EC\$9 million on nonconcessionary terms for the water export project. In addition, it would provide for scheduled net repurchases of EC\$7.2 million to the Fund, a buildup of foreign assets (EC\$3.0 million) and of borrowing capacity at the Eastern Caribbean Central Bank (EC\$2.3 million), and substantial repayments to domestic commercial banks (EC\$3.1 million). Government would endeavor to reduce its nonconcessionary debt by EC\$4 million during the first half of FY 1987/88.

10. The above indicators will serve as a benchmark for monitoring nonconcessionary financing of the Central Government. If any project in the agreed PSIP were not undertaken, Government will not engage in non-concessionary borrowing related to that project and, accordingly, the pace of reduction in Government's outstanding nonconcessionary debt will be accelerated unless further agreements are reached between Government and the Fund staff. If a temporary need for financing were to arise from unforeseen developments such as delays in aid disbursements, Government may borrow up to EC\$2 million on a net basis from domestic sources, thus lowering the target for the reduction in Government's nonconcessionary debt by up to EC\$2 million in FY 1987/88. Government will not guarantee any foreign loan on nonconcessionary terms in FY 1987/88. During FY 1987/88 and FY 1988/89, Government will not accumulate any domestic or external payments arrears, and will not borrow from foreign sources on nonconcessionary terms (i.e., loans with grant elements of less than 25 percent) except as noted in paragraph 35 of the attached PFP.

11. In FY 1988/89, the current account surplus of the Central Government is projected at 1 percent of GDP and government capital spending at 16 1/2 percent of GDP. The PSIP for FY 1988/89 is preliminary, and includes several tentative projects with unidentified financing (equivalent to 5 1/2 percent of GDP) which would require further preparation before implementation. Including these projects, the overall deficit (after grants) is projected to rise to 7 percent of GDP but would decline to 1 1/2 percent if they do not materialize. Net inflows of concessionary loans would more than cover the overall deficit, and the Government's nonconcessionary debt is projected to decline by 1 1/2 percent of GDP.

#### The operations of the rest of the public sector

12. Government remains committed to improving further the operations of the public enterprises with a view to increasing their contributions to the country's savings and investment efforts. In this respect, Government took several actions in the last fiscal year (see Section II of the PFP), and intends to implement additional measures in FY 1987/88. Government abolished the Central Water Authority last year and intends to reorganize and strengthen the management of the new National Water Service (NWS) in the current fiscal year. In addition, in FY 1987/88 it would begin the modernization and expansion phase of the NWS, and would review water charges. Government sold 60 percent of the equity in the Dominica Electricity Services Ltd. (DOMLEC) by early 1987, and approved an average increase of 10 percent in electricity charges in April 1987, which should help improve the operations of this enterprise. In addition, with external concessionary assistance, Government would begin this year the implementation of a hydropower project that would expand DOMLEC's capacity to supply electricity over the medium term. The financial position of the Dominica Banana Marketing Corporation (DBMC) improved markedly in 1986. Banana production and exports increased substantially in 1986, reflecting the

increased use of field packing (which reached 100 percent of production by July 1986), pesticides and fertilizers, an increase in the acreage under cultivation, and higher banana export prices. A continuation of growth in banana production and exports is expected to raise further the surpluses of the DBMC in 1987. Government will complete the review of port charges in FY 1987/88 with the objective of strengthening the financial position of the Port Authority.

13. Legislation for extending the Social Security Scheme's coverage to the self-employed is to be passed by December 1987, which would help increase its surpluses over the medium term. These surpluses will continue to be invested mainly as deposits with the domestic financial institutions.

#### The private sector

14. The creation of favorable conditions for the expansion of private sector activities has been the main element of the development strategy of this Government since it came into power in 1980. Government has made efforts to improve infrastructure, to strengthen the support programs and institutions for the private sector, to maintain stable labor relations, to help restrain wage increases, to expand fiscal incentives, and to reduce the public sector's indebtedness to domestic commercial banks. In addition, the above-mentioned tax reform this year is expected to reduce further disincentives to investment and production. Also, the PSIP provides for the construction of additional factory shells to meet the growing demand. Government intends to strengthen further the institutional support for the promotion of industry and tourism by integrating the Tourist Board and the Industrial Development Corporation in September 1987. Tourism would also benefit from a new regional tourism policy which promotes multi-island tourist packages. The PSIP envisages rehabilitation and expansion of access roads to Dominica's tourist attractions and the improvement and expansion of air transport facilities.

#### The financial sector

15. Government would continue to pursue a policy aimed at improving the public sector's net position with domestic commercial banks in order to enable them to expand room for private sector credits. With the growth of banana exports, the liquidity position of commercial banks improved markedly in 1986, and is expected to remain comfortable in 1987-88.

#### The external sector

16. As noted in Section IV of the PFP, Government believes that with the recent real effective depreciation of Dominica's currency and a number of measures taken to raise productivity, the country's international competitive position is not now a major obstacle to the growth of exports. Also, exchange rate action is not a realistic option at this

time since the unanimous agreement of the ECCB members required for such action would be difficult to reach, partly because of the differences in the movement of real effective exchange rates among the ECCB members. Nevertheless, Government intends to review in this fiscal year Dominica's international competitive position in the context of its re-examination of the overall development strategy. In the meantime, Government will continue to exercise strict control on public sector wages.

17. During the program period, Government does not intend to introduce any multiple currency practice or impose any restrictions on payments and transfers for current international transactions or, for balance of payments reasons, introduce any new or intensify any existing restriction on imports, and will not enter into bilateral payments agreements with member countries of the Fund.

18. Government will send, by cable, end-period data on summary operations of the Central Government for each month by the end of the following calendar month, and send any other information the Fund may request to monitor progress under the program.

Table 1. Dominica: Selected Economic Indicators

	1984	1985	Prel. 1986	Program 1/ 1987	1988
<u>(Annual percentage changes, unless otherwise specified)</u>					
GDP at constant prices	6.2	1.8	4.0	4.0	4.0
GDP deflator	5.1	7.7	5.7	3.5	3.5
Consumer prices	2.2	2.1	3.0	3.5	3.5
Exports (in U.S. dollars)	-6.9	10.5	37.5	8.0	9.0
Imports (in U.S. dollars)	18.5	2.5	-2.6	22.8	14.2
Bank credit to private sector <u>2/</u>	9.0	9.1	2.5	10.0	13.9
<u>(In percent of GDP, unless otherwise specified)</u>					
<u>Balance of payments 3/</u>					
Current account deficit	-4.4	-8.9	-3.8	-3.4	-7.3
Current account deficit before external grants	-20.7	-21.0	-8.1	-14.9	-17.6
External debt	48.9	49.3	50.4	52.5	56.7
Debt service as a percent of receipts from exports, services, and net private transfers	10.1	9.4	8.6	9.5	10.2
<u>Central government operations 4/</u>					
Current revenue	29.3	30.0	29.6	28.2	27.3
Current expenditure	29.3	28.9	27.9	27.2	26.3
Current balance	--	1.1	1.7	1.0	1.0
External grants	14.1	13.0	5.0	9.6	8.6
Capital expenditure and net lending	20.1	16.2	10.2	15.1	16.5
Overall balance	-6.0	-2.1	-2.8	-4.1	-6.9
External concessionary loans (net) <u>5/</u>	4.7	1.6	3.9	6.1	8.6
Nonconcessionary financing	1.3	0.5	-1.1	-2.0	-1.7

1/ Program beginning July 1, 1986.

2/ In relation to commercial banks' liabilities to private sector at beginning of period.

3/ The balance of payments estimates are made with assistance from the Fund staff, and are based on incomplete information.

4/ Refers to fiscal years beginning July 1.

5/ Includes disbursements under the Structural Adjustment Facility.

Table 2. Dominica: Indicators for the Second Annual Program  
Under the Structural Adjustment Facility  
July 1, 1987 - June 30, 1988

A. <u>Quantitative Indicators</u>	<u>Time</u>
1. Government would endeavor to reduce its nonconcessionary debt by EC\$4.0 million between July 1, 1987 and December 31, 1987; and by EC\$6.6 million between July 1, 1987 and June 30, 1988. If any project in the agreed PSIP were not undertaken, Government will not engage in nonconcessionary borrowing related to that project and, accordingly, the reduction in government nonconcessionary debt will be accelerated automatically, unless further agreements are reached between Government and the Fund staff.	During FY 1987/88
2. If a temporary need for financing were to arise from unforeseen developments such as delays in aid disbursements, Government may borrow an additional EC\$2 million on a net basis from domestic sources, thus lowering the target for the reduction in government nonconcessionary debt by EC\$2 million.	During FY 1987/88
3. Government will not guarantee foreign loans on nonconcessionary terms.	During FY 1987/88
4. Government will not borrow from external sources on nonconcessionary terms, except as provided in paragraph 35 of the Policy Framework Paper.	In FY 1987/88 and FY 1988/89
5. Government will not accumulate domestic or external payments arrears.	In FY 1987/88 and FY 1988/89
B. <u>Other Indicators</u>	
1. Implementation of the tax reform.	FY 1987/88
2. Wage legislation for the public sector.	October 1987
3. Completion of the Organization and Management exercise for job grading, job analysis, and performance evaluation of the civil service.	FY 1987/88
4. Integration of the Industrial Development Corporation and the Tourist Board.	September 1987
5. Extension of the Social Security Scheme's coverage to the self-employed.	December 1987

6. Completion of the reorganization and strengthening of the management of the National Water Service and review of the water charges. FY 1987/88
7. Completion of the review of port charges. FY 1987/88

Dominica--Fund Relations  
(As of June 30, 1987)

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 11.08 million (276.99 percent of quota)

(c) Fund credit: SDR 7.09 million (177.13 percent of quota)

Of which:

	<u>Millions of SDR</u>	<u>Percent of quota</u>
Credit tranche	0.97	24.25
Extended Fund Facility	3.47	86.64
Supplementary Financing Facility	2.65	66.24

(d) Reserve tranche position: SDR 0.01 million

III. Financial Arrangements and Special Facilities

(a) Stand-by arrangement

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

(b) Extended arrangement

- Duration: From February 6, 1981 to February 5, 1984
- Amount: SDR 8.55 million (213.8 percent of quota)
- Undrawn balance: None. The last purchase under the EFF was made on January 16, 1984

- (c) Compensatory financing facility: approval was given on February 6, 1981 for additional purchase of SDR 1.95 million (48.8 percent of quota).
- (d) Structural adjustment facility arrangement:
  - Duration = November 26, 1986 to November 25, 1989
  - Amount = SDR 2.54 million (63.5 percent of quota)
  - Undrawn balance = SDR 1.74 million. The first purchase of SDR 0.8 million was made on December 3, 1986.

IV. SDR Department

- (a) Net cumulative allocation: SDR 0.59 million
- (b) Holdings: SDR 0.047 million or 8.0 percent of net cumulative allocation.
- (c) Current designation plan: None.

V. Administered Accounts: Dominica has received SDR 0.47 million in subsidy payments under the Supplementary Financing Facility.

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

	Overdue Obligations	Scheduled Payments				
		<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
<u>Principal</u>	--	1.60	2.19	1.84	1.00	0.67
<u>Repurchases</u>	--	1.60	2.19	1.84	1.00	0.67
<u>SAF repayments</u>	--	--	--	--	--	--
<u>Charges and interest</u>	--	0.27	0.43	0.28	0.17	0.10
<u>Total</u>	--	1.87	2.62	2.12	1.17	0.77

(B) Nonfinancial Relations

- VII. Exchange rate arrangement: Since mid-1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC\$2.7 per U.S. dollar.
- VIII. Consultation with the Fund: The Last Article IV consultation was concluded by the Executive Board on October 17, 1986 (EBM/86/171; SM/86/242 and SM/86/247). The Board approved the Policy Framework Paper and the first annual program under the SAF arrangement on November 26, 1986 (EBM/86/188 and SM/86/248). Dominica is on the standard 12-month consultation cycle.

- IX. Technical Assistance: Mr. MacKellar, a member of the panel of fiscal experts, completed his assignment as fiscal advisor for a six-month period in June 1984. Mr. Latham visited Dominica in July this year, to discuss the tax reform that was introduced in the latest budget.
- X. Other: Mr. de Moraes, the Fund Regional Advisor who is stationed at the Eastern Caribbean Central Bank in St. Christopher and Nevis, has been accredited to Dominica since May 1986.

Dominica--Basic Data

<u>Area</u>	750 sq. kilometers
<u>Population and related vital statistics (1986)</u>	
Population (thousand)	85.1
Average annual rate of growth of population in 1970-86 (percent)	1.0
Density	
Total (per sq. kilometer)	113.5
Arable land (per sq. kilometer)	400.5
Life expectancy at birth in 1985 (years)	75
Infant mortality rate in 1983 (per thousand)	13.9
<u>Nutrition (1978)</u>	
Caloric intake as percent of requirement	87.0
Per capita protein intake (grams per day)	56.9
<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</u>	
Percent of population	...
<u>Education (1981)</u>	
Adult literacy rate (percent)	94.4
Primary school enrollment (percent)	...
<u>GDP (1986)</u>	SDR 94.1 million
GDP per capita (1986)	SDR 1,106
<u>Origin of GDP (1986)</u>	(percent)
Agriculture and mining	30.3
Manufacturing	8.8
Construction and utilities	7.8
Transport and communications	13.5
Government services	22.4
Other	17.2
<u>Ratios to GDP (1986)</u>	
Exports of goods and services	45.1
Imports of goods and services	59.4
Central government current revenue (FY 1986/87)	29.6
Central government current expenditure (FY 1986/87)	27.9
External public and publicly guaranteed debt, inclusive of use of Fund credit (end of year)	50.4
Money and quasi-money (end of year) <u>1/</u>	35.9

<u>Annual changes in selected economic indicators</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Prel. 1986</u>
		(percent)		
Real GDP per capita	0.8	5.6	0.8	3.0
Real GDP (at factor cost)	2.1	6.2	1.8	4.0
GDP at current market prices	11.0	11.8	10.7	11.4
GDP deflator	8.3	5.1	7.7	5.7
Consumer prices (annual averages)	4.1	2.2	2.1	3.0
Money and quasi-money <u>1/</u>	8.2	11.6	5.9	17.6
Money	(14.4)	(17.0)	(1.6)	(40.2)
Quasi-money	(6.6)	(10.2)	(7.1)	(11.7)
Net domestic assets <u>2/</u>	8.3	6.1 <u>3/</u>	7.2	-9.5
Credit to public sector (net) <u>2/</u>	(-0.4)	(-2.3) <u>3/</u>	(-3.7)	(-3.5)
Credit to private sector <u>2/</u>	(9.7)	(9.0)	(9.1)	(2.5)
Merchandise exports, f.o.b.	12.2	-6.9	10.5	37.5
Merchandise imports, c.i.f.	-0.8	18.5	2.5	-2.6
Travel receipts (gross)	24.2	31.7	-9.3	6.1
Central government current revenue <u>4/</u>	20.8	7.0	13.6	8.1
Central government current expenditure <u>4/</u>	11.0	7.2	9.6	5.8
<u>Central government finances <u>4/</u></u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>
	(millions of Eastern Caribbean dollars)			
Domestic revenue	69.9	74.6	84.8	93.7
Total expenditure	104.1	125.7	127.5	118.0
Current account balance	0.2	0.1	3.1	5.3
Foreign grants	20.5	35.9	36.7	15.6
Overall balance	-13.7	-15.2	-6.0	-8.7
Foreign concessionary borrowing	11.4	11.8	4.6	9.4
Structural adjustment facility	--	--	--	2.6
Change in Government's foreign assets	-0.6	-0.4	-0.8	-0.9
IMF (net purchases)	0.7	-2.1	-4.5	-4.7
Domestic financing (net) and residual	2.2	5.9	6.7	2.3
Of which: ECCB	(2.0)	(2.1)	(4.8)	(-2.2)
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Prel. 1986</u>
<u>Balance of payments</u>		(millions of U.S. dollars)		
Merchandise exports (f.o.b.)	27.5	25.6	28.3	38.9
Merchandise imports (c.i.f.)	-47.1	-55.8	-57.2	-55.7
Travel (net)	6.0	8.5	7.3	7.5
Other services and private transfers (net)	3.2	3.2	0.8	0.4
Official transfers	4.4	14.6	12.0	4.7
Balance on current account <u>5/</u>	-6.0	-3.9	-8.8	-4.2
Official borrowing (net)	5.9	4.7	4.6	5.1
Private capital (net) <u>6/</u>	-4.3	5.4	3.2	4.3
Overall balance	-4.4	6.2	-1.0	5.2

1/ Refers to commercial banks' liabilities to the private sector.

2/ Changes in relation to commercial banks' liabilities to the private sector at the beginning of the year.

3/ Excludes the transfer of the Central Government's special reserve deposits at commercial banks to statutory reserves and deposits at the ECCB.

4/ Refers to fiscal years beginning July 1.

5/ After foreign official transfers.

6/ Includes errors and omissions.

Dominica--Statistical Issues

1. Outstanding statistical issues

a. Prices

The Consumer Price Index (CPI) was reweighted in 1984 on the basis of a family expenditure survey conducted in 1982.

b. Government finance

The presentation of government finance data for Dominica in IFS was dropped beginning with the March 1987 issue of IFS, because the latest available government finance data relate only to 1979. In addition, the presentation for Dominica in the 1986 Government Finance Statistics Yearbook (GFSY) covers operations of the consolidated central government only through 1979 and does not contain data on financing and debt. The 1987 government finance statistics questionnaire, requesting updates of data beyond 1979, has yet to be received.

Although the 1986 GFSY publishes for the first time provisional data for many countries it does not do so for Dominica. The availability of such provisional data, even if they must include estimates or projections, is very useful for purposes of analysis and policy determination and would add appreciably to the usefulness of government finance data for Dominica in the GFSY.

c. Balance of payments

Dominica does not report balance of payments data directly to the Bureau of Statistics. The data for recent periods in the International Financial Statistics and Balance of Payments Statistics are derived mainly from "Dominica: Recent Economic Developments" (SM/86/247).

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Dominica in the August 1987 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Eastern Caribbean Central Bank and the Ministry of Finance which, during the past year, have been provided generally on a timely basis.

Status of IFS Data

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		<u>Latest Data in August 1987 IFS</u>
Real Sector	-National Accounts	1983
	-Prices	March 1987
	-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	February 1987
	-Deposit Money Banks	May 1987
	-Other Financial Institutions	n.a.
Interest Rates	-Discount Rate	n.a.
	-Bank Lending/Deposit Rates	May 1987
	-Government Bond Yield	n.a.
External Sector	-Merchandise Trade: Values	1985 <u>1/</u>
	Prices	n.a.
	-Balance of Payments	1985
	-International Reserves	April 1987
	-Exchange Rates	June 1987

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1/ Imports through 1986.

Summary of the Financial Program for FY 1987/88

1. Principal assumptions and objectives

a. Growth of real GDP of 4 percent in 1987-88, and annual increases of 3 1/2 percent in the consumer price index and the GDP deflator in 1987-88.

b. Project-related external grants and loans (mostly on concessionary terms) to finance 85 percent of the public sector capital outlays of EC\$66.4 million (20 percent of GDP) in FY 1987/88.

c. In FY 1987/88, external budgetary grants of EC\$9.5 million and nonproject concessionary loans of EC\$12.2 million (including the SAF loan of SDR 1.2 million).

d. In FY 1987/88, tax revenue of at least EC\$85.5 million; nontax and capital receipts to be at least EC\$8.6 million and EC\$1.2 million, respectively.

e. An exchange rate of SDR 1.00 = US\$1.26.

2. Targets

a. In the fiscal area, the program envisages a current account surplus of EC\$3.4 million (1 percent of GDP) and an overall deficit of EC\$13.6 million (4 percent of GDP). The deficit would be more than covered by external concessionary loans. Thus, under the program, government nonconcessionary debt (including outstanding Fund credit) would decline further by EC\$6.6 million (2 percent of GDP). If any project in the agreed PSIP were not undertaken, the Government will not engage in nonconcessionary borrowing related to that project and, accordingly, the reduction in the government nonconcessionary debt will be accelerated automatically, unless further agreements are reached between the Government and the Fund staff. The program also provides for the possibility that unforeseen developments may force the Government to temporarily lower the target for the reduction in nonconcessionary debt by up to EC\$2 million.

b. The program envisages external current account deficits of US\$4 million (3 1/2 percent of GDP) and US\$9.3 million (7 1/2 percent of GDP) in 1987 and 1988, respectively; before external grants, the deficit would be US\$17.6 million (15 percent of GDP) and US\$22.5 million (17 1/2 percent of GDP) respectively in those years.

3. Major elements of the program

a. Central government operations

(1) The new budget introduced a comprehensive tax reform with the objective of broadening the tax base and reducing disincentives to

investment and production. The tax reform includes (revenue impacts are indicated in parentheses):

- (i) reductions in personal income tax (-EC\$2.2 million);
- (ii) unification of corporation income tax (-EC\$0.3 million);
- (iii) introduction of a development levy on banana exports; (EC\$2.5 million);
- (iv) introduction of investment tax credit (-EC\$0.1 million);
- (v) removal of withholding tax on retained profit (-EC\$0.2 million);
- (vi) replacement of the stamp duty by a 3 percent tax on gross sales (EC\$6.4 million);
- (vii) introduction of wholesale tax on petrol and petroleum products (EC\$0.8 million);
- (viii) rationalization of the consumption tax (-EC\$1.2 million);
- (ix) removal of stamp duty on imports (-EC\$4.9 million);
- (x) unification of customs service charge (-EC\$2.9 million); and
- (xi) one-time loss of revenue during the transition (-EC\$1 million).

(2) The wage bill is projected to rise from an estimated EC\$49.3 million in FY 1986/87 to EC\$52.8 million in FY 1987/88 because of a 7 percent increase in pay rates. The growth of other current expenditure would be held at 2 1/2 percent in FY 1987/88.

(3) Capital outlays of the Central Government (including the delayed water export project and the on-lending of external concessionary loans for a hydro-electricity project to Dominica Electricity Services Ltd.) would rise from an estimated EC\$31.7 million (10 percent of GDP) in FY 1986/87 to EC\$50.3 million (15 percent of GDP) in FY 1987/88. These outlays are covered mainly by project-related external grants and loans (mostly on concessionary terms).

b. Operations of the rest of the public sector

(1) The Social Security Scheme would broaden its coverage in FY 1987/88, and would continue to deposit a large part of its surplus with domestic financial institutions.

(2) Operations of the public enterprises, which improved considerably in FY 1986/87, are expected to be strengthened further reflecting the continued growth of banana exports and policy actions to be taken in this area (see benchmarks below).

c. Other policies

(1) The projected improvements in the financial operations of the public sector would strengthen its net position with domestic commercial banks. Thus, the banks would be able to accommodate a relatively faster growth in private sector demand for credit without jeopardizing their liquidity position.

(2) Private sector activities are expected to be stimulated by the further expansion of fiscal incentives under the tax reform, the continued improvement in infrastructure, and the intensification of the export and tourism marketing efforts.

(3) The authorities would conduct a review of the country's international competitiveness in FY 1987/88.

d. Benchmarks for the second annual program

(1) The quantitative benchmarks include the following: (i) the Government would endeavor to reduce its nonconcessionary debt by EC\$4.0 million during the first half of FY 1987/88 and by EC\$6.6 million in FY 1987/88. If any project in the agreed PSIP were not undertaken, the Government will not engage in nonconcessionary borrowing related to that project and, accordingly, the reduction in the government nonconcessionary debt will be accelerated automatically, unless further agreements are reached between the Government and the Fund staff; (ii) if a temporary need for financing were to arise from unforeseen developments such as delays in aid disbursements, Government may borrow an additional EC\$2 million on a net basis from domestic sources, thus lowering the target for the reduction in government nonconcessionary debt by EC\$2 million; (iii) the Government will not guarantee foreign loans on nonconcessionary terms; (iv) the Government will not borrow from external sources on nonconcessionary terms (i.e., loans with grant elements of less than 25 percent), except as provided in paragraph 35 of the Policy Framework Paper; (v) the Government will not accumulate domestic or external payments arrears.

(2) The Government will (i) implement the tax reform in FY 1987/88; (ii) introduce wage legislation by October 1987; (iii) complete the Organization and Management exercise for the civil service in FY 1987/88; (iv) integrate the IDC and the Tourist Board by September 1987; (v) extend the Social Security Scheme's coverage to the self-employed by December 1987; (vi) strengthen the management of the National Water Service and review water charges in FY 1987/88; and (vii) complete the review of port charges in FY 1987/88.

(3) In addition, the program contains the customary injunctions against (i) imposition of restrictions on payments and transfers for current international transactions; (ii) introduction of multiple currency practices; (iii) conclusion of bilateral payments agreements which are inconsistent with Article VIII; and (iv) imposition or intensification of import restrictions for balance of payments reasons.

Dominica: Financial Relations of the  
World Bank Group with Dominica

(In millions of U.S. dollars)

	Outstanding as of March 31, 1987						
	Disbursed	Undisbursed	Total	Repayments			
<u>Total IDA</u>	<u>4.4</u>	<u>0.2</u>	<u>4.6</u>	<u>-</u>			
Road rehabilitation and maintenance project	4.4	0.2	4.6	-			
	Net Disbursements during Fiscal Year 1/						
	Actual	Actual	Est.	Projected			
	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Net disbursement IDA <u>2/</u>	1.8	1.5	0.3	--	2.3	1.4	0.7
Road rehabilitation and maintenance project	1.8	1.5	0.3	--	--	--	--
Hydropower	--	--	--	--	0.3	0.4	0.7
Other proposed operations	--	--	--	--	2.0	1.0	--

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.

Dominica: IDA Credits and Service Charges, 1983-90 1/

(In millions of U.S. dollars)

	1983	1984	1985	1986	Projections			
					1987	1988	1989	1990
IDA (net)	0.8	1.8	1.5	0.3	--	2.3	1.4	0.7
Disbursements	0.8	1.8	1.5	0.3	--	2.3	1.4	0.7
Amortization	--	--	--	--	--	--	--	--
Interest and commitment fees <u>2/</u>	--	--	--	--	--	0.1	0.1	0.1

Source: World Bank

1/ World Bank fiscal year ending June 30.

2/ Projections for road and power projects only.