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CONFIDENTIAL

March 18, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Dominican Republic - Review Under Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the review under the stand-by arrangement for the Dominican Republic. A draft decision appears on page 22.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Gonzâlez (ext. 8637) or Mr. E. S. Williams (ext. 8624) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Review Under Stand-By Arrangement

Prepared by the Western Hemisphere Department

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

Approved by Eduardo Wiesner and Manuel Guitián

March 17, 1986

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I. Introduction

On April 15, 1985 the Executive Board approved the Dominican Republic's request for a stand-by arrangement in the amount of SDR 78.5 million (70 percent of the quota). The Dominican Republic made an initial purchase of SDR 28 million and a purchase of SDR 33.4 million in December 1985 based on the observance of performance criteria for June and September and the completion of the first review by the Executive Board on November 26, 1985 (EBM/85/172). The final purchase of SDR 17.1 million is subject to observance of the performance criteria for end-December and completion of the second review. This review was to examine the implementation of the economic program in 1985, to reach understandings with the authorities on the economic policies to be pursued for the remaining period of the arrangement and to discuss with the authorities the Government's economic program for 1986 as a whole.

Discussions for the second review were held in Santo Domingo from January 25 to February 5, 1986. The Dominican representatives included the Minister of Finance, the Technical Secretary to the Presidency, the Governor of the Central Bank and other senior officials of the Ministry of Finance and the Central Bank. At the conclusion of the mission a meeting was held with the President of the Republic. The staff was represented by Messrs. J. Gonzalez (Head), E. Williams and R. Incer (all WHD), N. Weerasinghe (ETR), and Mrs. G. Lanio (Secretary-WHD). The mission was assisted by Ms. Elizabeth Milne, the Fund resident representative in Santo Domingo.

As of December 31, 1985, the Fund holdings of Dominican pesos subject to repurchase amounted to SDR 270.4 million (241.2 percent of quota). The scheduled purchase would raise the Fund holdings of Dominican pesos subject to repurchase to SDR 277.7 million or 247.7 percent of quota (Table 1).

The last Article IV consultation with the Dominican Republic was concluded by the Executive Board on November 26, 1985 (EBM/85/172).

II. The Economic Program for 1985

The economic and financial program for 1985 aimed at strengthening the country's external position while containing inflation and creating conditions for renewed growth. Central to the achievement of these objectives was the unification of the exchange system and the establishment of arrangements whereby the external value of the peso was to be determined by exchange market forces. The program called for a number of corrective price adjustments and a tightening of fiscal and monetary policies.

With a view to reducing inflationary pressures, the overall deficit of the public sector (including the quasi-fiscal deficit of the Central Bank) was to be reduced from the equivalent of 5.2 percent of GDP in

Table 1. Dominican Republic: Projected Purchases and Scheduled Repurchases
(April 1985-April 1986)

	Outstanding Feb. 28, 1985	1985 Jan.-Mar.	1985 Apr.-June	1985 July-Sept.	1985 Oct.-Dec.	1986 Jan.-Mar.	1986 Apr.
	(In millions of SDRs)						
Transactions under tranche policies (net)	--	--	28.0	--	33.4	--	17.1
Purchases	--	--	28.0	--	33.4	--	17.1
Repurchases	--	--	--	--	--	--	--
Transactions under special facilities (net) 1/	225.7	-23.2 2/	--	-4.5	11.0	-4.5	-5.3
Total Fund credit outstanding (end of period)	225.7	202.5	230.5	226.0	270.4	265.9	277.7
Under tranche policies	--	--	28.0	28.0	61.4	61.4	78.5
Special facilities	225.7	202.5	202.5	198.0	209.0	204.5	199.2
	(As percent of quota)						
Total Fund credit outstanding (end of period)	201.3	180.6	205.6	201.6	241.2	237.2	247.7
Under tranche policies	--	--	25.0	25.0	54.7	54.8	70.0
Special facilities	201.3	180.6	180.6	176.6	186.4	182.4	177.7

Source: IMF Treasurer's Department.

1/ Includes outstanding use under EFF, CFF and buffer stock financing facility.
2/ Early repurchase under Buffer Stock Financing Facility (sugar).

1984 to 4.9 percent of GDP in 1985 (Table 2). This deficit was to be entirely financed by external credits. As for the balance of payments, export receipts were expected to decline as a result of poor market prospects for traditional exports (particularly sugar) but a strong growth in tourist receipts and transfers was envisaged. In addition, the tight monetary and fiscal policies were expected to lead to a decline in imports. In these circumstances the external current account deficit was projected to decline from 4.6 percent of GDP in 1984 to 0.6 percent of GDP in 1985. 1/

The fiscal outcome depended heavily on (1) the introduction of a temporary exchange surcharge of 36 percent and 5 percent, respectively, on earnings from exports of traditional and nontraditional goods and services, and (2) large increases in petroleum taxes and import duties. The increase in import duties was to be the result of a change in the accounting rate used for that purpose, from RD$2 per U.S. dollar to the moving average of the actual rate for the previous three months. The measures adopted in the area of monetary policy included (1) a reduction in outstanding central bank rediscounts and advances of 10 percent and 5 percent to commercial banks and development banks, respectively, and (2) introduction of a 100 percent marginal reserve requirement on commercial banks' deposits in excess of their average balances outstanding in the last quarter of 1984. In addition, the interest rate on financial certificates was raised from 10-14 percent to 18 percent and the minimum denomination for these certificates was reduced from RD$100,000 to RD$10,000.

III. Performance Under the 1985 Program

Performance under the program has been broadly satisfactory. A more efficient system of relative prices has been established and, despite increases in the prices of a number of basic items, the rate of inflation has decelerated during the course of the year. The price increases introduced in 1985 also have reduced the cost of government subsidies. Some subsidies still remain and further price and structural adjustment measures will be required to put the public enterprises on a sounder footing. In the external sector, the sharper fall in exports than envisaged and greater than expected import growth have kept the current account deficit higher than projected.

The quantitative performance criteria (on net domestic assets of the Central Bank, net bank credit to the public sector, net foreign assets of the Central Bank, the cash reduction in external payments

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1/ At the time of the first program review, based on early trends in the public finances and in imports, the projection for the overall fiscal deficit for 1985 was revised downward to 1.9 percent of GDP and that for the external current account deficit was revised upward to 1.1 percent of GDP.

Table 2. Dominican Republic: Selected Economic and Financial Indicators, 1981-86

	1981	1982	1983	1984	1985 Prog.	1985 Proj. Sept.	1985 Prel.	Proj. 1986
	(Annual percentage changes, unless otherwise specified)							
National income and prices								
GDP at constant prices	3.9	1.7	4.0	0.5	2.0	-0.4	-1.2	2.0
GDP at current market prices	9.6	9.8	7.4	27.9	23.4	34.4	36.8	17.0
GDP deflator	5.4	8.0	3.3	27.2	21.0	35.0	38.5	15.0
Consumer prices (average)	7.5	7.6	7.0	24.4	24.0	35.0	37.5	15.0
Consumer price (end of year)	7.3	7.2	7.8	38.1	...	...	28.1	...
External sector (on the basis of U.S. dollars)								
Exports, f.o.b.	23.5	-35.4	2.3	10.6	-7.8	-9.4	-15.0	7.6
Imports, f.o.b.	-4.5	-13.4	2.0	-2.0	-8.5	-4.1	2.3	-6.7
Export volume	10.9	-25.7	-1.4	6.3	0.3	-7.3	-11.0	-3.4
Import volume	-10.8	-14.7	2.2	-7.7	-9.0	-4.8	1.4	--
Terms of trade (deterioration -)	4.0	-14.0	3.9	-1.2	-8.4	-2.9	-5.2	18.2
Effective exchange rate 1/								
Nominal	4.2	-3.1	-10.6	-41.2	...	...	-4.7	--
Real	0.8	-1.8	-10.4	-21.6	...	...	13.0	--
Central Government								
Revenue	3.8	-18.5	22.4	30.2	95.1	99.7	88.4	12.5
Expenditure	2.7	-9.7	17.0	12.5	86.7	100.7	85.9	7.0
Money and credit 2/								
Domestic credit 3/	29.1	37.1	32.5	25.4	16.8	--	7.7	15.1
Public sector (net) 3/	26.2	26.4	20.3	7.1	--	-2.8	-11.7	--
Private sector 3/	-1.9	6.5	9.5	8.6	7.7	5.9	11.2	14.2
Money and quasi-money (M2)	11.9	15.9	7.9	30.2	24.0	7.6	15.2	15.0
Velocity (GDP relative to M2)	6.2	5.8	5.8	5.7	5.8	7.1	6.6	6.7
	(In percent of GDP)							
Public sector deficit								
Nonfinancial public sector	-6.2	-6.2	-4.2	-2.7	-4.9	-1.9	-2.0	-3.0
Nonfinancial public sector, including the quasi-fiscal deficit of the Central Bank	-6.4	-6.6	-4.6	-5.2	-4.9	-1.9	-2.3	-3.0
Gross domestic investment	23.4	20.6	20.8	19.8	21.7	17.8	17.8	17.9
Gross national savings	17.8	15.1	15.9	17.8	21.1	16.7	13.1	15.9
BOP-current account deficit 4/	-6.0	-6.4	-6.1	-4.6	-0.6	-1.1	-4.7 4/	-2.0
External public debt 5/	27.0	28.8	36.1	49.7	57.8	54.4	59.6	61.0
	(In percent of exports of goods and services)							
Debt service 6/	30.9	42.8	44.3	41.4	63.8 7/	30.6 8/	26.7 8/	35.6 8/
Of which: Interest payments	20.0	24.9	24.7	19.6	16.8 7/	21.2 8/	18.1 8/	21.0 8/
	(In million of U.S. dollars)							
Overall balance of payments	-109.6	-356.3	-352.7	-154.7	-149.6	-130.7	-189.3	-140.0
Change in net international reserves (increase -)	109.6	356.3	58.2 9/	-92.2 10/	-108.7	-69.3	-89.2	-37.0
Arrears (decrease -) 11/	--	--	142.6	246.9	-77.5 12/	-108.0 12/	-65.6 12/	-40.0
Other 13/	--	--	151.9	--	335.8	308.0	344.0	217.0
Gross official reserves	283.5	172.4	204.3	268.0	295.0	277.6	356.6	283.0
(weeks of imports)	10.3	7.1	8.3	11.1	13.3	12.0	14.7	12.5

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

1/ Based on a composite exchange rate which reflects non-oil transactions in the official and parallel markets through 1984. Change shown is from fourth quarter to fourth quarter.
2/ Excludes nonbank financial intermediaries.
3/ Changes in relation to broad money (currency in circulation, demand deposits and time and savings deposits at commercial banks) outstanding at the beginning of the period.
4/ The identity gross national investment equal to gross national saving plus the current account deficit (surplus) does not hold prior to 1984 because the national accounts valued the balance of payment transactions at the official exchange rate (RD$1.0 per U.S. dollar) instead of the implicit rate applied for the estimate of this ratio.
5/ Debt of all maturities (including use of Fund credit, but excluding other reserve liabilities of the Central Bank) in relation to GDP in U.S. dollars. The implicit exchange rates applied to convert GDP to U.S. dollars are RD$1.16 in 1982, RD$1.25 in 1983, RD$2 in 1984, and RD$3.1 in 1985 per U.S. dollar.
6/ Repayments of medium- and long-term loans and interest payments on debt of all maturities.
7/ Before debt relief.
8/ After debt relief.
9/ During the year there was an accumulation of unpaid external obligations outside the Central Bank.
10/ During the year there was a further accumulation of unpaid external obligations outside the Central Bank.
11/ Other than arrears on the foreign exchange liability of the Central Bank.
12/ Reduction of arrears through cash payment.
13/ Includes debt relief in 1983 and 1985 and 1986.

arrears, and net foreign borrowing) for end-December have all been observed, in some cases, with substantial margins (Table 3). The reduction in the temporary export surcharge on traditional exports from 36 percent to 20 percent, which is a prior condition for the completion of the review, also has been implemented. 1/

The monthly rate of inflation declined from about 3 percent in the first half of 1985 to 1 percent in the second half, and by end-December the 12 month rate of inflation was 28 percent compared with 38 percent in December 1984 (see Table 2). However, the rapid rise in prices early in the year, because of the unification of the exchange market and corrective price adjustments, raised the average rate of inflation for the year as a whole to 38 percent compared with 24 percent originally projected. According to official estimates real GDP is estimated to have fallen by about 1 percent in 1985. The decline was apparently due to lower agricultural output related to adverse weather conditions, weak international demand conditions for sugar, and a fall in construction activity associated with the reduced availability of mortgage financing. 2/

The overall deficit of the public sector in 1985 (including the quasi-fiscal deficit of the Central Bank) is estimated to have been equivalent to 2.3 percent of GDP compared with the original program limit of 4.9 percent of GDP. 3/ External financing exceeded the overall fiscal deficit and permitted a reduction of close to RD$200 million in net public sector indebtedness to the Central Bank and the Reserve Bank, the state-owned commercial bank (Table 4). The large reduction in public sector bank indebtedness was influenced, in part, by some year-end disbursements of project loans and larger than programmed accumulation of counterpart deposits associated with PL-480 commodity loans.

Government revenues turned out to be slightly higher than originally programmed and total expenditures were less than had been programmed. The expenditure shortfall reflected markedly lower capital spending and savings on interest payments. Included in total expenditures are the operating losses of the public enterprises which in 1985 amounted to the equivalent of 8 percent of total public sector expenditure (as against a break even position envisaged in the program). Of the shortfall in interest payments of RD$237 million, RD$136 million

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1/ As is discussed below, the reduction in the export surcharge to 18 percent was effected through a mechanism whereby the exporter paid the 36 percent and was reimbursed 18 percent after 60 days. The staff has calculated that the effective rate of surcharge is 19 percent. In addition, the 5 percent surcharge on nontraditional exports was eliminated.

2/ This estimate is being re-examined because production and trade indicators do not support the conclusion that real GDP fell in 1985.

3/ If the cash deficit is corrected for scheduled interest payments not paid, the overall deficit is the equivalent of 2.7 percent of GDP.

Table 3. Dominican Republic: Quantitative Performance Criteria Under Stand-By Arrangement, 1985

	1984 Dec. 31	1985 June 30	1985 Sept. 30	1985 Dec. 31
	(In millions of Dominican pesos)			
Net credit to the public sector 1/				
Ceiling		1,902.0	1,852.0 2/	1,802.0 3/
Revised ceiling		1,910.8 3/	1,750.0 4/	1,785.9 4/
Adjustment 3/		...	-50.0	
Actual	1,810.8 3/	1,603.1	1,644.3	1,620.1 5/
Margin or excess (-)		307.7	55.7	165.8
Cumulative reduction in net domestic assets of the Central Bank				
Target		-50.0	-114.9 2/	-164.8 2/
Revised target			-180.0	-207.4
Adjustment for letters of credit and greater than programmed debt relief 6/		...	3.6	-21.3
Actual	1,632.1 7/	-309.4	-226.8	-244.5 8/
Margin or excess (-)		259.4	50.4	15.8
	(In millions of U.S. dollars)			
Net foreign assets of the Central Bank				
Target		-300.0	-278.6 2/	-227.2 2/
Revised target			-335.0	-266.6
Adjustment for letters of credit 6/		-16.7	-1.2	1.2
Actual	-335.9	-285.7	-310.1	-247.7 9/
Margin or excess (-)		31.0	26.1	20.5
Cumulative cash reductions in external arrears				
Target		64.0	74.0 2/	89.0 2/
Revised target			74.0	105.0
Actual	506.6 4/7/	65.1	79.5	106.7
Margin or excess (-)		1.1	5.5	1.7
External debt disbursements 10/				
Debt of 0-1 year (net)				
Ceiling on gross disbursements		90.7	90.7	90.7
Ceiling on net disbursements 11/				19.3
Revised ceiling on net disbursements 11/				--
Actual gross disbursements		79.0		
Margin or excess (-)		11.7		
Debt of 1-5 years				
Ceiling 12/		64.2	64.2	64.2
Actual		36.3	...	55.7
Margin or excess (-)		27.9		8.5
Debt of 1-12 years				
Ceiling		198.5	198.5	198.5
Actual		69.4	...	122.4
Margin or excess (-)		129.1		76.1

Sources: Technical Memorandum of Understanding; and Central Bank of the Dominican Republic.

1/ Combined net credit of the Central Bank and the Reserve Bank to the nonfinancial public sector.
2/ Indicative ceiling or target.
3/ Ceiling was adjusted to reflect revision in the outstanding stock as of December 31, 1984.
4/ Ceilings adjusted as indicated in footnote 1 to Table 2 annexed to the Technical Memorandum of Understanding and for greater than programmed debt relief.
5/ Adjusted for deposits of Plan Reagan funds credited to public sector.
6/ Reflects use of collateral deposits to liquidate letters of credit. See footnote 2 to Table 3 annexed to the Technical Memorandum of Understanding.
7/ Stock outstanding.
8/ For the definition of NDA the changes of NFA are valued at the monthly average exchange rate.
9/ Adjusted by US$1.2 of arrears with the Bank of Nova Scotia converted to medium- and long-term debt.
10/ Disbursements under nonconcessional external public and publicly guaranteed debt.
11/ Applies to the period December 31, 1984-December 31, 1985.
12 Subceiling within the disbursements of debt of 1-12 years maturity.

Table 4. Dominican Republic: Public Sector Operations, 1982-86

	1982	1983	1984	1985 1/ Prog.	1985 1/ Sept. Proj.	1985 1/ Prel. Est.	1986 1/ Proj.
			(In millions of Dominican pesos)				
Total revenue	765.6	935.4	1,257.6	2,156.3	2,408.7	2,269.1	2,552.6
Central Government	752.7	922.9	1,201.4	2,153.4	2,399.2	2,265.0	2,548.4
Current	743.2	912.2	1,194.3	2,146.9	2,335.2	2,196.9	2,393.2
Capital	9.5	10.7	7.1	6.5	64.0	68.1	155.2
Public enterprises	12.9	12.5	56.2	2.9	9.5	4.1	4.2
Operating surplus	--	--	49.1	--	--	--	--
Capital revenue	12.9	12.5	7.1	2.9	9.5	4.1	4.2
Total expenditure	1,169.3	1,278.8	1,435.2	2,750.0	2,650.0	2,536.2	2,965.4
Central Government	958.2	1,126.4	1,258.0	2,002.8	2,130.9	1,979.3	2,332.5
Current expenditure	774.3	870.3	975.1	1,580.4	1,749.6	1,615.3	1,856.5
Capital expenditure	183.9	256.1	282.9	422.4	381.3	364.0	476.0
Of which: capital formation	110.7	130.7	106.3	401.8	231.3	181.4	250.0
Public enterprises	211.1	152.4	177.2	747.2	519.1	556.9	632.9
Operating loss	27.7	13.4	--	1.1	215.4	209.1	234.0
Interest payments	68.5	58.5	36.2	168.4	48.7	36.0	56.2
Capital expenditure	114.9	80.5	141.0	577.7	255.0	311.8	342.7
Of which: capital formation	100.1	66.2	117.2	571.2	255.0	305.0	336.2
Deficit of the consolidated public sector	-403.7	-343.4	-177.6	-593.7	-241.3	-267.1	-412.8
Residual 2/	-88.5	-13.2	-121.0	-36.3	-36.3	-29.7	-98.9
Overall deficit (-)	-492.2	-356.6	298.6	-630.0	-277.6	-296.8	-511.7
Financing	492.2	356.6	298.6	630.0	277.6	296.8	511.7
External	108.6	38.7	165.1	630.0	284.8	491.6	533.1
Domestic	383.6	317.9	133.5	--	-7.2	-194.8	-21.4
Banking system	383.6	282.6	168.6	--	--	-224.0	--
Other 3/	--	35.3	-35.3	--	--	29.2	-21.4
			(In percent of GDP)				
Memorandum items							
Overall deficit	-6.2	-4.2	-2.7	-4.9	-1.9	-2.0	-3.0
Overall deficit, including the quasi-fiscal deficit of the Central Bank 4/	-6.6	-4.6	-5.2	-4.9	-1.9	-2.3	-3.0

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

1/ Foreign exchange transactions are valued at RD$2.8 per U.S. dollar in the program; RD$3.00 per U.S. dollar in the September projection; and RD$3.10 per U.S. dollar in the preliminary estimate; and RD$3.00 per U.S. dollar for 1986.

2/ Includes overall surplus/deficit of nonconsolidated public sector; unrecorded investment spending of the Central Government and statistical discrepancy since the fiscal data are on a checks-issued basis while the Bank data are on a checks-cleared basis.

3/ Change in cash balances, items in transit, bonds of the National Housing Institute (INVI), and in 1985 and 1986 transfers from the Plan Reagan accounts to the PL 480 account.

4/ Defined as the deficit of the nonfinancial public sector plus interest owed by the Central Government to the Central Bank but not paid, plus interest paid by the Central Bank on the debt it assumed under the December 1983 rescheduling agreement with foreign commercial banks.

represented an overestimation of scheduled domestic and foreign interest, RD$63 million (0.4 percent of GDP) represented foreign interest payments which were either rescheduled (RD$18 million) or did not really fall due until 1986 (RD$45 million); 1/ and RD$38 million represented interest on bonded debt held by the Central Bank, which was not paid. 2/ Central government wage payments were 30 percent larger than envisaged because of wage increases introduced with effect from midyear (Table 5). 3/

As mentioned earlier, in the course of 1985 there were substantial price adjustments in the public enterprise sector, including increases in the prices of domestic refined sugar (93 percent), molasses (70 percent), electricity tariffs (46 percent), rice (40 percent), and milk (66 percent). In addition, the Dominican Electricity Company (CDE) and the State Sugar Company (CEA) took steps to reduce their operating expenditures through personnel reductions, a more efficient use of spare parts and materials, and a rationalization of operations (in the case of the sugar company). Notwithstanding these measures, the public enterprises registered operating losses of RD$209 million. The underperformance derived from a number of factors, among which were (1) the larger than anticipated reduction in sugar output and exports, due mainly to the reduction in the Dominican Republic's quota in the U.S. market, (2) unprogrammed increases in producer prices for rice, and (3) sizable payments for end-of-year bonuses, which were not envisaged in the program. In addition, the two large enterprises, the Institute of Price Stabilization (INESPRE) and CEA, undertook to reduce sizable accumulated arrears due to rice and sugar farmers. The payment of these arrears (about RD$60 million) which had been accumulated in 1984, was not included in the program.

According to preliminary information, the current account deficit of the balance of payments is estimated at 4.7 percent of GDP in 1985, about the same as in 1984 but well above the 0.6 percent originally

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1/ The moratorium interest on rescheduled Paris Club credits was programmed to be paid in 1985 because the bilateral agreements were expected to be signed by end-December 1985. There were however delays in the negotiation of some of these agreements. The last agreement is to be signed mid-March 1986 and the moratorium interest is to be paid by end-March 1986.

2/ The nonpayment of this interest is already reflected in the quasi-fiscal deficit of the Central Bank.

3/ The wage increase was not included in the original program because the government had undertaken to implement it only if Congress had approved compensating revenue measures. At the time of the mid-term review, the authorities informed the staff of congressional reluctance to introduce new revenue measures and indicated that the wage increase was to be covered by the liquidation of mortgage bonds held by the Rosario mining company. In the event, such liquidation did not take place.

Table 5. Dominican Republic: Operations of the Central Government, 1982-86 1/

	1982	1983	Prel. 1984	1985 Prog.	1985 Sept. Proj.	1985 Prel. Actual	Proj. 1986
Total revenue	754.6	923.3	1,201.7	2,154.0	2,399.2	2,265.0	2,548.4
Current revenue	745.1	912.6	1,194.6	2,147.5	2,335.2	2,196.9	2,393.2
Tax revenue	661.3	782.4	1,084.2	2,030.8	2,214.6	2,116.8	2,291.4
Income tax	181.9	199.6	261.9	243.9	329.5	341.7	395.1
Taxes on goods and services	213.9	320.4	496.3	638.5	689.4	678.4	969.6
Taxes on foreign trade	185.2	239.6	295.5	338.6	476.0	468.6	560.1
Surcharge	--	--	--	712.0	667.3	547.8	270.0
Other taxes	20.8	22.8	30.5	97.8	52.4	80.2	96.6
Nontax revenue	83.8	130.2	110.4	116.7	120.6	80.1	101.8
Capital revenue	9.5	10.7	7.1	6.5	64.0	68.1	155.2
Total expenditure	976.1	1,142.1	1,284.7	2,403.6	2,578.2	2,388.3	2,555.8
Current expenditure	781.7	871.3	996.3	1,851.4	2,115.4	1,947.7	2,066.8
Wages and salaries	427.8	448.8	499.9	482.2	629.9	627.3	691.8
Goods and services	135.0	163.0	192.4	209.1	322.7	316.7	340.1
Transfers	167.3	193.5	257.8	789.1	908.7	860.9	819.1
Interest payments	48.3	62.4	46.2	371.0	243.8	133.5	193.4
Other	3.3	3.6	--	--	10.3	9.3	1.6
Other expenditure	194.4	270.8	288.4	552.2	462.8	440.6	489.0
Capital formation	110.7	130.7	106.3	401.8	231.3	181.4	250.0
Capital transfers to nonfinancial public sector 2/	80.3	116.6	158.7	150.4	203.0	203.3	182.1
Other 3/	3.4	23.5	23.4	--	28.5	46.0	56.9
Current account surplus or deficit (-)	-36.6	41.3	198.3	296.1	219.8	249.2	326.4
Overall deficit	-221.5	-218.8	-83.0	-249.6	-179.0	-123.3	-7.4

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

1/ Totals may differ from those in Table 4 where identified transfers between the Central Government and the public enterprises are netted out.
2/ Includes payments of foreign interest on behalf of some public enterprises.
3/ Includes capital transfers to the rest of the public sector and the financial public sector.

projected in the program (Table 6). These data suggest that the deficit was largely financed by private capital inflows, which are part of the residual item, and debt relief. There is, however, the strong possibility that a sizable part of these capital inflows represents underestimation of travel receipts, migrants' remittances, and some public transfers which are counterpart to certain public sector imports. Exports in 1985 were 8 percent below program projections and about 15 percent below the 1984 level, mainly as a result of a decline in the volume of sugar exports to the U.S. market and lower free market sugar prices. Total imports were 2 percent higher than in 1984 and 12 percent above the amount projected in the program. Reliable data on the composition of imports are not yet available.

Total debt relief in 1985 amounted to US$344 million compared with the originally programmed US$335 million: an estimated US$108 million represented debt rescheduling under a Paris Club agreement and US$236 million represented the deferment of interest and principal payments due to commercial banks. During 1985, the reduction of external arrears amounted to US$107 million, compared to the program target of US$105 million, and net foreign assets of the Central Bank increased by US$89 million, compared to a revised program target of US$69 million.

The unification of the exchange system in late January 1985 was followed by a depreciation of the Dominican peso from RD$3.00 per U.S. dollar to RD$3.32 per U.S. dollar at the end of March 1985. The rate returned to RD$3.00 per U.S. dollar by mid-1985 and has since appreciated by 6 percent to RD$2.82 per U.S. dollar as of February 1986. In real effective terms, the peso appreciated by 13 percent during 1985, but its real effective value at year-end was still some 14 percent below the level at the end of 1983 and more than 20 percent below the period 1980-82 (Chart 1).

During 1985 net domestic assets of the Central Bank declined by 7 percent, in relation to money and quasi-money outstanding at the beginning of the period, reflecting the sharp reduction in the public sector's net indebtedness to the banking system (Table 7). Bank credit extended to the private sector increased by 10 percent in nominal terms, implying a sharp decline in real terms. Private sector credit expansion by the nonbank financial intermediaries increased at a much faster rate, as these institutions were able to mobilize significant resources through the sale of high-yielding financial certificates and by offering higher deposit rates than the commercial banks. A large part of the private capital inflows from abroad apparently went to these institutions.

Despite increases introduced early in the year, the maximum time deposit interest rate paid by the commercial banks in 1985 was 9 1/2 percent. In addition, banks offered financial certificates which paid interest rates up to 18 percent. These rates were negative in real terms for much of the year and contributed to a slower than programmed growth in money and quasi-money and an increase in the velocity of

Table 6. Dominican Republic: Summary Balance of Payments, 1981-85

(In millions of U.S. dollars)

	1981	1982	1983	1984	1985 Program	1985 Revised Program	1985 Prel. Est.
Current account	-405.9	-442.0	-421.1	-254.0	-29.3	-46.5	-220.4
Trade balance	-263.7	-489.7	-497.0	-389.0	-350.0	-410.5	-548.0
Exports, f.o.b.	1,188.0	767.6	785.2	868.1	800.0	789.5	737.9
Imports, f.o.b.	-1,451.7	-1,257.3	-1,282.2	-1,257.1	-1,150.0	-1,200.0	-1,285.9
Services (net)	-335.2	-157.3	-139.1	-130.0	5.7	14.0	-28.7
Receipts	336.4	378.5	451.5	507.3	609.0	609.0	606.2
Of which: travel	206.3	266.1	320.0	370.0	477.7	430.0	439.3
Payments	-671.6	-535.8	-590.6	-637.3	-603.3	-595.0	-634.9
Of which: interest	-228.0	-248.0	-270.0	-269.0	-236.2	-255.0	-255.0
Transfers (net)	193.0	205.0	215.0	265.0	315.0	350.0	356.3
Private	176.3	190.0	195.0	205.0	215.0	230.0	242.0
Public	16.7	15.0	20.0	60.0	100.0	120.0	114.3
Capital account	296.3	85.7	68.4	99.3	-120.3	-84.2	31.1
Direct investment	79.7	-1.4	22.0	68.0	42.0	42.0	40.0
Medium- and long-term loans (net)	153.6	150.5	24.1	34.0	-143.0	-152.0	-116.1
Drawings	320.2	355.8	248.7	324.0	280.0	264.0	263.6
Amortization	-166.6	-205.3	-224.6	-290.0	-423.0	-416.0	-379.7 1/
Other 2/	63.0	-63.4	22.3	-2.7	-19.3	25.8	107.2
Overall balance	-109.6	-356.3	-352.7	-154.7	-149.6	-130.7	-189.3
Financing	109.6	356.3	352.7	154.7	149.6	130.7	189.3
Net foreign assets of Central Bank (increase -)	109.6	356.3	58.2	-92.2	-108.7	-69.3	-89.2
Assets	-8.3	111.1	-31.9	-63.7	-27.0	...	-86.9
Liabilities	117.9	245.2	90.1	-28.5	-81.7	...	-2.3
Fund (net)	-25.5	48.6	174.6	-25.0	29.2	44.7	44.7
Arrears	166.8	119.9	-67.4	34.3	-12.5	-46.3	-46.3
Other liabilities	-23.4	76.7	-17.1	-37.8	-98.4	...	-0.7
Arrears (decrease -) 3/	--	--	142.6	246.9	-77.5	-61.7	-65.6
Debt relief	--	--	151.9	--	335.8	308.0	344.1
Memorandum item							
Current account deficit/GDP	-6.0	-6.4	-6.1	-4.6	-0.6	-1.0	-4.7

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

1/ After adjustment for overestimation, in the program of, amortization payments due under the San-Jose agreement.
2/ Includes SDR allocation in 1981, short-term public and private capital (net), gold revaluation and monetization, and errors and omissions (net).
3/ Outside the Central Bank.

Table 7. Dominican Republic: Summary Accounts of the Central Bank and the Banking System, 1982-86

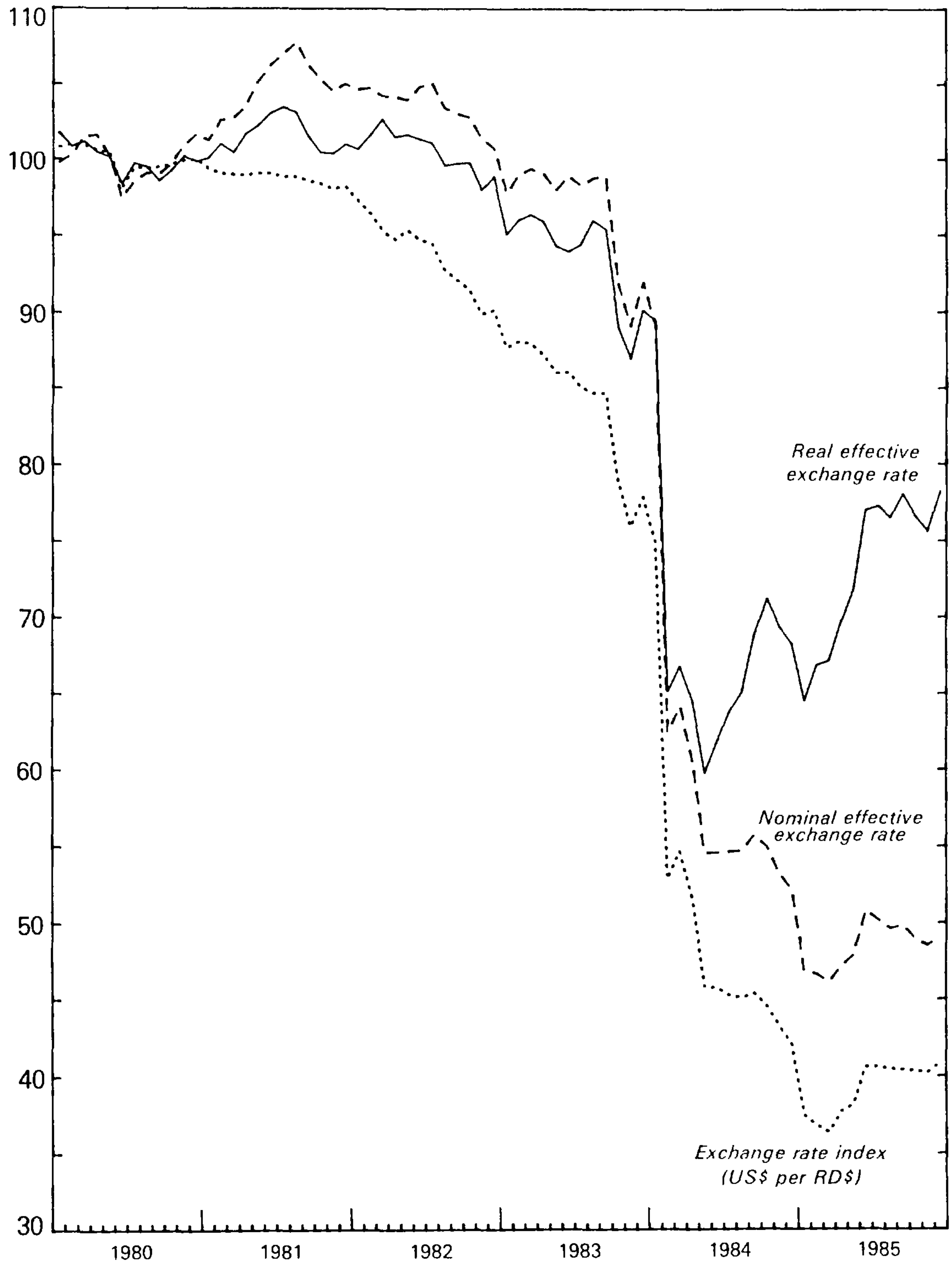
(End-of-year balances in millions of Dominican pesos)

	1982	1983	Actual 1984 1/	Prog. 1985 2/	Sept. Proj. 1985 1/	Prel. Dec. 1985 1/	Proj. Dec. 1986 3/4/
			I. Central Bank				
Net international reserves	-678.6	-428.1	-987.5	-636.1	-783.8	-724.7	-613.7
Assets	172.4	204.3	789.4	826.0	817.6	1,048.5	...
Liabilities	-851.0	-632.4	-1,776.9	-1,462.1	-1,601.4	-1,773.2	...
Net domestic assets	1,109.8	915.0	1,679.1	1,467.4	1,562.9	1,525.9	1,535.1
Claims on the public sector (net)	970.5	1,223.8	1,341.8	1,341.8	1,341.8	1,251.5	1,251.5
Central Government	739.7	866.6	937.4	937.4	937.4	953.5	...
Counterpart funds of foreign aid (mostly PL-480)	-7.7	-30.5	-2.1	-2.1	-2.1	-67.6 5/	...
Public financial institutions	151.2	149.6	148.2	148.2	148.2	156.2	...
Rest of the public sector	87.3	238.1	258.3	249.9	258.3	209.4	...
Credit to commrcial banks (net)	201.0	301.9	193.5	155.5	115.9	112.8	112.8
Credit to the rest of the financial system	157.9	190.7	215.3	215.9	338.7 6/	256.5	274.3
Medium- and long-term foreign liabilities	-359.1	-808.2	-2,582.1	-2,545.7	-2,628.7 7/	-2,678.2	-2,691.7
Revaluation account	--	--	2,355.7	2,185.7	2,583.6	2,884.7	2,943.5
Deposits from U.S. grants (Plan Reagan)	--	--	-50.0	-50.0	-408.8 8/	-351.0	-404.9 9/
Net unclassified assets	139.4	6.8	205.3	74.7	220.4	49.6	49.6
Currency issue	431.2	486.9	691.6	831.3	779.1	801.2	921.4
Currency in circulation	357.1	414.7	592.8	724.2	672.0	677.2	778.8
Cash in vaults	74.1	72.2	98.8	107.1	107.1	124.0	142.6
			II. Banking System				
Net foreign assets	-700.7	-479.2	-1,065.8	-710.6	-861.7	-454.6	-361.8
Net domestic assets (net)	2,389.5	2,425.4	3,454.6	3,566.5	3,570.4	3,306.0	3,640.9
Of which:							
credit to the public sector	1,379.1	1,661.7	1,830.5	1,767.6	1,776.2	1,606.5	1,606.5
credit to the private sector	1,113.5	1,261.3	1,413.0	1,744.8	1,527.0	1,628.6	1,944.5
Liabilities to the private sector	1,688.8	1,946.2	2,388.8	2,855.9	2,708.7	2,851.4	3,279.1
Of which: money	703.7	755.2	1,140.7	1,338.5	1,247.0	1,295.7	1,490.2
quasi-money	662.7	719.2	779.9	997.4	820.0	917.6	1,055.2

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

1/ Foreign exchange transactions valued at RD$2.94 per U.S. dollar.
2/ Foreign exchange transactions valued at RD$2.80 per U.S. dollar.
3/ Foreign exchange transactions valued at RD$3 per U.S. dollar.
4/ Assumes an annual inflation rate of 13 percent during the 12-month period ending in December 1986 and 2 percent real GDP growth in 1986.
5/ Includes RD$28 million transferred from deposits from U.S. grants.
6/ Includes loans extended by Fondo de Inversiones para el desarollo Economico (FIDE) to the financial system with IDB funds.
7/ Includes IDB loan for US$45 million for the Industrial Reactivation program.
8/ Includes funds from the 1984 U.S. grants that were revalued in March 1985 plus funds from the 1985 U.S. grants.
9/ Assumes US$40 million of U.S. grants and drawings of RD$66.1 million.

CHART 1
DOMINICAN REPUBLIC
EXCHANGE RATE DEVELOPMENTS[1]
(1980 = 100)



Source: IMF.
[1] Increase indicates appreciation.

circulation from 5.7 to 6.6. Deposit rates paid in the informal financial market, which ranged from 20 to 30 percent, have been positive since early 1985. With a view to integrating in due course the formal and informal financial markets, the Central Bank has started to register all nonbank financial intermediaries and to ensure that they comply with the minimum liquidity requirements introduced by the Monetary Board in January 23, 1985.

IV. Relations with the World Bank

The Dominican Republic's relations with the World Bank are summarized in Appendix II. After averaging close to US$30 million a year in 1980-83, net lending by the World Bank tapered off to about US$7.5 million a year in 1984-85.

Since April 1985, the World Bank has approved two loans worth US$41.6 million. One, a US$5.8 million loan for vocational training, was approved in June 1985; the other, a US$35.8 million loan for highway reconstruction, was approved in July 1985. Both these loans are awaiting approval by the Congress of the Dominican Republic. The Bank is now working with the authorities on a loan to support the electricity power sector, and to reduce losses through improvements in distribution; an appraisal mission visited the Dominican Republic in October 1985. The Bank is also discussing a possible US$30 million loan to construct a coal unloading terminal at Haina.

To lay the foundation for additional lending, a Bank economic mission visited the Dominican Republic in April 1985 to analyze the long-term obstacles to growth. A draft report of this mission has just been completed and is to be discussed with the authorities shortly.

V. Discussions on Economic Policy for 1986

Discussions on policies for 1986 were conducted against the background of the Presidential elections which take place in mid-May 1986 with the new administration taking office in August. The Dominican authorities expressed their intention to maintain efforts to bring down inflation and strengthen the balance of payments while seeking a resumption of economic growth. As in 1985, public sector access to domestic bank credit will be avoided and steps are to be taken to control bank liquidity. External policy will focus on measures to promote exports including a substantial reduction in the export surcharge.

While the decline in sugar production is expected to continue in 1986, favorable weather conditions, the intensification of the diversification effort away from sugar, and the increase in producer prices for rice, introduced in the second half of 1985, should result in an increase in total agricultural production. This, along with some pickup in public construction activity and continued growth in manufacturing and tourism, should lead to an increase in real GDP of about 2 percent in 1986. The sharp fall in fuel prices and the generally restrictive monetary policy stance should facilitate a reduction in the average inflation rate to about 15 percent in 1986.

1. Fiscal policy

A draft budget for 1986 was presented to Congress in November 1985 but no action has been taken on it as yet. In the meantime, the Administration has announced a fiscal plan which it is in the process of implementing. The program implies a small increase in the overall public sector deficit to around 3 percent of GDP, to be financed almost fully from foreign credits.

Total revenue is projected to increase by 12 percent in 1986. The effect of the reduction in the export surcharge from 36 percent to 18 percent, estimated at RD$268 million, would be more than offset by an increase in the windfall profits tax recently imposed on coffee exports and by higher petroleum taxes resulting from the reduction in the cost of imported fuel. 1/ Total expenditures are expected to increase by 17 percent, largely because of the projected growth in interest outlays (45 percent) and in capital expenditures (20 percent). The increase in interest outlays results, for the most part, from the rescheduling of certain obligations that fell due in 1985 and from the fact that the current interest obligations to Paris Club creditors, which were rescheduled last year, are to be paid in 1986. The projected rise in capital expenditures reflects the expectation that foreign loans which were tied up in Congress in 1985 will be approved in 1986. Central Government wage outlays are projected to increase by 10 percent to cover annual increments and end-of-year bonuses. Moreover, the government has established monthly expenditure ceilings which would restrict the increase in expenditures on goods and services to a maximum of 7 percent.

The operating deficit of the major public enterprises is expected to increase slightly in 1986. The deficit of the CDE is projected to decline from RD$161 million to RD$126 million mainly as a result of lower fuel costs 2/ and continuing monthly adjustments in electricity rates. The CEA intends to continue with its rationalization program and to accelerate efforts already underway to reduce costs. Nevertheless,

1/ In January 1985 the Government reduced the price of gas oil by 50 cents a gallon and in February the price of gasoline was reduced by the same amount. Despite these price reductions, the large reduction in imported fuel prices has meant that the petroleum taxes will almost double.

2/ As CDE's fuel requirement is imported directly from Venezuela and not subject to domestic petroleum taxes, the enterprise will benefit from the reduction in international prices.

the sharp reduction in sugar exports to the U.S. market would result in an operating deficit of RD$55 million in 1986 as against a small overall surplus last year. The Institute of Price Stabilization (INESPRE) is expected to have an operating deficit of about RD$50 million, the same as in 1985.

The staff underscored the need for increases in the remaining subsidized prices (mainly rice, wheat flour, and unrefined sugar) in 1986 so as to reduce the reliance of state enterprises on government transfers. For the longer term, the staff urged the initiation of structural reforms in CEA and in the Corporation of State Enterprises (CORDE) which receives no transfers from the Central Government but has accumulated arrears to the electricity company and the Reserve Bank. These reforms should encompass a consolidation of the system of state-owned sugar factories, a reduction in the scope of INESPRE's activities (which now include the marketing of a wide range of domestic and imported commodities and agricultural price support), and the closing down or divestment of some of CORDE's enterprises.

2. Monetary policy

While net bank credit to the public sector is not expected to increase in 1986, the authorities will aim at a slightly greater increase in bank credit to the private sector than in 1985. Accordingly, in mid-January, the Central Bank announced that the proportion of the 100 percent marginal liquidity requirements to be met by cash would, from February 1986, be reduced from 25 percent to 10 percent and that rediscounting arrangements would be relaxed slightly during the year. The resources made available by the former measure were to be directed to loans to the agricultural sector.

The authorities noted that rates paid on certificates of deposits by the commercial banks were now positive in real terms, given the recent reduction in inflation. Moreover, they reiterated their intention to begin to remove interest rate controls later this year after consideration of the Fund staff study on the financial sector.

Steps are being implemented to improve the liquidity position of the Reserve Bank. Credit facilities have been discontinued for certain public enterprises which have arrears on interest and amortization payments. In addition, efforts are being intensified to collect arrears owed to the Bank and to use greater selectivity in the granting of loans.

3. External policies

The balance of payments is expected to show a marked improvement in 1986 with the external current account deficit declining to the equivalent of 2 percent of GDP (Table 8). While private sector capital inflows may taper off, private remittances and tourist receipts are

Table 8. Dominican Republic: Medium-Term Balance of Payments Scenario, 1984-90

(In millions of U.S. dollars)

	1984	Prel. 1985	Projections 1986	1987	1988	1989	1990
Current account	-254	-220	-94	-25	-21	-90	-68
Trade balance	-389	-548	-406	-401	-436	-535	-538
Exports, f.o.b.	868	738	794	845	881	858	936
Imports, f.o.b.	-1,257	-1,286	-1,200	-1,246	-1,317	-1,393	-1,474
Services (net)	-130	-29	-17	34	59	75	86
Receipts	507	606	627	660	702	746	793
Of which: travel	(371)	(439)	(470)	(503)	(538)	(576)	(616)
Payments	-637	-635	-644	-626	-643	-670	-707
Of which: interest	(-269)	(-255)	(-269)	(-234)	(-236)	(-247)	(-267)
Transfers (net)	265	356	329	342	355	369	384
Private	205	242	254	267	280	294	309
Public	60	114	75	75	75	75	75
Capital account	99	31	-46	21	108	235	277
Direct investment	68	40	40	45	50	55	60
Medium- and long-term loans (net)	34	-116	-86	-24	58	180	217
Drawings	324	264	267	310	341	369	380
Amortization	-290	-380	-353	-333	-283	-189	-163
Other	-3	107	--	--	--	--	--
Overall balance	-155	-189	-140	-4	87	145	209
Financing	155	189	140	4	-87	-145	-209
Net foreign assets of Central Bank (increase -) 1/	-92	-89	-37	-139	-150	-94	-96
Assets	-64	-87	...	...	...	...	...
Liabilities	-26	-2	...	...	...	...	...
Of which:							
IMF	(-25)	(45)	(-22)	(-49)	(-44)	(-71)	(-56)
Arrears	(34)	(-46)	(-60) 2/	(--)	(--)	(--)	(--)
Arrears (decrease -) 3/	247	-66	-40 2/	--	--	--	--
Debt relief 4/	--	344 5/	151	103	63	-51	-113
Financing gap	--	--	66	40	--	--	--
Memorandum item:							
Current account/GDP	-4.6	-4.7	-2.0	-0.5	-0.4	-1.6	-1.1

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

1/ Includes an average increase in gross reserves of US$50 million per year in 1987-90.
2/ Reduction of arrears through cash payment.
3/ Arrears outside of the foreign liabilities of the Central Bank.
4/ For 1986-90 includes debt relief negotiated with the commercial banks under the MYRA.
5/ Includes debt relief obtained from the commercial banks and Paris Club creditors.

expected to continue to increase. Taking into account debt relief already lined up (mainly from the commercial banks) and allowing the elimination of external payments arrears (US$100 million) the prospect is for an overall balance of payments deficit of US$140 million compared with a deficit of US$189 million in 1985.

In 1986, total exports are projected to increase by 8 percent with sugar receipts declining by 5 percent in reflection of a further reduction in the Dominican Republic's quota in the U.S. market as well as a contraction in exports to the world market where export prices (about 6 U.S. cents a pound) are one-half the cost of production. Coffee export receipts are projected to increase by 22 percent as a result of the increase in prices. Total imports are projected to decline by 7 percent, reflecting a reduction of US$125 million in fuel imports, while nonfuel imports would increase by about 5 percent.

The consolidation period under the 1985 Paris Club agreement ends April 1, 1986 and, in the absence of a new agreement, debt service to Paris Club creditors in the period April-December 1986, would amount to US$106 million, of which US$35 million would be for interest payments. In addition, moratorium interest payments of US$15 million related to the last agreement, fall due in early 1986. 1/ Also to be paid in 1986 are interest payments amounting to US$30 million which fell due in 1985 but were deferred to be paid by April 15, 1986.

On February 24, 1986, the Dominican Republic signed a multiyear rescheduling agreement (MYRA) with commercial banks. The rescheduling covers all maturities that fell or will fall due in the period 1984-89 2/ estimated at US$797 million (of which US$183 million is in respect of 1986). Repayments are refinanced with a grace period of 2 years and a final maturity of 12 years. The interest rate will be 1 3/4 percent over LIBOR or over the adjusted CD rate, at the option of the lender. It has been stipulated that the agreement will become effective only if it is approved by the Government before end-July 1986 and if the Government is in a financial arrangement with a multilateral institution. If these conditions are not met, the 1986 maturities will be deferred as were the 1984 and 1985 maturities.

As mentioned earlier, the program provided for the reduction of the export surcharge on traditional exports from 36 percent to 20 percent in early 1986. On January 19, 1986, the Government announced a reduction in the surcharge on traditional exports from 36 percent to 18 percent as well as the elimination of the 5 percent surcharge on nontraditional exports. The reduction in the surcharge on traditional exports is to be effected through a "reimbursement" mechanism whereby the exporter pays

1/ This payment falls due after the last bilateral agreement (with Canada) is signed in mid-March.

2/ Maturities that fell due in 1984 and 1985 had been deferred pending the finalization of this agreement.

the 36 percent and is reimbursed the equivalent of 9 percentage points after 30 days and another 9 percentage points after 60 days.

The authorities explained that, as the first quarter of the year was a peak period for export receipts, the "reimbursement" mechanism was devised to prevent a sudden expansion of liquidity which would undermine the fight against inflation and perhaps facilitate capital flight in the pre-election period. They undertook however to terminate the "reimbursement" mechanism by end-May and expressed the intention to reduce the surcharge to 10 percent by end-June. The authorities noted that pending congressional approval of new revenue measures, the surcharge was the most assured means of raising resources to assist in the servicing of central government debt. They expected that by the time of the 1987 budget, at the latest, the remaining surcharge would be replaced by more permanent fiscal measures.

The Dominican authorities said that they were satisfied with the workings of the exchange system and emphasized that it was free of official interference. Moreover, they were not unduly concerned about the recent appreciation of the Dominican peso which, in their view, was the result of sizable capital inflows, the exceptional tourist season and the improved economic outlook for the country. They expected that with the leveling off of capital inflows, the end of the tourist season, and the usual anxieties of the pre-election period, some of the recent appreciation would be reversed.

The medium-term balance of payments outlook presented during the first review has been revised in light of developments in 1985 and the 1986 outlook (see Table 8). As noted earlier, the current account deficit in 1986 is projected at about 2 percent of GDP mainly as a result of the reduction in petroleum imports and the projected increase in coffee exports. With the poor prospects for traditional exports, the trade deficit is expected to widen from about US$400 million in 1986 to about US$530 million in 1990. However, the services account is projected to shift from a deficit of US$17 million in 1986 to a surplus of US$86 million in 1990. On this basis, the current account is projected to register a deficit of around 1 percent of GDP in 1990. This balance of payments scenario assumes a strong performance of nontraditional exports and tourism which would depend critically on a shift of resources to these sectors and on an exchange rate policy which provides adequate incentives over the coming years.

The capital account projections are essentially the same as in the first program review. They imply that, given the debt relief already negotiated with the commercial banks and the target of a modest improvement in the net foreign asset position of the Central Bank over the medium term, there will be a financing gap of around US$50 million a year in 1986-87. This gap is likely to be closed through additional debt relief. From 1988, the balance of payments would appear to be fully financed.

Before rescheduling, the Dominican Republic's debt service ratio was estimated to reach 52 percent of exports of goods and services in 1985 and to decline thereafter to 28 percent in 1990 (Table 9). The effect of the rescheduling obtained so far is to stabilize the debt service ratio around 33-34 percent in the period 1986-90.

VI. Staff Appraisal

The 1985 economic program, which was supported by a one year stand-by arrangement, aimed at reducing inflationary pressures and strengthening the balance of payments. Central to the achievements of the program's objectives were the unification of the exchange market and adjustments to prices of many basic commodities. In the fiscal area, a temporary export surcharge was introduced and the authorities also implemented a number of discretionary revenue measures, including increases in petroleum and import taxes. During the course of the year there were further tax increases (on alcoholic beverages and cigarettes) and steps were taken to reduce government transfers to public enterprises. As regards monetary policy, interest rates on financial certificates were increased, rediscount arrangements were tightened, and a 100 percent marginal reserve requirement on commercial bank deposits was imposed. All the performance criteria for end-December 1985 were observed, and the export surcharge was reduced as had been envisaged in the program.

Despite corrective price adjustments, the monthly rate of inflation declined from an average of 3 percent in the first half of 1985 to 1 percent in the second half, mainly as a result of the pursuit of prudent fiscal and monetary policies. The overall public sector deficit (including the quasi-fiscal deficit of the Central Bank), which was 5.2 percent in 1984, fell to 2.3 percent of GDP in 1985, compared with the program target of 4.9 percent of GDP. Part of the improvement in the public finances reflected the nonpayment of certain interest obligations. Taking these into account, the overall deficit in 1985 was 2.7 percent of GDP, still well below the program target. The reduction in the fiscal deficit made possible a sizable reduction in public sector indebtedness to the Central Bank and the Reserve Bank.

Despite the overperformance on the fiscal side, the external current account deficit remained virtually unchanged from the 1984 level, at the equivalent of 4.7 percent of GDP. Sugar exports fell by much more than expected because of the reduction of the Dominican Republic's export quota in the U.S. market, and there was a sharper than projected increase in imports. The official data indicate that the larger current account deficit was partly financed by a significant inflow of private capital; however, some of this inflow of foreign exchange may reflect an underestimation of travel receipts and private transfers. In 1985, US$107 million of external payments arrears were eliminated through cash payments, compared to the program target of US$105 million, and net foreign assets of the Central Bank increased by US$89 million, compared to the revised program target of US$69 million.

Table 9. Dominican Republic: External Debt Medium-Term Indicators, 1984-90 1/

(Values in millions of U.S. dollars; ratios in percent)

	1984	Prel. 1985	Projections 1986	1987	1988	1989	1990
After rescheduling 2/							
Debt outstanding, end of period 1/	2,725	2,940	3,015	3,115	3,266	3,404	3,531
Of which: IMF	221	265	243	194	150	78	23
Debt service payments	569	359 3/	508	497	495	555	595
Principal 4/	300	125	209	210	190	331	253
Interest 5/	269	244	299	287	305	324	342
Debt service ratio	41	28	36	33	31	34	34
Debt outstanding/GDP	50	60	61	61	60	60.0	59
Before rescheduling							
Debt service payments	569	703	691	616	563	507	486
Principal 4/	300	448	422	382	327	260	219
Interest 5/	269	255	269	234	236	247	267
Debt service ratio	41	52	48	41	36	32	28
Memorandum items							
Exports of goods and services	1,375	1,345	1,426	1,506	1,583	1,603	1,729
Current account/GDP	-4.6	-4.7	-2.0	-0.5	-0.4	-1.6	-2.2

Sources: Data provided by the Dominican authorities; IBRD, DRS; and Fund staff estimates and projections.

1/ Excluding foreign reserve liabilities of the Central Bank, other than liabilities to the IMF.
2/ For 1986-90 includes debt relief negotiated with the commercial banks under the MYRA. Differs from EBS/85/237, Table 9, which also incorporated potential rescheduling under the Paris Club.
3/ Includes debt relief obtained from the commercial banks, Paris Club, and non-Paris Club bilateral creditors.
4/ Medium- and long-term debt, including IMF repurchases.
5/ Includes interest on short-term debt.

On the basis of the policies described by the authorities, inflation may be expected to come down further in 1986, while output would show some growth following declines in the past two years. With the anticipated recovery in public investment and increased use of foreign credits, the overall fiscal deficit is expected to widen a little to 3 percent of GDP. However, the external current account deficit is projected to decline to about 2 percent of GDP in 1986 as a result of modest growth in export receipts and a reduction in imports related to the weakening in oil prices.

The major fiscal problem at the present time is the underlying weakness of the state enterprises. Despite the price increases and other adjustment measures undertaken in 1985, many of these enterprises continue to require large transfers from the Central Government, notwithstanding sizable arrears to the Reserve Bank and to domestic suppliers (mostly the rice and sugar farmers). These arrears have weakened the financial position of the state-owned commercial bank and may have adversely affected the performance of the agricultural sector. The staff urges that action be taken in respect of the finances of the public enterprises to make possible an increase in public investment in a setting of a declining deficit.

On monetary policy, the main area of concern is the over-regulation of the banking system and particularly the system of interest rate ceilings on the commercial banks. These ceilings have affected the banks' ability to mobilize savings and have given rise to an increase in disintermediation. The authorities are currently studying a report prepared by the Central Banking Department of the Fund on ways of integrating the formal and informal financial market. In the meantime, the staff urges the early removal of the interest rate ceilings.

The staff welcomes the elimination of the surcharge on nontraditional exports and the reduction in the surcharge on traditional exports announced in early January 1986, and notes the commitment given by the authorities to terminate the reimbursement mechanism applicable to the surcharge on traditional exports by the end of May and to reduce the surcharge to 10 percent by end-June. The staff further recommends that the surcharge be eliminated by the end of 1986, at the latest, with compensatory fiscal action.

In real effective terms, the peso appreciated by 13 percent during 1985, although its real effective value remains well below the level in the period 1980-82. The medium-term outlook for the Dominican Republic, including in particular the difficult prospects for traditional exports, underscores the need for an intensification of the adjustment effort involving the continued pursuit of tight demand management policies and an exchange rate policy that provides adequate incentives to exports.

In summary, the staff believes that despite the weaknesses apparent in certain areas, the policies followed in 1985 have helped to improve the performance of the economy and that the policies described for 1986 should contribute to a consolidation of recent gains.

VII. Proposed Decision

Review Under Stand-By Arrangement

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

1. The Dominican Republic has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for the Dominican Republic (EBS/85/75, Supplement 1, 4/17/85) and paragraph 30 of the letter of February 28, 1985 attached to the stand-by arrangement, supplemented and modified by the letter of October 28, 1985 with annexed technical memorandum, in order to review progress made in implementation of the program and to reach understandings for the remaining period of the arrangement on exchange rate policy, interest rate policy, the reduction in external payments arrears, and on external financing policies and quantitative performance criteria.

2. The Fund finds that no additional understandings are necessary on exchange rate policy, interest rate policy, the reduction in external payments arrears, and on external financing and decides that the review under paragraph 4(c) of the stand-by arrangement is completed.

Dominican Republic--Fund Relations
(As of February 28, 1986)

I. Membership Status

(a) Date of membership: December 28, 1945

(b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

	Millions of SDRs	Percent of Quota
(a) Quota:	112.10	
(b) Fund holdings of Dominican pesos:	378.03	337.22
(c) Fund credit:	265.94	237.21
Of which: CFF	80.75	72.03
Credit tranche	61.43	54.79
EFF	61.88	55.19
Enlarged access under EFF	61.88	55.20
(d) Reserve tranche position:	--	--

III. Current Stand-by and Special Facilities

(a) Stand-by arrangement

(i) Duration: From April 15, 1985 to April 14, 1986
(ii) Amount: SDR 78.5 million
(iii) Utilization: SDR 61.44 million

(b) Special facilities since 1974:

Facility	Date of Purchase	Amount
Stand-by	December 3, 1985	SDR 33.40 million
CFF	December 3, 1985	SDR 11.00 million
BSFF	August 1983	SDR 12.64 million
CFF	January 1983	SDR 42.75 million
BSFF	July 1982	SDR 10.55 million
CFF	May 1982	SDR 36.00 million
CFF	September 1979	SDR 27.50 million
BSFF	January 1979	SDR 11.51 million
CFF	September 1976	SDR 21.50 million

IV. SDR Department

(a) Net cumulative allocation: SDR 1.3 million

(b) Holdings: SDR 9.87 million (4.1 percent of net cumulative allocation)

B. Nonfinancial Relations

V. Exchange Rate Arrangement

Since January 23, 1985 the Dominican peso has been floating freely. Prior to that date, it was linked to the U.S. dollar at the rate of RD$1=US$1. An active parallel market existed and a number of multiple currency practices were in operation.

Exchange taxes are levied on traditional exports. These taxes constitute multiple currency practices subject to Fund approval. The exchange restrictions and the multiple currency practices of the Dominican Republic had been approved by the Fund through August 15, 1986.

VI. Last Article IV Consultation

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

VII. Technical Assistance

The Bureau of Statistics provided technical assistance in June 1984 in the field of government finance statistics, with special reference to: (1) the reconciliation of fiscal data compiled by the Ministry of Finance and the Central Bank; (2) the compilation of data on central government financing and debt; and (3) the compilation of data on the fiscal operations of the local government. Technical assistance was also provided by the Bureau in April/May 1985 in the area of monetary statistics and in October 1985 in the area of informal financial markets.

VIII. Resident Representative

A resident representative has been stationed in Santo Domingo since April 1, 1985.

Dominican Republic: Relations with the World Bank Group

(In millions of U.S. dollars)

A. IBRD Operations (as of December 31, 1985)

	Commitments (net of cancellations)	Disbursements	Undisbursed Amount
Agriculture and irrigation	69.0	40.7	28.3
Industry	25.0	25.0	—
Tourism	46.0	37.1	8.9
Transport	100.8 1/	65.0	35.8
Population	5.0	5.0	--
Education	17.8 1/	12.0	5.8
Housing	25.4	3.5	21.9
Sugar rehabilitation	35.0	7.3	27.7
Urgent imports requirements	25.0	25.0	--
Energy	3.8	2.7	1.1
Total	352.8	223.3	129.5

B. IFC Operations (as of December 31, 1986)

	Loans	Equity	Total
Commitments (gross)	16.0	2.9	18.9
Total held by IFC	5.6	2.9	8.5
Total undisbursed (including participants)	1.0	0.3	1.3

C. IBRD Loan Transactions

	Actual					
	1980	1981	1982	1983	1984	1985
Disbursements	39.1	33.8	24.9	26.9	21.1	16.6
Repayments	2.1	2.3	2.3	4.0	10.5	11.4
Net lending	37.0	31.5	22.6	22.9	10.6	5.2

Source: IBRD.

1/ Vocational and Third Highway Projects approved May 28, 1985 and July 23, 1985, respectively, not yet effective.

DOMINICAN REPUBLIC - BASIC DATA

Area and population	
Area	48,400 kilometers
Population	6.2 million
Annual rate of population increase	2.9 percent
Unemployment rate	N.A.
GDP (1985)	RD$14.6 billion
GDP per capita (1985)	RD$2,356

	1981	1982	1983	1984	Prel. 1985
Origin of GDP			(percent)		
Agriculture	20.4	21.0	20.8	20.5	20.1
Mining	5.6	3.8	4.8	5.2	5.6
Manufacturing	15.1	15.5	15.0	14.8	14.4
Construction	6.9	6.6	6.9	7.1	6.6
Government	8.6	8.8	8.7	8.8	9.1
Other services	43.4	44.3	43.8	43.4	44.2
Ratios to GDP					
Exports of goods and nonfactor services 1/	22.3	16.6	17.9	25.0	27.9
Imports of goods and nonfactor services 1/	26.8	22.3	22.9	28.4	33.7
Current account of the balance of payments	-6.0	-6.4	-6.1	-4.6	-4.7
General government revenues	12.7	9.5	10.8	11.0	15.5
General government expenditures	14.9	12.2	13.3	11.7	16.3
Public sector savings	0.5	-1.5	-0.1	2.3	4.2
Public sector overall surplus or deficit (-)	-6.4	-6.6	-4.6	-5.2 7/	-2.3 7/
External public debt (end of year) 2/	27.0	28.8	36.1	49.7	59.6
Gross national savings 8/	17.8	15.1	15.9	17.8	13.1
Gross domestic investment 8/	23.4	20.6	20.8	19.8	17.9
Banking system liabilities to private sector (end of year) 3/	20.0	19.4	20.8	20.1	17.8
Annual changes in selected economic indicators					
Real GDP	3.9	1.7	4.0	0.5	-1.2
GDP at current prices	9.6	9.8	7.4	27.9	36.8
Domestic expenditures (at current prices)	5.0	9.7	6.8	24.3	43.1
Investment	3.2	-3.3	8.6	21.6	43.3
Consumption	5.6	13.3	6.3	25.0	19.5
GDP deflator	5.4	8.0	3.3	27.2	38.5
Consumer prices (annual average)	7.5	7.6	7.0	24.4	37.5
Central government revenues	3.9	-18.5	22.4	30.2	88.4
Central government expenditures	2.7	-9.7	17.0	12.5	85.9
Banking system liabilities to private sector 3/	11.1	6.8	15.1	23.5	17.9
Money	5.4	5.3	3.3	21.6	13.6
Quasi-money 4/	5.7	1.5	11.8	1.9	22.7
Net domestic assets of the banking system 5/	29.1	37.1	32.4	25.4	7.3
Credit to public sector	26.7	26.4	18.2	9.4	-10.1
Credit to private sector	-1.9	6.4	9.5	8.4	9.8
Merchandise exports (in U.S. dollars)	23.5	-35.4	2.3	10.6	-15.0
Merchandise imports (in U.S. dollars)	-4.5	-13.4	2.0	-2.0	2.3

	1981	1982	1983	1984	Prel. 1985
Central government finances		(millions of pesos)			
Revenues	926.0	754.6	923.3	1,201.7	2,265.0
Expenditures	1,080.9	976.1	1,142.1	1,284.7	2,388.3
Current account surplus or deficit (-)	153.0	-36.6	41.3	198.3	249.2
Overall surplus or deficit (-)	-154.9	-221.5	-218.8	-83.0	-123.3
External financing (net)	60.2	48.4	81.3	101.3	117.2
Balance of payments		(U.S. dollars)			
Merchandise exports	1,188.0	767.6	785.2	868.1	737.9
Merchandise imports	1,451.7	-1,257.3	-1,282.2	-1,257.1	-1,285.9
Investment income (net)	-304.9	-254.1	-297.1	-332.0	-301.0
Other factor income (net)					
Other services and transfers (net)	162.7	301.9	373.0	467.0	628.6
Balance on current account	-405.9	-442.0	-421.1	-254.0	-220.4
Direct investment	79.7	-1.4	22.0	68.0	40.0
Medium- and long-term loans (net)	153.6	150.5	24.1	34.0	-116.1
Other	63.0	-63.4	22.3	-2.7	107.2
Overall balance	-109.6	-356.3	-352.7	-154.7	-189.3
Debt rescheduling	--	--	151.9	--	344.1
Change in arrears 6/	--	--	142.6	246.9	-65.6
Change in foreign assets	109.6	356.3	58.2	-92.2	-89.2
International reserve position		(millions of SDRs)			
Central Bank (net)	-276.9	-615.2	-408.9	-342.7	-225.5
Financial system (net)	-334.5	-633.5	-431.0	-366.9	-148.7

1/ The implicit effective exchange rates used are RD$1.07 in 1981, RD$1.16 in 1982, RD$1.25 in 1983, RD$2.0 in 1984, and RD$3.1 in 1985 per U.S. dollar.
2/ Ratio to GDP expressed in U.S. dollars.
3/ Excluding private capital and surplus.
4/ Includes time and savings deposits and other liabilities (excluding private capital and surplus).
5/ Changes in relation to liabilities to private sector (excluding private capital and surplus) at the beginning of the period.
6/ Outside the foreign liabilities of the Central Bank.
7/ Includes the quasi-fiscal deficit of the Central Bank.
8/ The identity of gross domestic saving equal to gross national saving plus the current account surplus (deficit) does not hold prior to 1984 because the national accounts valued the balance of payment transactions at the official exchange rate instead of the implicit rate applied for the estimate of the ratio of the current account deficit to GDP.