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October 30, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Dominican Republic - Staff Report for the 1985 Article IV Consultation and Review, Technical Modification, and Waiver Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with the Dominican Republic and a review, technical modification, and waiver under its stand-by arrangement. Draft decisions appear on pages 29-31.

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

Mr. J. E. Gonzalez (ext. 8637) or Mr. van Beek (ext. 8635) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

Dominican Republic

Staff Report for the 1985 Article IV Consultation and Review, Technical Modification, and Waiver Under the Stand-By Arrangement

Prepared by the Staff Representatives for the 1985 Consultation with the Dominican Republic

Approved by Marcello Caiola and Manuel Guitián

October 29, 1985

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I. Introduction

The 1985 Article IV consultation discussions with the Dominican Republic and the mid-term review under the current stand-by arrangement were held in Santo Domingo from July 1-25, 1985 and August 24-September 14, 1985. 1/ The representatives of the Dominican Republic included the Secretary of the Presidency; the Governor of the Central Bank; the Technical Secretary of the Presidency; the Secretaries of State for Finance and Industry and Commerce; the Director of the Budget; the General Manager of the Reserve Bank; and senior officials from the Central Bank, the ministries, and various government agencies and enterprises. The mission was received twice by the President of the Republic. In addition, the mission met with members of the business and financial communities. The staff representatives who participated in one or both rounds of discussions were Messrs. Gonzalez (Head), van Beek, McLoughlin, Incer, Ewenczyk (all WHD), Berengaut (ETR), Pastor (STAT), and Ms. Ulmschneider (Secretary-WHD). The mission was assisted by Ms. Milne, the Fund resident representative in Santo Domingo. Mr. Rivera, Alternate Executive Director for the Dominican Republic in the World Bank, participated in several of the policy discussions.

The previous Article IV consultation with the Dominican Republic was concluded by the Executive Board on August 8, 1984 (EBM/84/124). On April 15, 1985 the Executive Board approved a stand-by arrangement in support of the 1985 financial program of the Dominican Republic in an amount of SDR 78.5 million (70 percent of the quota). The Dominican Republic made a purchase of SDR 28.0 million (equivalent to the first credit tranche) upon approval of the stand-by arrangement.

In their letter dated February 28, 1985 requesting the stand-by arrangement, the Dominican Republic authorities undertook to consult with the Fund prior to August 15, 1985 in order to review the progress made in implementing the program for the first six months of 1985 and to establish appropriate performance criteria for the second half of 1985. A second purchase of SDR 16.7 million became available in July 1985 but is pending until the completion of this review. Under the provisions of the arrangement, there remain additional purchases of SDR 16.7 million--subject to compliance with performance criteria established for end-September 1985--and SDR 17.1 million--subject to compliance with the performance criteria for end-December 1985 and to completion of a second review prior to February 28, 1986 (Table 1).

The Dominican Republic authorities are also requesting a purchase under the CFF in an amount of SDR 15.5 million (13.8 percent of quota), which would raise the Fund's holdings of Dominican pesos under this facility to 80 percent of quota.

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

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/	325.7	-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	283.0	277.7
Under tranche policies	--	--	28.0	28.0	61.4	78.5	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	252.4	247.7
Under tranche policies	--	--	25.0	25.0	54.7	70.0	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.
2/ Early repurchase under Buffer Stock Financing Facility (sugar).

II. Background Developments

1. Developments through 1984

The Dominican Republic, which traditionally had enjoyed sustained economic growth coupled with relatively low rates of inflation, has experienced severe imbalances since the late 1970s (Table 2). Growing deficits in the current account of the balance of payments were largely financed by recourse to foreign borrowing and, when access to foreign loans dried up, by the accumulation of substantial payments arrears. Adverse external developments--the oil price shocks, the surge in international interest rates, the recession in industrial countries, the plummeting of prices of primary commodity exports, and the spillover effects of the global debt crisis--contributed to the widening external imbalance.

However, these imbalances were aggravated by the failure of economic policy to adapt to changing external economic conditions. The expansionary stance of fiscal policy since 1978 was a major factor in the deterioration of the balance of payments. Adjustment of domestic interest rates was slow and partial, while the dual exchange market was maintained and only limited transfers were made from the official to the parallel market. Furthermore, the prices of products subject to price control were not adjusted in a timely fashion, leading to further distortions in resource allocation.

The Government which took office in August 1982 adopted a number of measures in an effort to stem the rapidly deteriorating situation. The economic program for 1983-85 was supported by an extended arrangement with the Fund approved by the Executive Board on January 21, 1983. The Dominican Republic made all purchases available during the first year of the EFF. 1/ However, compliance with some of the performance criteria had reflected rescheduling of commercial bank debt which had not been contemplated in the program. On the fiscal front a major anticipated revenue source, the general sales tax, was not implemented until end-1983 and its base was narrower than had been planned. Furthermore, a major relaxation in fiscal discipline took place during the second half of the year resulting from an attempt by the authorities to reactivate the stagnant economy through expanded public works outlays. Some improvement was achieved in the monetary and external sectors. New financial instruments were introduced and ceilings on rediscounts for overdrafts of two public sector enterprises were established. During the year, exchange incentives were granted to traditional and nontraditional exporters and selected imports were shifted to the parallel market.

1/ Performance under the program for the first year of the extended arrangement was described in detail in the Staff Report for the 1984 Article IV Consultation (SM/84/161, 7/5/84, pages 11-13).

Table 2. Dominican Republic: Selected Economic and Financial Indicators, 1981-85

	1981	1982	1983	Prel. 1984	Prog. 1985	Proj. 1985
(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
GDP at current market prices	9.6	9.8	7.4	27.9	23.4	34.4
GDP deflator	5.4	8.0	3.3	27.2	21.0	35.0
Consumer prices (average)	7.5	7.6	7.0	24.4	24.0	35.0
External sector (on the basis of U.S. dollars)						
Exports, f.o.b.	23.5	-35.4	2.3	11.0	-7.4	-9.4
Imports, f.o.b.	-4.5	-13.4	2.0	-2.4	-8.4	-4.1
Export volume	10.9	-25.7	-1.4	5.7	0.3	-7.3
Import volume	-10.0	-14.6	2.2	-7.0	-9.0	-4.8
Terms of trade (deterioration -)	5.0	-14.2	3.8	0.1	-8.4	-2.9
Effective exchange rate 1/						
Nominal	4.2	-3.1	-10.6	-41.2	...	...
Real	0.8	-1.8	-10.4	-21.6	...	...
Central Government						
Revenue	3.9	-18.5	22.4	30.2	95.1	99.7
Expenditure	2.7	-9.7	17.0	12.5	86.7	100.7
Money and credit 2/						
Domestic credit 3/	36.1	45.7	36.8	30.8	16.8	--
Public sector (net)3/	(32.5)	(32.5)	(20.7)	(11.4)	(--)	(-2.8)
Private sector 3/	(-2.3)	(7.9)	(10.8)	(10.3)	(17.7)	(5.9)
Money and quasi-money (M2)	11.9	15.9	7.9	30.2	24.0	7.6
Velocity (GDP relative to M2)	6.2	5.8	5.8	5.7	5.8	7.1
(In percent of GDP)						
Public sector deficit						
Nonfinancial public sector	-6.2	-6.2	-4.2	-2.7	-4.9	-1.9
Nonfinancial public sector, including the quasi-fiscal deficit of the Central Bank	-6.4	-6.6	-4.6	-5.2	-4.9	-1.9
Gross domestic investment	23.4	20.6	20.8	19.8	21.7	17.8
Gross national savings	17.8	15.1	15.9	17.8	21.1	16.7
BOP-current account deficit	-5.6	-5.5	-4.9	-2.0	-0.6	-1.1
External public debt 4/	27.0	28.8	36.1	49.7	57.8	54.4
(In percent of exports of goods and services)						
Debt service 5/	30.9	42.8	44.3	41.3	63.8	30.6
Of which: Interest payments	(20.0)	(24.9)	(24.7)	(21.5)	(16.8)6/	(21.2)
(In millions of U.S. dollars)						
Overall balance of payments	-109.6	-356.3	-352.7	-154.7	-149.6	-130.7
Change in net international reserves (increase -)	109.6	356.3	58.2 7/	-92.2 8/	-108.7	-69.3
Arrears (decrease -)	--	--	142.6	246.9	-77.5 9/	-108.0 9/
Other 10/	--	--	151.9	--	335.8	308.0
Gross official reserves	283.5	172.4	204.3	268.0	295.0	277.6
(weeks of imports)	(10.3)	(7.1)	(8.3)	(11.1)	(13.3)	(12.0)

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 or M2 (currency in circulation, demand deposits and time and savings deposits at commercial banks) outstanding at the beginning of the period.
4/ 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$1.07 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.
5/ Repayments of medium- and long-term loans and interest payments on debt of all maturities.
6/ Before debt relief.
7/ During the year there was an accumulation of unpaid external obligations outside the Central Bank as well as debt relief.
8/ During the year there was a further accumulation of unpaid external obligations outside the Central Bank.
9/ Reduction of arrears through cash payment.
10/ Includes debt relief in 1983 and 1985.

As uncertainty mounted about the timely implementation of adjustment measures, the peso came under renewed pressures in the parallel market in late 1983 and the early months of 1984, depreciating to around RD$2.9 per U.S. dollar (buying) in February 1984 from around RD$1.8 per U.S. dollar in November 1983. Only a modest further depreciation of the peso occurred in the remainder of 1984, to a rate of about RD$3 per U.S. dollar at year-end. The real effective exchange rate depreciated by 22 percent during 1984, following a depreciation of 10 percent during 1983 (Chart 1).

While agreement could not be reached on a financial program for the second year of the EFF, during 1984 the authorities began to implement measures which led to the eventual unification of the exchange rate. These measures included: the transfer to the parallel market of all payments for current international transactions other than petroleum imports, debt service, and selected obligations of the Central Bank (April 1984); the establishment of an intermediate exchange rate for nonpublic sector oil imports (August); the transfer of virtually all nontraditional exports to the parallel market (January); the granting of exchange incentives for traditional exports and services (April); and the adjustment of prices of many basic foodstuffs and other products subject to control (April-August).

As already noted, in 1981-83 fiscal policy was a major source of excess demand pressure. The overall deficit of the nonfinancial public sector averaged 6 1/4 percent per year in 1981-82, but declined to 4 1/4 percent in 1983 as revenue recovered from a sharp drop in 1982 while expenditure growth for the year as a whole was relatively restrained (Tables 3 and 4). By 1983, central government revenue had become highly income inelastic, reflecting the rise in exemptions and tax avoidance as well as an erosion of the tax base with increased reliance on excise and other specific taxes. In addition, the rest of the public sector continued to incur operating losses.

During 1984, efforts were intensified to redress the disequilibrium. Revenues were buoyed by the implementation of the general sales tax (of the value-added type) at the end of 1983 and the establishment of a devalued exchange rate for valuation of imports for tax purposes. Moreover, the largest public sector enterprises shifted into surplus following price adjustments in certain products, a partial reduction in redundant workers, and the improvement in the finances of the state sugar company (CEA) which benefited from the exchange incentive granted for traditional exports. Thus, the overall fiscal deficit declined to 2.7 percent of GDP in 1984. The Central Bank, however, experienced a substantial quasi-fiscal deficit in 1984 (equivalent to about 2 1/2 percent of GDP) arising from the assumption by the Central Bank of private sector debt obligations as part of the 1983 restructuring exercise and the continued failure of the Central Government to pay interest on bonded debt held by the Central Bank. The deficit of the public sector, including the quasi-fiscal deficit of the Central Bank, increased to 5 1/4 percent of GDP in 1984 (from 4 1/2 percent in 1983).

Table 3. Dominican Republic: Public Sector Operations, 1981-85

	1981	1982	1983	Prel. 1984	Prog. 1985 1/	Proj. 1985 2/
	(In millions of Dominican pesos)					
Total revenue	933.3	765.6	935.4	1,257.6	2,156.3	2,408.7
Central Government	926.0	752.7	922.9	1,201.4	2,153.4	2,399.2
Current	(909.2)	(743.2)	(912.2)	(1,194.3)	(2,146.9)	(2,335.2)
Capital	(16.8)	(9.5)	(10.7)	(7.1)	(6.5)	(64.0)
Public enterprises	7.3	12.9	12.5	56.2	2.9	9.5
Operating surplus	(--)	(--)	(--)	(49.1)	(--)	(--)
Capital revenue	(7.3)	(12.9)	(12.5)	(7.1)	(2.9)	(9.5)
Total expenditure	1,286.3	1,169.3	1,278.8	1,435.2	2,750.0	2,650.0
Central Government	1,058.1	958.2	1,126.4	1,258.0	2,002.8	2,130.9
Current expenditure	(755.0)	(774.3)	(870.3)	(975.1)	(1,580.4)	(1,749.6)
Capital expenditure	(303.1)	(183.9)	(256.1)	(282.9)	(422.4)	(381.3)
Of which: capital formation	/151.8/	/110.7/	/130.7/	/106.3/	/401.8/	/231.3/
Public enterprises	228.2	211.1	152.4	177.2	747.2	519.1
Operating loss	(63.2)	(27.7)	(13.4)	(--)	(1.1)	(215.4)
Interest payments	(50.9)	(68.5)	(58.5)	(36.2)	(168.4)	(48.7)
Capital expenditure	(114.1)	(114.9)	(80.5)	(141.0)	(577.7)	(255.0)
Of which: capital formation	/81.8/	/100.1/	/66.2/	/117.2/	/571.2/	/255.0/
Deficit of the consolidated public sector	-353.0	-403.7	-343.4	-177.6	-593.7	-241.3
Overall deficit of the nonconsolidated public sector	-95.4	-88.5	-13.2	-121.0	-36.3	-36.3
Overall deficit (-)	-448.4	-492.2	-356.6	-298.6	-630.0	-277.6
Financing	448.4	492.2	356.6	298.6	630.0	277.6
External	105.6	108.6	38.7	165.1	630.0	284.8
Domestic	342.8	383.6	317.9	133.5	--	-7.2
Banking system	(342.8)	(383.6)	(282.6)	(168.6)	(--)	(-54.3) 3/
Other 4/	(--)	(--)	(35.3)	(-35.3)	(--)	(47.1) 5/
	(In percent of GDP)					
Memorandum items						
Overall deficit	-6.2	-6.2	-4.2	-2.7	-4.9	-1.9
Overall deficit, including the quasi-fiscal deficit of the Central Bank 6/	-6.4	-6.6	-4.6	-5.2	-4.9	-1.9

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

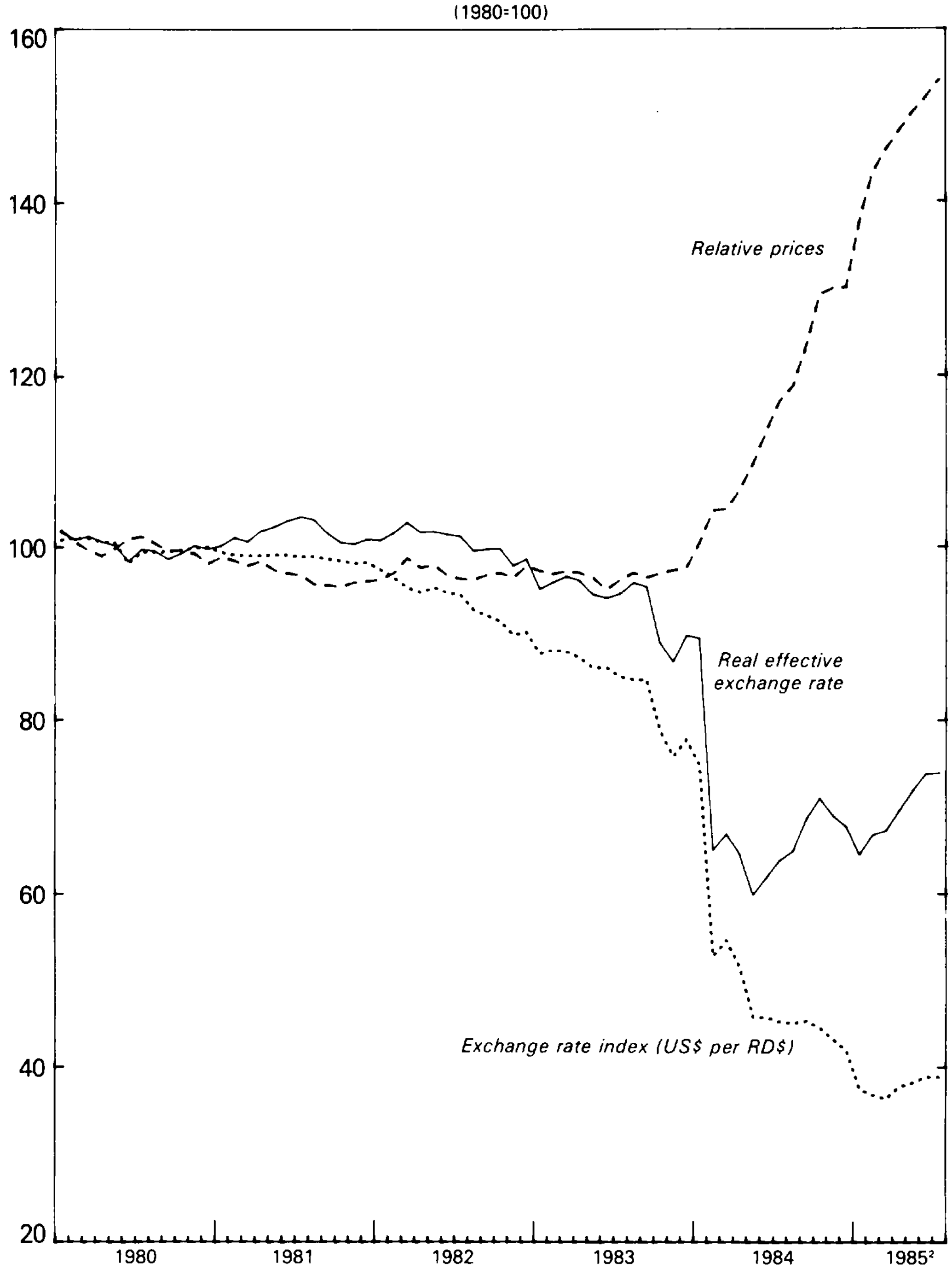
1/ Based on an exchange rate of RD$2.8 per U.S. dollar.
2/ Based on an exchange rate of RD$3 per U.S. dollar.
3/ Consists of RD$11.2 million of net financing from private commercial banks and RD$65.5 million of negative financing from official banks. Of the latter, about RD$61 million corresponds to the projected use of ESF grants for transfers to the private sector and for replenishing the PL 480 accounts, for which a reduction is to be made in the ceiling on credit from official banks (see footnote 3 to Table 7).
4/ Change in cash balances, items in transit, bonds of the National Housing Institute (INVI), and other.
5/ Represents liquidation of financial investments of the Rosario gold mining company.
6/ 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.

CHART 1

DOMINICAN REPUBLIC

EXCHANGE RATE DEVELOPMENTS[1]

(1980=100)



Source: Fund staff calculations.
[1] Increase indicates appreciation.
[2] July.

Table 4. Dominican Republic: Operations of the Central Government, 1981-85

	1981	1982	1983	Prel. 1984	Prog. 1985 1/	Proj. 1985 2/
Total revenue	926.0	754.6	923.3	1,201.7	2,154.0	2,399.2
Current revenue	909.2	745.1	912.6	1,194.6	2,147.5	2,335.2
Tax revenue	734.4	661.3	782.4	1,084.2	2,030.8	2,214.6
Nontax revenue	174.8	83.8	130.2	110.4	116.7	120.6
Capital revenue	16.8	9.5	10.7	7.1	6.5	64.0
Total expenditure	1,080.9	976.1	1,142.1	1,284.7	2,403.6	2,578.2
Current expenditure	756.2	781.7	871.3	996.3	1,851.4	2,115.4
Wages and salaries	402.2	427.8	448.8	499.9	482.2	629.9
Goods and services	138.7	135.0	163.0	192.4	209.1	322.7
Transfers	166.7	167.3	193.5	257.8	789.1	908.7
Interest payments	45.9	48.3	62.4	46.2	371.0	243.8
Other	2.7	3.3	3.6	--	--	10.3
Other expenditure	324.7	194.4	270.8	288.4	552.2	462.8
Capital formation	151.8	110.7	130.7	106.3	401.8	231.3
Capital transfers to non-financial public sector	163.0	80.3	116.6	158.7	150.4	221.6
Other	9.9	3.4	23.5	23.4	--	9.9
Current account surplus or deficit (-)	153.0	-36.6	41.3	198.3	296.1	219.8
Overall deficit	-154.9	-221.5	-218.8	-83.0	-249.6	-179.0

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

1/ On the basis of an exchange rate of RD$2.8 per U.S. dollar.
2/ On the basis of an exchange rate of RD$3 per U.S. dollar.

During 1981-84 only limited external financing was available and the overall fiscal deficits were mainly financed with domestic bank credit (Table 5). Net credit of the banking system to the public sector almost tripled from 1981 to 1984 and the share of net credit to the public sector rose from 33 percent of total domestic bank credit in 1980 to 47 percent in 1984. The increasing demand for financing by the public sector and the losses of the Central Bank in 1984 held back the expansion of credit to the private sector, which grew at a rate of less than 8 percent a year during this period. During 1981-83, the growth of banking system liabilities to the private sector was relatively slow, reflecting only a moderate growth in currency issue and the impact of capital outflows attracted by relatively high foreign interest rates. In 1984 there was a sharp increase in liquidity as a result of a 50 percent increase in narrow money, but liabilities to the private sector were, at less than 35 percent of GDP in 1984, only slightly above the average in 1981-83.

The deficit in the current account of the balance of payments, which had averaged around US$420 million per year in the period 1981-83, was almost halved in 1984, to an estimated US$218 million (Table 6). Imports declined, while export earnings recovered somewhat from the low levels of 1982-83 reflecting an increase in realized prices of traditional exports and the improvement of nontraditional exports, assisted by the depreciation of the peso. The growth of receipts from tourism and transfers, which has been strong since 1980, was sustained in 1984.

Net capital inflows in 1984 continued at the reduced levels of 1982-83, amounting to an estimated US$64 million. Direct investment rose sharply in 1984 as the depreciation of the peso attracted foreign investors and encouraged Dominicans living abroad to repatriate capital for investment in real estate property. Net drawings of medium- and long-term foreign loans, which had fallen from US$150 million in 1982 to US$24 million in 1983, increased marginally to US$34 million in 1984.

The overall deficit of the balance of payments, which had averaged US$350 million in 1982-83, was contained to US$155 million in 1984. While the 1983 deficit was financed by a drawdown in reserves, some buildup of arrears and relief from the renegotiation of commercial bank debt, the 1984 deficit was financed entirely by the accumulation of payments arrears in an amount of US$281 million, including the increase in central bank arrears. The buildup of arrears allowed the Central Bank to add marginally to its gross foreign exchange position. Thus, gross foreign exchange reserves rose from the equivalent of only two months of imports in 1982-83 to almost three months in 1984.

Real GDP showed virtually no increase in 1984 after rising by 4 percent in 1983. Manufacturing activity declined by 1 percent, due mainly to a decline in sugar refining. Agricultural production also fell, in part because the shift of imported inputs to the parallel

Table 5. Dominican Republic: Summary Accounts of the Central Bank and the Banking System, 1981-85

(In millions of Dominican pesos)

	1981	1982	1983	1984	1984 1/	Prog. 1985 1/	1984 2/	Proj. 1985 2/
I. Central Bank								
Net international reserves	-322.3	-678.6	-428.1	-335.9	-940.5	-636.1	-1,007.7	-799.8
Assets	283.5	172.4	204.3	268.5	751.8	826.0	805.5	834.3
Liabilities	-605.8	-851.0	-632.4	-604.4	-1,692.3	-1,462.1	-1,813.2	1,634.1
Net domestic assets	718.2	1,109.8	915.0	1,027.5	1,632.1	1,467.4	1,699.3	1,578.9
Claims on the public sector (net)	688.0	970.5	1,223.8	1,341.8	1,341.8	1,341.8	1,341.8	1,341.8
Central Government	(542.5)	(739.7)	(866.6)	(937.4)	(937.4)	(937.4)	(937.4)	(937.4)
Counterpart funds of foreign aid (mostly PL-480)	(-6.4)	(-7.7)	(-30.5)	(-2.1)	(-2.1)	(-2.1)	(-2.1)	(-2.1)
Public financial institutions	(146.5)	(151.2)	(149.6)	(148.2)	(148.2)	(148.2)	(148.2)	(148.2)
Rest of the public sector	(5.4)	(87.3)	(238.1)	(258.3)	(258.3)	(249.9)	(258.3)	(258.3)
Credit to commercial banks (net)	-39.8	201.0	301.9	231.4	231.4	155.5	231.4	115.9
Credit to the rest of the financial system	133.0	157.9	190.7	215.3	215.3	215.9	215.3	338.7 3/
Medium- and long-term foreign liabilities	-259.0	-359.1	-808.2	-868.8	-2,432.6	-2,545.7	-2,606.4	-2,682.3 4/
Revaluation account	--	--	--	--	2,168.5	2,185.7	2,409.4	2,583.6
Deposits from U.S. grants (Plan Reagan)	--	--	--	-50.0	-50.0	-50.0	-50.0	-411.2 5/
Net unclassified assets	196.0	139.4	6.8	157.8	157.8	174.7	157.8	292.4
Currency issued	395.9	431.2	486.9	691.6	691.6	831.3	691.6	779.1
Currency in circulation	323.8	357.1	414.7	592.8	592.8	724.2	592.8	672.0
Cash in vaults	72.1	74.1	72.2	98.8	98.8	107.1	98.8	107.1
II. Banking System								
Net foreign assets	-391.2	-700.7	-479.2	-362.5	-1,015.0	-710.6	-1,087.5	-879.6
Net domestic assets (net)	1,978.9	2,389.5	2,425.4	2,751.3	3,403.8	3,566.5	3,476.3	3,588.3
Of which: credit to the public sector	995.6	1,379.1	1,661.7	1,830.5	1,830.5	1,767.6	1,830.5	1,776.2
credit to the private sector	1,019.6	1,113.5	1,261.3	1,413.0	1,413.0	1,744.8	1,413.0	1,527.0
Liabilities to the private sector	1,587.7	1,688.8	1,946.2	2,388.8	2,388.8	2,855.9	2,388.8	2,708.7
Of which:	626.3	703.7	755.2	1,140.7	1,140.7	1,338.5	1,140.7	1,247.0
quasi-money	553.1	662.7	719.2	779.9	779.9	997.4	779.9	820.0

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

1/ Foreign exchange transactions valued at RD$2.80 per U.S. dollar.
2/ *Foreign exchange transactions valued at RD$3.00 per U.S. dollar.*
3/ Includes loans extended by FIDE to the financial system with IDB funds.
4/ Includes IDB loan for US$45 million for the PRI program.
5/ Includes funds from the 1984 U.S. grants that were revalued in March 1985 plus funds from the 1985 U.S. grants.

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

(In millions of U.S. dollars)

	1981	1982	1983	Prel. 1984	Prog. 1985	Proj. 1985
Current account	-405.9	-442.0	-421.1	-218.3	-29.3	-46.5
Trade balance	-263.7	-489.7	-497.0	-379.8	-350.0	410.5
Exports, f.o.b.	(1,188.0)	(767.6)	(785.2)	(871.7)	(800.0)	(789.5)
Imports, f.o.b.	(-1,451.7)	(-1,257.3)	(-1,282.2)	(-1,251.5)	(-1,150.0)	(-1,200.0)
Services (net)	-335.2	-157.3	-139.1	-105.5	5.7	14.0
Receipts	(336.4)	(378.5)	(451.5)	(507.3)	(609.0)	(609.9)
Of which: travel	/206.3/	/266.1/	/320.0/	/370.0/	/477.7/	/430.0/
Payments	(-671.6)	(-535.8)	(-590.6)	(-612.8)	(-603.3)	(-595.0)
Of which: interest	/-304.9/	/-285.5/	/-304.0/	/-296.0/	/-236.2/	/-255.0/
Transfers (net)	193.0	205.0	215.0	267.0	315.0	350.0
Private	(176.3)	(190.0)	(195.0)	(210.0)	(215.0)	(230.0)
Public	(16.7)	(15.0)	(20.0)	(57.3)	(100.0)	(120.0)
Capital account	296.3	85.7	68.4	63.6	-120.3	-84.2
Direct investment	79.7	-1.4	22.0	68.0	42.0	42.0
Medium- and long-term loans (net)	153.6	150.5	24.1	34.0	-143.0	-152.0
Drawings	(320.2)	(355.8)	(248.7)	(324.0)	(280.0)	(264.0)
Amortization	(-166.6)	(-205.3)	(-224.6)	(-290.0)	(-423.0)	(-416.0)
Other 1/	63.0	-63.4	22.3	-38.4	-19.3	25.8
Overall balance	-109.6	-356.3	-352.7	-154.7	-149.6	-130.7
Financing	109.6	356.3	352.7	154.7	149.6	130.7
Net foreign assets of the Central Bank (increase -)	109.6	356.3	58.2 2/	-92.2	-108.7	-69.3
Assets	(-8.3)	(111.1)	(-31.9)	(-63.7)	(-27.0)	(...)
Liabilities	(117.9)	(245.2)	(90.1)	(-28.5)	(-81.7)	(...)
Use of Fund credit	/-25.5/	/48.6/	/174.6/	/-25.0/	/29.2/	/44.7/
Arrears	/166.8/	/119.9/	/-67.4/	/34.3/	/-12.5/	/.../
Other liabilities	/-23.4/	/76.7/	/-17.1/	/37.7/	/-98.4/	/.../
Arrears (decrease -) 3/	--	--	142.6	246.9	-77.5 4/	-108.0
Debt relief	--	--	151.9	--	335.8 5/	308.0

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

1/ Includes SDR allocation in 1981, short-term public and private capital (net), gold revaluation and monetization, and errors and omissions (net) through 1984.
2/ In December 1983 an amount of US$309.7 million of central bank reserve liabilities was converted into a medium-term loan as a result of a rescheduling with commercial banks.
3/ Outside the Central Bank.
4/ Reduction of arrears through cash payment.
5/ Financing gap that was expected to be met with debt relief.

exchange market substantially raised costs and in part because sugar output was scaled back as a result of the fall in the world price of sugar below the cost of production.

The rate of inflation in the 1981-83 period remained fairly stable--ranging from 7.6 percent in 1982 to 7.0 percent in 1983--mainly reflecting the existence of a system of extensive price controls and overvalued official exchange rate. During 1984 consumer prices rose by 38 percent, reflecting the discrete upward adjustments that were implemented in a number of controlled prices of basic foodstuffs and petroleum products, as well as the de facto large devaluation of the peso.

2. Performance under the 1985 stand-by arrangement

Notwithstanding the adjustment efforts undertaken since April 1984, slippages in 1983 and delays in policy implementation in 1984 rendered the original objectives of the EFF arrangement unattainable, and therefore the program for 1985 was supported by a new one-year stand-by arrangement. The Dominican Republic authorities canceled the extended arrangement on January 17, 1985. On February 28, 1985 the authorities forwarded a letter of intent requesting the Fund's support for a program of adjustment for 1985 under a stand-by arrangement. This requested arrangement was approved by the Executive Board on April 15, 1985 (EBS/85/75, 3/27/85).

The economic and financial program for 1985 aimed at strengthening the country's external position while containing inflation and creating the conditions for renewed economic growth. Central to the achievement of these objectives was the adoption of realistic exchange rate and pricing policies. Accordingly, on January 23, 1985, the exchange system was unified and since then the peso has been floating with the rate freely determined by exchange market forces. At the same time, prices of petroleum products and several basic foodstuffs were raised and a schedule of monthly increases in electricity tariff was implemented.

Regarding fiscal policy, the overall deficit of the public sector (including the quasi-fiscal deficit of the Central Bank) was to be held to 4.9 percent in 1985. The improvement in performance was expected to derive mainly from: (i) the introduction of a temporary exchange tax of 36 percent and 5 percent (respectively) on earnings from traditional and nontraditional goods and services (yielding RD$712 million); (ii) higher petroleum prices (yielding RD$184 million); and (iii) a revaluation of imports from the accounting rate of RD$2 per U.S. dollar to the moving average of the actual rate for the previous three months (yielding an additional RD$100 million). These discretionary revenue measures were implemented in January, prior to the effective date of the stand-by arrangement. Expenditure was expected to increase as implicit subsidies arising from preferential exchange rates that had previously existed became explicit. In particular, the overall deficit of the largest public sector enterprises was expected to be substantially greater, primarily because of the higher foreign exchange costs of the sizable investment program of the Dominican Electricity Corporation (CDE). In addition, payments were to be made to the Central Bank in an amount sufficient to cover its losses.

Regarding monetary policy, ceilings were established on the expansion of net domestic assets of the Central Bank and the expansion of the combined net domestic credit to the nonfinancial public sector extended by the Central Bank and the Reserve Bank (the state-owned commercial bank and fiscal agent of the Government). In the latter regard, the nonfinancial public sector was to make no net use of domestic bank credit--except for seasonal needs--during 1985. In order to ensure better control over the expansion of domestic liquidity, the Central Bank was to place stabilization bonds with the financial institutions in an amount of at least RD$100 million during 1985. Also, on January 23, 1985 the Central Bank raised the marginal reserve requirement to 100 percent on commercial bank liabilities to the private sector; froze the discount operations; and introduced a schedule to reduce by 10 percent and 5 percent rediscounts to commercial banks and financial investment banks, respectively. In addition, to promote private sector savings, the terms on which financial institutions can issue high-yield financial certificates were liberalized.

Regarding the balance of payments, the current account deficit was projected to be reduced from 4.3 percent of GDP to 0.6 percent in 1985 (before debt relief), and targets for an improvement in the net foreign reserve position and cash payment of external arrears were established. In addition, in view of the debt servicing difficulties experienced in recent years, the program placed strict limits on disbursement of non-concessional public sector loans in 1985. At the same time, debt relief from Paris Club creditors and foreign commercial banks was expected in an amount of US$336 million.

As of the June 30, 1985 testing date, all performance criteria established to monitor the financial program were met, most with a sizable margin (Table 7). As of end-June, the net domestic assets of the Central Bank were some RD$309 million below the end-December 1984 level, compared with a programmed reduction of RD$50 million. The larger than anticipated reduction in domestic credit reflected the decline of RD$105 million in net credit extended by the Central Bank to the public sector during this period and a decline in rediscounts to financial institutions of RD$25 million. Legal reserves held by the Central Bank rose by RD$105 million and RD$48 million in stabilization bonds were placed. The banking system's liabilities to the private sector increased very moderately (4.4 percent) in the first half of 1985, as currency in circulation declined by 10 percent. As a result of these factors, the net international reserves of the Central Bank increased by US$50 million in January-June 1985, to a negative US$286 million--US$31 million above the adjusted target.

Table 7. Dominican Republic: Quantitative Performance Under
Stand-By Arrangement, 1985

	1984	1985		
	Dec. 31	June 30	Sept. 30	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/	1,810.8 4/
Adjustment 3/		...	-50.0	
Actual	1,810.8 3/	1,603.1	1,644.3	
Margin or excess (-)		307.7	55.7	
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 5/		...	3.9	
Actual	1,632.1 6/	-309.4	-226.8	
Margin or excess (-)		259.4	50.7	
		(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 5/		-16.7	-1.3	
Actual	-335.9	-285.7	-310.1	
Margin or excess (-)		31.0	26.2	
Cumulative cash reduction in external arrears				
Target		64.0	74.0 2/	89.0 2/
Revised target			74.0	105.0
Actual	506.6 4/6/	65.1	79.5	
Margin or excess (-)		1.1	5.5	
External debt disbursements 7/				
Debt of 0-1 year (net)				
Ceiling on gross disbursements		90.7	90.7	90.7
Ceiling on net disbursements 8/				19.3
Revised ceiling on net disbursements 8/				--
Actual gross disbursements		79.0		
Margin or excess (-)		11.7		
Debt of 1-5 years				
Ceiling 9/		64.2	64.2	64.2
Actual		36.3	...	
Margin or excess (-)		27.9		
Debt of 1-12 years				
Ceiling		198.5	198.5	198.5
Actual		69.4	...	
Margin or excess (-)		129.1		

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 to be adjusted as indicated in footnote 1 to Table 2 annexed to the Technical Memorandum of Understanding.
5/ Reflects use of collateral deposits to liquidate letters of credit. See footnote 2 to Table 3 annexed to the Technical Memorandum of Understanding.
6/ Stock outstanding.
7/ Disbursements under nonconcessional external public and publicly guaranteed debt.
8/ Applies to the period December 31, 1984 - December 31, 1985.
9/ Subceiling within the disbursements of debt of 1-12 years maturity.

During the first half of 1985, the nonfinancial public sector recorded an overall surplus and reduced its net indebtedness to the Central Bank and the Reserve Bank by more than RD$200 million, allowing a margin of RD$307 million below the ceiling at the end of June. This outturn reflects in part an overestimation in the program of external debt service payments and a heavier-than-programmed concentration of such payments in the second half of 1985. Furthermore, the impact of the tax measures introduced at the beginning of the year was stronger than had been anticipated. Also, contrary to what had been programmed, a small amount of ESF grants (received from the United States under the Caribbean Basin Initiative) was transferred to the public sector and RD$28 million of such grants was deposited in the Central Government's account in the Central Bank.

Receipts from income taxes, the general sales tax, and taxes from trade benefited from an exchange rate that was more depreciated than the rate of RD$2.8 per U.S. dollar assumed in the program. The yield from the export surcharge was lower than programmed as the exchange rate effect was not sufficient to compensate for the decline in export earnings in the first seven months of the year. Central government expenditure on wages, goods and services, and current transfers rose faster than programmed, while interest payments remained substantially below programmed levels. Capital spending (including that of the major enterprises) was curtailed in line with the reduced use of foreign loans as a consequence of congressional action to prevent any new indebtedness irrespective of the degree of concessionality.

Considerable progress also has been made toward the achievement of other objectives of the program. The monthly rate of inflation, which peaked at 6 percent in January following the adjustments in controlled prices, has moderated significantly. By July, notwithstanding the adverse impact of a drought on agricultural production, the monthly rate of inflation had decelerated to 0.4 percent and in August prices declined slightly. However, indications are that real GDP declined in the first half of 1985, and a small decline is now projected for the year as a whole.

The exchange rate of the peso vis-à-vis the U.S. dollar appreciated from RD$3.3 per U.S. dollar in March to below RD$3 per U.S. dollar in August, reflecting the tight stance of monetary and fiscal policy. In real effective terms, the peso appreciated by some 13 percent during the first eight months of the year (see Chart 1).

The negotiations for debt relief with official creditors and commercial banks have progressed satisfactorily. On May 21, 1985 the Dominican Republic signed an agreed minute with the Paris Club creditors on the terms for rescheduling the arrears as of end-1984 and eligible debt service falling due in the period January 1, 1985-March 31, 1986. Agreement also has been reached with the commercial banks on the terms of a multi-year rescheduling arrangement (MYRA), but the arrangement has yet to be formally completed.

3. Relations with the World Bank

The Dominican Republic's financial relations with the World Bank Group are summarized in Appendix III. After averaging US$55 million yearly in loan commitments during 1978-82, new loans from the World Bank tapered off to under US$5 million yearly in 1983-84. With the implementation of the 1985 stabilization program, the Bank has accelerated processing of new loans as well as begun developing a future lending program.

Since April, 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; the other, a US$35.8 million loan for highway reconstruction, was approved in July. The Bank is now working with the authorities on a loan to support the electricity power sector; the project would reduce losses through improvements in distribution; an appraisal mission was sent to 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. Finally, the Bank is considering a government request for a quickly disbursing, policy-based loan to promote nontraditional exports.

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; Fund staff participated in the mission to review public finances. Bank staff have also participated in Fund missions, most recently to help analyze the pricing policies of the electricity company.

III. Summary of Policy Discussions

The 1985 Article IV consultation discussions centered mainly on the issues relevant to the completion of the mid-term review of the Dominican Republic's stand-by arrangement. Particular attention was given to the stance of fiscal policy for the second half of 1985 and the early implementation of the reduction in the exchange surcharge. In accordance with the emphasis given in the Summing Up at the conclusion of the 1984 Article IV consultation, the staff also discussed interest rate policy, external debt management and the need to eliminate the restrictive features of the exchange system.

1. Fiscal policy

Discussions in the area of fiscal policy focused on the sharp reversal in the Central Government's finances that was in prospect from the first to the second half of 1985 and on the deterioration in the finances of some of the major public enterprises.

For 1985 as a whole, the overall deficit of the nonfinancial public sector is now projected at 1.9 percent of GDP (less than RD$280 million), or substantially below the program objective of 4.9 percent of GDP (RD$630 million) (see Table 3). This performance reflects a large shortfall from the programmed level (RD$365 million or more than one third) in capital expenditure, due mainly to the sharply reduced availability of foreign financing.

As was noted above, central government revenue grew rapidly in the first half of 1985, and for the year as a whole revenue is projected to be some RD$250 million (almost 12 percent) above program (see Table 4). However, revenue growth is expected to slow down in the remainder of the year due to normal seasonal factors and a number of nonrecurring factors that boosted collections in early 1985. At the same time, expenditure commitments of the Central Government have been larger than expected because of public sector wage adjustments and a deterioration in the financial situation of the State Sugar Company (CEA), the Electricity Corporation (CDE) and the Institute of Price Stabilization (INESPRE). In addition, a large external debt service payment is to be made in December 1985 in connection with the rescheduling exercise.

Effective July 1985, minimum wages were raised (from RD$175 a month to RD$250) and public sector wages were adjusted accordingly, even though the new revenue legislation proposed by the Government for covering additional wage payments (estimated at RD$73 million for the remainder of 1985 or close to 30 percent on a full year basis) was not passed. More recently, increases in salaries for the judicial system and for agricultural workers were put into effect after Congress approved certain revenue measures requested by the Government to cover the budgetary cost. These measures involve a broadening of the base of the value-added tax (ITBI) to include such sources as hotel rooms, movie theaters, cable, telephone, telex, and cable television. The Government's 1985 wage bill is now projected to exceed the program level by close to RD$150 million or over 30 percent.

The authorities explained that in 1985 the funds to cover the July wage increase would be obtained from the Rosario gold mining company, which would liquidate its holdings of mortgage bonds for the amount required. This state-owned enterprise pays income taxes and makes other contributions to the central government budget according to a formula linked inter alia to the gold price. Since Rosario's average gold sales price in 1985 was likely to exceed the price assumed in the budget estimates, its contribution was now projected to exceed the budgeted level by some RD$26 million, thus leaving almost RD$50 million to be secured out of Rosario's liquid assets.

Central government transfers to the rest of the nonfinancial public sector are also expected to exceed the level contemplated in the program by a substantial margin, mostly reflecting higher transfers to the CDE, CEA, and INESPRE, whose combined operating loss is projected at RD$218 million (compared with a small programmed surplus). Because of the failure to adjust the price of flour, a substantial transfer is also being made to the flour mill (Molinos Dominicanos), and transfers to other entities and enterprises are expected to exceed the original projections as well. These expenditure overruns would be partly offset by lower-than-projected payments of interest. Altogether, current expenditures would exceed the program level by some RD$260 million or more than 14 percent. The overrun in total expenditures would amount to only RD$175 million or 7 percent, reflecting the weakness of investment spending mentioned above. The Central Government's overall deficit would be RD$70 million less than programmed, but the amount financed externally would be only one third of that contemplated in the program.

The deterioration in the finances of the major public enterprises had various causes. Operating costs of the CDE have risen due to the prevalence of drought during the spring and early summer, which reduced hydroelectric generating capacity. Also, for a time the CDE continued to carry out its investment program despite the reduced availability of foreign financing; action has since been taken to scale down the investment program. Revenues are running about 10 percent below the program projections; collections from private users were on target, but several public sector entities were incurring arrears, which apparently were paid only in part by special transfers from the Central Government.

The Price Stabilization Institute (INESPRE) remains a potential drain on the budget as a consequence of an unforeseen large increase in the domestic subsidy on rice that was introduced last June, when the price support to producers was raised without a concommitant increase in the retail prices. This situation will be alleviated for some time by the importation of rice necessitated by the drought conditions in the early part of the year. Accordingly, the Dominican Republic representatives stated that no further transfers to INESPRE would be made in the last four months of 1985.

The operations of the State Sugar Company (CEA) have been affected adversely by the fall in world sugar prices and the reduction of the import quota in the preferential U.S. market. CEA's outstanding debts have reached more than RD$400 million and include debt to suppliers and banking institutions as well as arrears on wages, social security payments, and payments to cane growers. The Government is beginning to take far-reaching measures to improve the financial situation of CEA. In late August 1985, the full benefits of domestic commercialization of sugar at the wholesale level were passed from INESPRE directly to CEA, and the retail prices of processed sugar were raised between 67 percent and 76 percent. At the same time, the Government ordered that in the last four months of the year, the expenditures of the six least efficient sugar mills be reduced by 50 percent and those of the six most efficient mills by 25 percent, and that CEA's crop in 1986 be reduced by the equivalent of 100,000 short tons of sugar (about 14 percent of the projected crop in 1985). Also, the Dominican Republic representatives stated that the subsidy on molasses would be eliminated. These measures will help in alleviating the immediate liquidity problems of CEA, while efforts to diversify production out of sugar are being intensified.

As noted above, an overall deficit of the nonfinancial public sector of less than RD$280 million is now projected for 1985 as a whole, on the basis of actual data for the first seven months of the year and of the policies and prospects just described. Foreign financing (mostly through concessionary loans), while much less than programmed, would exceed the deficit, leaving a small negative domestic financing requirement. There would be negative financing of some RD$65 million from the Central Bank and the Reserve Bank, offset in part by the planned operation with the Rosario gold mining company described above and a small amount of financing from private commercial banks to certain public enterprises that was not contemplated in the program. The projected reduction in net credit from official banks would exceed by a small margin the reduction projected in the end-December ceiling on such credit on account of public sector use of ESF grants (see Section III.4 below).

The Dominican Republic authorities were well aware that these estimates did not leave much room for slippage, and they agreed on the need for tight fiscal discipline. In this connection, they also noted that the Government had made a renewed effort to monitor the operations of the major public enterprises more closely.

An important element in the fiscal outlook for 1986 is the authorities' decision to make an early start with the process of dismantling the temporary export surcharges. The surcharge on nontraditional exports will be reduced from 36 percent to 20 percent in early 1986, before the second review of the program with the Fund which is due to be completed prior to February 28, 1986.

It is estimated that this reduction would entail a loss of RD$325 million relative to projected 1985 collections, or 14 percent of total 1985 government revenues. A little more than half of this loss will be absorbed by the Electricity Corporation (CDE) and the remainder by the Central Government. The Central Bank will continue to receive a transfer for the interest payments on the foreign debt it assumed under the 1983 rescheduling agreement with commercial banks and for the interest due on its holdings of government bonds. The transfer received by CDE out of the proceeds of the export surcharge (RD$225 million in 1985) would be reduced by RD$165 million in 1986 to RD$60 million, as the programmed monthly increase in electricity tariffs remains in effect, while cost-reducing measures are put into place.

The remaining revenue loss of about RD$160 million would have to be absorbed by the Central Government. Given the difficulties the Administration has had in the past in securing tax legislation with the Congress, and the coming Presidential election, the revenue shortfall caused by the reduction of the surcharge would have to be compensated by expenditure cuts. To that end, all government agencies have been instructed to cut their outlays on goods and services (other than wages) and current transfers by 30 percent. In this connection, the authorities indicated that the 1986 budget, which is now being formulated, would include adequate provisions for meeting the full government external debt service at the market rate of exchange.

2. Monetary policy

The authorities were of the view that the policy of credit restraint was appropriate and had contributed significantly to the slowdown of inflation and the appreciation of the peso since the beginning of 1985. In order to consolidate these gains, they were committed to maintaining a restrained credit policy in the period ahead, particularly since the Government's financing requirement would be sizable in the second half of the year. The Dominican Republic representatives recalled that an array of monetary measures had been taken in January 1985 and, therefore, no further action was being contemplated at this time. The placement of stabilization bonds, which had proceeded successfully, would continue.

An area of concern to the authorities was the operational and exchange losses which the Central Bank has been incurring. These losses amounted to some RD$270 million in 1984, equivalent to 2 1/2 percent of GDP, compared with a financing requirement of the nonfinancial public sector of close to RD$300 million. Exchange losses resulted from the introduction in April 1984 of a preferential exchange rate for traditional exports, that was compensated only in part by a special exchange rate for oil imports introduced in August 1984. For many years prior to 1985 the Central Bank had not collected the interest due on its holdings of government securities, which in any event carry relatively low interest rates. The assumption by the Central Bank of substantial external debt obligations under the refinancing agreement reached with foreign commercial banks in December 1983, raised the Bank's operating costs by some US$70 million in 1984. Interest rates on some of the Bank's lending operations were increased in January 1985.

Under the stand-by program, the Government was expected to pay RD$105 million to the Central Bank in 1985, representing not only interest actually due (RD$50 million) but also a payment for interest accrued in 1984. Only the part actually due will be paid, however, inasmuch as the Central Bank will receive a transfer from the Central Government for the US$70 million of interest due on the assumed debt in 1985. This transfer will be financed from the proceeds of the export surcharge. The authorities did not foresee any need for the Central Bank to purchase foreign exchange on a net basis in the market in 1985 (see below), and hence foreign exchange losses are expected to be minimal. The mission noted that looking beyond 1985, and beyond the eventual elimination of the temporary export surcharge, it would be necessary to provide for specific appropriations in the central government budget to cover the Central Bank's losses. In this connection, attention also was drawn to the financial situation of the Reserve Bank, because its nonperforming assets had been increasing. Under the program, a timetable was established for the gradual elimination of the Reserve Bank's deficiency of required reserves on deposits existing as of December 31, 1984, but the authorities noted that progress in this regard had been slow.

As regards interest rate policy, the authorities recognized that many interest rates were negative in real terms in the early months of 1985 because of the high rates of domestic inflation. However, now that inflation has come down sharply and private sector confidence appears to have strengthened, the interest rate structure seemed to be generally appropriate. Nevertheless, they agreed with the staff that flexibility in interest rate management was required. In this connection, they said the experience with the high-yield financial certificates had been gratifying after the liberalization of the terms of issuance that was effected as part of the January 23, 1985 package of measures. They also noted that they would await the recommendations of a study of the informal financial system before taking further action to liberalize interest rates.

3. External sector policies and medium-term outlook

Balance of payments developments since the inception of the program do not point to marked divergences from the original projections for 1985. Exports will be slightly weaker than projected and imports somewhat stronger, but the larger current account deficit would be more than offset by a stronger capital account (see Table 6). The overall deficit is now expected to be reduced to US$130 million in 1985, as compared with the program projection of virtually no change from the 1984 deficit of US$155 million.

As was noted above, the debt relief envisaged in the program has been secured. At the same time, the reduction through cash payment of external arrears outside the Central Bank will be some US$30 million larger than programmed, while the Central Bank paid off some US$20 million in arrears that had not been counted as part of its reserve liabilities. In these circumstances, the authorities proposed that the target for the increase in the Central Bank's net foreign assets during 1985 be reduced accordingly.

The balance of payments situation appears manageable in the near term, but the medium-term outlook for the external position of the Dominican Republic is clouded by the poor prospects for traditional exports. It would be influenced importantly by the degree of the authorities' commitment to the adjustment process and the level of external support. The application of adjustment policies would need to be strict and continuous because a major structural change of the economy is needed to attain external viability over the medium term.

As regards exports, prospects are especially poor for sugar, the single most important export product. Uneconomical prices in the free market coupled with uncertainties regarding the size of the quota in the U.S. market underscore the urgent need to reduce the economy's reliance on sugar. With the prospective exhaustion of known gold and silver deposits, new exploration would need to be undertaken or alternatively other export opportunities would have to be developed. The most promising among the latter would be nontraditional export products, tourism, and the free trade zones. A policy environment necessary to effect the required structural changes would include flexible exchange rate policy, the removal of taxes and tariffs that discriminate against the export sector, and the maintenance of cautious monetary and fiscal policies.

The time element of the adjustment process is quite important because of the modalities of the debt rescheduling, especially with commercial banks. The MYRA that was recently negotiated in principle with the banks provides for a rescheduling of 100 percent of principal payments for 1985-89 and end-1984 arrears to be repaid in 1988-97 (the total amount to be rescheduled was US$787 million). The repayment profile is quite favorable with annual repayments starting in 1988 at US$9 million and only increasing gradually to US$111 million by 1994. Nonetheless, from 1991 onward substantial amounts will need to be amortized and the current account would need to have undergone sufficient improvement to allow for nondisruptive servicing of these and other prospective obligations.

The prospects for the balance of payments over the medium term are presented in Table 8. Underlying this scenario is the assumption that the adjustment effort initiated in 1985 will be maintained in the coming years and, in particular, that fiscal and monetary policies will remain sufficiently restrained and be supported by appropriate exchange rate policies.

The trade deficit is expected to widen from about US$410 million in 1985 to US$560 million in 1990. This is primarily a result of limited prospects for traditional exports and the expected cessation of gold mining in 1989. Thus, while nontraditional exports are projected to grow at 16 percent a year in 1986-90, total exports would increase by only 4 1/2 percent per year during this period. Imports are projected to rise at an average annual rate of 5 1/4 percent. The surplus on services is forecast to increase from US$14 million in 1985 to about US$140 million in 1990, on the basis of a strong performance of the tourist sector (made possible by the flexible exchange rate) and the stabilization of interest payments (due to improvement in the structure of the external debt). Accordingly, the current account is projected to record a small deficit by 1990.

For 1986 it is likely that the capital account will continue to register an outflow, but of a smaller magnitude than in 1985. From 1987 to 1990 net inflows of public and private capital are projected, on

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

(In millions of U.S. dollars)

	Prel.	Projections					
	1984	1985	1986	1987	1988	1989	1990
Current account	-218	-46	-2	25	42	-38	-29
Trade balance	-380	-410	-421	-414	-431	-546	-560
Exports, f.o.b.	(872)	(790)	(815)	(886)	(942)	(904)	(990)
Imports, f.o.b.	(-1,251)	(-1,200)	(-1,236)	(-1,300)	(-1,373)	(-1,450)	(-1,550)
Services (net)	-106	14	77	85	108	129	137
Receipts	(507)	(609)	(660)	(690)	(735)	(783)	(833)
Of which: travel	/371/	/430/	/522/	/567/	/606/	/647/	/690/
Payments	(-613)	(-595)	(583)	(-605)	(-627)	(-654)	(-696)
Of which: interest	/-296/	/-255/	/-239/	/-233/	/-237/	/-249/	/-270/
Transfers	267	350	342	354	366	380	394
Private	(210)	(230)	(242)	(254)	(266)	(280)	(294)
Public	(57)	(120)	(100)	(100)	(100)	(100)	(100)
Capital account	63	-84	-75	55	161	267	320
Direct investment	68	42	50	60	65	70	75
Medium- and long-term loans	34	-152	-125	-5	96	197	245
Drawings	(324)	(264)	(259)	(328)	(379)	(386)	(407)
Amortization	(-290)	(-416)	(-383)	(-333)	(-283)	(-189)	(-163)
Other	-39	23	--	--	--	--	--
Overall balance	-155	-131	-77	80	203	229	291
Financing	155	131	77	-80	-203	-229	-291
Net foreign assets of the Central Bank (increase -) 1/	-92	-69	-20	-150	-200	-150	-150
Assets	(-64)	(...)	(...)	(...)	(...)	(...)	(...)
Liabilities	(-28)	(...)	(...)	(...)	(...)	(...)	(..)
Use of Fund credit	/-25/	/45/	/-22/	/-49/	/-44/	/-71/	/-56/
Arrears	/34/	/.../	/.../	/.../	/.../	/.../	/.../
Others	/-38/	/.../	/...	/.../	/.../	/.../	/.../
Arrears (decrease -)	247	-108 2/	-100 2/	--	--	--	--
Debt relief	...	308	141	53	60	-18	-120
Financing gap	...	...	56	17	-63	-61	-21

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

1/ Includes increase in gross reserves of at least US$50 million per year in 1987-90.
2/ Reduction of arrears through cash payment.

account of the expected recovery in investment and economic activity, and lower amortization.

The balance of payments is expected to record overall deficits in 1986 and 1987 but should thereafter shift into surplus. By 1990 an overall surplus of close to US$300 million is projected. Over the period 1987-90 it would be important to improve the net foreign asset position of the Central Bank. Hence, an annual increase in gross reserves of at least US$50 million in 1987-90 is targeted. Before debt relief, financing gaps totaling about US$575 million were in prospect for 1985-87. However, given the debt relief already negotiated, a financing gap of only US$50 million remains in prospect for 1986. If the Dominican Republic were to approach the Paris Club in 1986 and obtain terms similar to those that were obtained in 1985, based on the scenario assumed above, the balance of payments throughout 1990 would appear to be fully financed.

Before rescheduling, the Dominican Republic's debt service obligations were high in 1985-86 (Table 9). The debt service ratio was expected to reach 50 percent of exports of goods and services in 1985 and to decline steadily thereafter to 27 percent in 1990. The debt reschedulings provided some relief, especially during 1985-86; their effect on the debt service ratio was to stabilize it around 30 percent for the whole period. By 1990, owing to amortization payments of rescheduled amounts, the debt service ratio would be about 4 percentage points higher than what it would have been without rescheduling. This underscores the need to use the breathing space provided by the reschedulings to effect adjustment policies that would lead to a more viable external position.

The authorities were well aware that export growth is a sine qua non for establishing a viable external position over the medium term, and that adequate incentives were required for both traditional and nontraditional exports. In this connection they underscored their determination to make an early start with the process of dismantling the temporary export surcharges.

The Dominican Republic representatives said that the experience with the unified exchange system, with a freely floating exchange rate, had been satisfactory. The Central Bank had not intervened in the market for the purpose of influencing the exchange rate, and they indicated that this policy would be continued. It was noted that in the period since January 23, 1985, the Central Bank's operations in the foreign exchange market, which are conducted at average buying and selling rates determined by reference to the preceding five working days, had given rise at times to excessive spreads. In order to eliminate the multiple currency practice and to bring the central bank exchange rate more closely into line with market conditions, the authorities said a system will be adopted whereby the last actual market rate known will be used for foreign exchange transactions of the Central Bank.

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

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

	1984	1985	1986	1987	1988	1989	1990
After rescheduling							
Debt outstanding, end of period 1/	2,725	2,896	2,619	2,669	2,904	3,064	3,406
Of which: IMF	(221)	(265)	(243)	(194)	(150)	(78)	(23)
Debt service payments	569	428	433	458	446	512	553
Principal 2/	300	131	147	162	143	191	210
Interest 3/	269	297	286	296	303	321	343
Debt service ratio	41.3	30.6	29.6	29.1	26.6	30.3	30.3
Debt outstanding/GDP	49.7	54.4	51.4	49.0	49.9	50.0	51.1
Before rescheduling							
Debt service payments	569	703	681	615	564	509	489
Principal 2/	300	448	442	382	327	260	219
Interest 3/	269	255	239	233	237	249	270
Debt service ratio	41.3	50.2	46.5	39.0	33.6	30.2	26.8
Memorandum items							
Exports of goods and services	1,379	1,399	1,463	1,576	1,677	1,687	1,823
Current account/GDP	-2.0	-1.1	--	0.5	0.7	-0.6	-0.4

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/ Medium- and long-term debt.
3/ Includes interest on short-term debt.

The Dominican Republic retains a number of exchange restrictions and multiple currency practices subject to Fund approval. The export surcharge (levied at the rate of 36 percent on proceeds from exports of traditional products and services and 5 percent on proceeds from exports of nontraditional products) and a tax on profit remittances (including a surcharge on the amount of the tax), constitute multiple currency practices subject to approval under Article VIII, Section 3. There are also exchange restrictions subject to Fund approval as evidenced by the existence of external payments arrears.

Considerable progress has been made in the settlement of external payments arrears. In the first half of 1985, US$65 million of arrears were paid in cash and for the year as a whole total cash payments would amount to at least US$105 million, compared with US$89 million contemplated in the program. It is estimated that as a result of reduction of arrears through cash payments and through renegotiation with the Paris Club creditors and commercial banks, outstanding external payments arrears would decline to less than US$100 million by the end of 1985, from US$507 million at the end of 1984. These arrears would be fully paid in cash in the course of 1986.

4. Performance criteria and mid-term review

Because a number of key elements--mainly the amount of debt relief and the evolution of the exchange rate--were subject to great uncertainties when the program was approved, most quantitative performance criteria were set initially only for June 30, 1985. As part of the mid-term review, understandings were reached on performance criteria for end-September and end-December 1985 (see Table 7 and the tables annexed to the Technical Memorandum of Understanding) for (a) net credit to the public sector from the Central Bank and the Reserve Bank; (b) net domestic assets of the Central Bank; (c) net foreign assets of the Central Bank; (d) cash reduction in external payments arrears; and (e) disbursements of nonconcessional public sector loans.

The ceiling on net credit to the public sector will be adjusted downward for any use by the public sector of ESF grants received from the United States under the CBI, which are classified outside the ceiling, and for any transfers from the ESF grant counterpart deposit account to the Central Government's deposit account. The new ceilings incorporate an increase in the original target for the cumulative cash reduction in external arrears in 1985, and some easing of the indicative end-1985 target for the net foreign assets of the Central Bank (see Section III.3 above). At the same time, the original target for the cumulative reduction in the Central Bank's net domestic asset was tightened to take account of the very substantial reduction in the currency issue in the first eight months of the year.

As regards the performance criteria related to short-term foreign debt (see Table 7 and Table 5 of the Technical Memorandum of Understanding), the authorities proposed two modifications. The limit on cumulative disbursements was eliminated because of the difficulties posed by advance export sales that are repaid within the year. Also, based on preliminary data, the program had assumed repayments in 1985 which, in fact, had been already made in 1984, or were subject to rescheduling, and accordingly the limit on the net change in the level of short-term debt during 1985 was modified from a negative US$19.3 million to zero.

A second review with the Fund is scheduled to take place before February 28, 1986. This review will focus on the evaluation of economic and financial policies for 1986, and on the reduction and eventual elimination of the export surcharge.

IV. Staff Appraisal

The 1985 economic and financial program of the Dominican Republic is supported by a stand-by arrangement, approved by the Executive Board on April 15, 1985. Pursuant to paragraph 4(b) of the arrangement, the authorities have discussed with the staff the progress achieved in the first half of the year and the performance criteria for the remainder of the program. In the attached letter and technical memorandum, the Dominican Republic authorities describe the policies they intend to follow to achieve the aims of the program. Those are: to strengthen the country's external position, contain inflation, and create the conditions for renewed economic growth.

In the view of the staff, significant progress has been achieved in redressing the mounting internal and external disequilibria of the early 1980s. The unification of the exchange system, with a freely floating exchange rate, and the substantial progress in realigning domestic prices to reflect costs, have been crucial in coming to grips with the economic crisis. Equally important has been the cautious stance of fiscal and monetary policies, which was instrumental in bringing about a sharp drop in the monthly rate of inflation (from 6 percent in January to 0.4 percent in July) and an appreciation of the exchange rate (from RD$3.3 to around RD$3 per U.S. dollar). With the support of the foreign commercial banks and official creditors, the external debt (including arrears) is being restructured. A sizable reduction of external arrears through cash payment also has been made and the Central Bank's net foreign assets have increased. All of the performance criteria established to monitor the evolution of the program through June 1985 were met, mostly by wide margins.

However, the stronger-than-programmed fiscal performance in 1985 masks a number of worrisome developments. Contrary to what was envisaged in the program, public sector wages were increased (by almost one third on average) around midyear even though the Congress did not approve the compensating revenue measures requested by the Administration. Moreover, central government transfers to the major public enterprises have exceeded the program targets by sizable amounts; while this was due in part to exogenous factors (such as drought conditions, low world sugar prices and a cut in the U.S. sugar export quota), it also reflected inadequate control over the operations of INESPRE and the investment program of the CDE. Also, a sizable subsidy has resulted from the failure to adjust the price of flour. In June 1985 the producer price for rice was raised without a concommitant increase in the retail price, creating a potentially large subsidy.

Recently, the authorities have taken a number of measures that should help to assure the achievement of the program's fiscal objectives. The investment program of the CDE was cut back and INESPRE will not receive any further transfers while having to liquidate its domestic arrears. The CEA, which is beset by a major financial crisis, has been ordered to cut production and outlays; the prices of refined sugar in the domestic market were increased; and negotiations on a restructuring of CEA's domestic debts have started. The authorities feel that this action is sufficient to keep the 1985 fiscal program on track. While the staff welcomes the measures, it would stress that the margin of safety they provide is small and it urges the authorities to be prepared to take additional action if that becomes necessary. In this connection, it is important that the operations of the enterprises be monitored very closely. The staff would also note that the cuts ordered in CEA's output and expenditure, while providing short-term relief, need to be followed up with a lasting restructuring of the company's operations.

Looking ahead, it is particularly important that the fiscal expansion underway in the second half of 1985 not be allowed to accelerate in 1986, since revenues will be reduced by the dismantling of the export surcharge and expenditures will be under election-year pressure. In this connection, the staff would note that liquidating financial assets of the Rosario gold mining company, as is contemplated for 1985, is not an appropriate way of raising the resources for a public sector wage increase, and one that could not be used on a permanent basis. Also, the budgetary cost of the rice subsidy introduced in mid-1985, which was suppressed by the importation of rice due to the drought, would reemerge when INESPRE resumes purchases of domestic rice in the course of 1986. In the view of the staff, any weakening of the public finances in 1986 could entail excessive credit expansion and put renewed pressure on prices, on the exchange rate and on the Central Bank's net foreign assets, thereby jeopardizing the substantial gains that have been achieved.

An additional aspect of the fiscal problem that needs to be addressed more forcefully in the future is the question of the operational losses of the Central Bank, which are quite large relative to the imbalances in the nonfinancial public sector. These losses stem mainly from the Bank's assumption of external debt obligations under the 1983 refinancing arrangement with commercial banks, and to a large extent are of a fiscal nature. Once the export surcharge is eliminated, the Central Government will still need to cover these losses from the budget with other fiscal resources.

The medium-term outlook for the Dominican Republic, influenced as it is by the unfavorable prospects for many of the traditional export commodities, underscores the dual need for an intensified and sustained effort to restructure the economy away from primary products, especially sugar, and for a continuation of the adjustment effort accompanied by an exchange rate policy that provides adequate incentives for both traditional and nontraditional exports. In this connection, the staff welcomes the authorities' decision to reduce the surcharge on proceeds from traditional exports from 36 percent to 20 percent in early 1986 and it urges the authorities to eliminate the surcharge entirely as soon as possible. The staff also welcomes the intention of the Central Bank to continue its policy of not intervening in the foreign exchange market for the purpose of influencing the level of the exchange rate. In these circumstances, the staff recommends that the Executive Board approve the retention by the Dominican Republic of the remaining exchange restrictions and multiple currency practices until the end of the stand-by arrangement.

It is proposed that the next Article IV consultation with the Dominican Republic take place on the regular 12-month cycle.

VI. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

I. 1985 Consultation

1. The Fund takes this decision relating to the Dominican Republic's exchange measures subject to Article VIII, Sections 2(a) and 3, in the light of the 1985 Article IV consultation with the Dominican Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions, including those evidenced by external payments arrears, and the multiple currency practices maintained by the Dominican Republic are described in EBS/85/237. The Fund notes the intentions of the authorities concerning the withdrawal of these exchange restrictions and multiple currency practices and, in the circumstances of the Dominican Republic, grants approval for the retention of these restrictions and practices until April 14, 1986. The Fund will review these exchange measures on the occasion of the next review under the stand-by arrangement for the Dominican Republic (EBS/85/75, Supplement 1, April 17, 1985) to take place before February 28, 1986.

II. Review, Technical Modification, and Waiver Under Stand-By Arrangement

1. The Dominican Republic has consulted with the Fund in accordance with paragraph 4(b) 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, in order to review progress made in implementation of the program, to reach understandings on policies and quantitative performance criteria for the remaining period of the arrangement, and on circumstances in which purchases by the Dominican Republic can be resumed under the arrangement.

2. The letter of October 28, 1985 with an annexed technical memorandum from the authorities of the Dominican Republic shall be attached to the stand-by arrangement, and the letter of February 28, 1985 and annexed technical memorandum attached to the stand-by arrangement, shall be read as supplemented and modified by the letter of October 28, 1985 with annexed technical memorandum.

3. Accordingly, the Dominican Republic will not make purchases under the stand-by arrangement that would increase the Fund's holdings of the Dominican Republic's currency in the credit tranches beyond 25 percent of quota during any period in which the data at the end of the preceding period indicate that:

(i) the limit on the combined central bank and reserve bank net credit to the public sector set forth in paragraph 3 of, and in Table 1 of the memorandum annexed to, the attached letter dated October 28, 1985 is not observed;

(ii) the cumulative reduction of the net domestic assets of the Central Bank of the Dominican Republic set forth in paragraph 4 of, and in Table 2 of the memorandum annexed to, the attached letter dated October 28, 1985 is not observed;

(iii) the target for the net foreign assets of the Central Bank set forth in paragraph 5 of, and in Table 3 of the memorandum annexed to, the attached letter dated October 28, 1985 not observed;

(iv) the cumulative reduction through cash payments in external arrears set forth in paragraph 6 of, and in Table 4 of the memorandum annexed to, the attached letter dated October 28, 1985 is not observed;

(v) the ceilings on disbursements under nonconcessional external public and publicly guaranteed debt, set forth in paragraph 7 of, and in Table 5 of the memorandum annexed to, the attached letter dated October 28, 1985 are not observed.

4. The Fund finds that no other understandings are necessary regarding the circumstances in which the Dominican Republic can resume purchases under the stand-by arrangement and decides, pursuant to paragraph 4(b) of the stand-by arrangement, that the review provided for in that paragraph is completed.

Dominican Republic - Fund Relations
(As of September 30, 1985)

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	338.13	301.63
(c)	Fund credit:	226.03	201.63
	Of which: CFF	74.25	66.24
	Credit tranche	28.02	25.00
	EFF	61.88	55.20
	Enlarged access under EFF	61.88	55.20
(d)	Reserve tranche position	--	--
(e)	Current operational budget:	--	--
(f)	Lending to the Fund:	--	--

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 28.0 million

(b) *Special facilities since 1974:*

Facility	Date of purchase	Amount
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 31.59 million
(b)	Holdings:	SDR 0.03 million (0.09 percent of net cumulative allocation)
(c)	Current designation plan:	Not in designation plan

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 of 36 percent and 5 percent, respectively, are levied on traditional and nontraditional 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, 1985 at the latest.

VI. Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on August 8, 1984 (EBM/84/124). The relevant staff reports were SM/84/161 and SM/84/166. 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 governments. Technical assistance was also provided by the Bureau in April/May 1985 in the area of monetary statistics.

VIII. Resident Representative

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

Dominican Republic: Statistical Issues

1. Outstanding statistical issues

a. Government finances

Annual data covering the consolidated general government sector through 1983 will be published in the 1985 GFS Yearbook. Recent monthly data covering the budgetary transactions of the Central Government are published in IFS based on information reported by the Central Bank. Technical assistance was provided in June 1984 in the area of government finance statistics.

b. Balance of payments

The annual data published in IFS are reported by the Central Bank. The latest balance of payments data refer to 1983.

c. Price, production and trade statistics

Monthly information is reported by the Central Bank on a timely basis and published in IFS.

d. National accounts

Preliminary information is available after six months. Revised data are reported by the Central Bank and published in IFS. Some questions on the methodology have been raised and the World Bank may send a technical mission to survey the current status of the National Account Statistics.

e. Financial survey

Although there are a number of substantive problems in the area of monetary statistics, data on the monetary authorities and commercial banks are reported on a timely basis by the Central Bank for publication in IFS. Data on other financial institutions are also reported on a fairly timely basis. A Bureau of Statistics technical assistance mission on money and banking statistics was undertaken in April/May 1985 to review the accounts of the Central Bank. Further work is necessary to review the accounts of the rest of the financial system.

f. External debt

External debt data are reported by the Central Bank and published in IFS. As a result of the revision of the external debt data being undertaken by the World Bank and the Central Bank, the quality of the data will improve as will the reporting lags.

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 the Dominican Republic in the October 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of the Dominican Republic, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in October 1985
Real Sector	- National Accounts	1982
	- Prices	April 1985
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	May 1985
	- Financing	May 1985
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	April 1985
	- Deposit Money Banks	April 1985
	- Other Financial Institutions	April 1985
	- Interest Rates	n.a.
External Sector	- Merchandise Trade: Value	March 1985
	Prices	March 1985
	- Balance of Payments	1983
	- International Reserves	August 1985
	- Exchange Rates	July 1985

Dominican Republic: Relations with the World Bank Group

(In millions of U.S. dollars)

A. IBRD Operations (as of June 30, 1985)

	Commitments (net of cancellations)	Disbursements	Undisbursed Amount
Agriculture and irrigation	69.0	36.4	32.6
Industry	25.0	25.0	--
Tourism	46.0	36.3	9.7
Transport	65.0	65.0	--
Population	5.0	5.0	--
Education	17.8 1/	12.0	5.8
Housing	25.4	3.3	22.1
Sugar rehabilitation	35.0	4.6	30.4
Urgent imports requirements	25.0	25.0	--
Energy	3.8	2.2	1.6
Total	317.0	214.8	102.2

B. IFC Operations (as of June 30, 1985)

	Loans	Equity	Total
Commitments	16.0	2.9	18.9
Total held by IFC	8.6	2.9	11.5
Total undisbursed	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 Education Project approved May 28, 1985 not yet effective.

DOMINICAN REPUBLIC

Area and population				
Area				48,400 sq. kilometers
Population				6.1 million
Annual rate of population increase				2.9
Unemployment rate				N.A.
GDP (1984)				RD$11.0 billion
GDP per capita (1984)				RD$1,747

	1981	1982	1983	Prel 1984
Origin of GDP		(percent)		
Agriculture	20.4	21.0	20.8	20.6
Mining	5.6	3.8	4.8	5.2
Manufacturing	15.1	15.5	15.0	14.8
Construction	6.9	6.6	6.9	7.4
Government	8.6	8.8	8.7	8.8
Other services	43.4	44.3	43.8	43.3
Ratios to GDP				
Exports of goods and nonfactor services 1/	20.8	14.3	14.3	12.5
Imports of goods and nonfactor services 1/	25.0	19.2	18.3	14.0
Current account of the balance of payments	-5.6	-5.5	-4.9	-2.0
Central government revenues	12.7	9.5	10.8	11.0
Central government expenditures	14.9	12.2	13.3	11.7
Public sector savings	0.5	-1.5	-0.1	2.3
Public sector overall surplus or deficit (-)	-6.2	-6.2	-4.2	-2.7
External public debt (end of year)2/	27.0	28.8	36.1	49.7
Gross national savings	17.8	15.1	15.9	17.8
Gross domestic investment	23.4	20.6	20.8	19.8
Banking system liabilities to private sector (end of year)3/	20.0	19.4	20.8	20.1
Annual changes in selected indicators				
Real GDP	3.9	1.7	4.0	0.5
GDP at current prices	9.6	9.8	7.4	27.9
Domestic expenditures (at current prices)	5.0	9.7	6.8	24.3
Investment	3.2	-3.3	8.6	21.6
Consumption	5.6	13.3	6.3	25.0
GDP deflator	5.4	8.0	3.3	27.2
Consumer prices (annual averages)	7.5	7.6	7.0	24.4
Central government revenues	3.9	-18.5	22.4	30.2
Central government expenditures	2.7	-9.7	17.0	12.5
Banking system liabilities to private sector 3/	11.1	6.8	15.1	23.5
Money	5.4	5.3	3.3	21.6
Quasi-money 4/	5.7	1.5	11.8	1.9
Net domestic assets of the banking system 5/	29.1	37.1	32.4	25.4
Credit to public sector	26.7	26.4	18.2	9.4
Credit to private sector	-1.9	6.4	9.5	8.4
Merchandise exports (in U.S. dollars)	23.5	-35.4	2.3	11.0
Merchandise imports (in U.S. dollars)	-4.5	-13.4	2.0	-2.4

	1981	1982	1983	Prel. 1984
Central government finances		(millions of pesos)		
Revenues	926.0	754.6	923.3	1,201.7
Expenditures	1,080.9	976.1	1142.1	1,284.7
Current account surplus or deficit (-)	153.0	-36.6	41.3	198.3
Overall surplus or deficit (-)	-154.9	-221.5	-218.8	-83.0
External financing (net)	60.2	48.4	81.3	101.3
Balance of payments		(U.S. dollars)		
Merchandise exports	1,188.0	767.6	785.2	871.7
Merchandise imports	1,451.7	-1,257.3	-1,282.2	-1,251.5
Investment income (net)	-304.9	-254.1	-297.1	-328.2
Other services and transfers (net)	162.7	301.9	373.0	489.7
Balance on current account	-405.9	-442.0	-421.1	-218.3
Direct investment	79.7	-1.4	22.0	68.0
Medium and long-term loans (net)	153.6	150.5	24.1	34.0
Other	63.0	-63.4	22.3	-38.4
Overall balance	-109.6	-356.3	-352.7	-154.7
Debt rescheduling	--	--	151.9	--
Change in arrear	--	--	142.6	246.9
Change in net foreign assets	109.6	356.3	58.2	-92.2
International reserve position		(millions of SDRs)		
Central Bank (net)	-276.9	-615.2	-408.9	-342.7
Financial system (net)	-334.5	-633.5	-431.0	-366.9

1/ Imports and exports valued at the exchange rate of RD$1.0 per U.S. dollar, except for 1985 when the exchange rate of RD$3.1 per U.S. dollar was applied.

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.

Santo Domingo
October 28, 1985

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

1. On February 28, 1985 the Dominican authorities addressed to you a letter setting forth the economic and financial policies to be followed in 1985 and requesting a stand-by arrangement from the Fund. On April 15, 1985 the Fund approved a one-year stand-by arrangement in the amount of SDR 78.5 million, or 70 percent of the quota of the Dominican Republic. Under the arrangement, the Dominican Republic undertook to consult with the Fund, to establish appropriate performance criteria for end-September and end-December 1985, and to reach understandings on exchange rate policy, interest rate policy, reduction of external payments arrears, and on external financing for the remaining period of the arrangement. The proposed understandings and performance criteria are set forth below.

2. During the first six months of 1985, substantial progress was achieved in the attainment of the program's objectives, primarily as a result of the tight stance of monetary and fiscal policy that the authorities have maintained. As of end-June 1985, all the performance criteria established to monitor the program have been met. The monthly rate of inflation has declined sharply from 6 percent in January to only 0.4 percent in July. During this period, the exchange rate of the peso vis-a-vis the dollar has appreciated through June and has remained stable thereafter.

3. The key instrument of financial stabilization in 1985 was the reduction of the combined deficit of the nonfinancial public sector and the Central Bank to the equivalent of 4.9 percent of GDP before debt relief. This policy objective will be maintained and the public sector will not use credit on a net basis from the Central Bank or the Reserve Bank during the year. Despite smaller than expected foreign financing in the first half of the year, the Government increased its deposits with the banking system and thus stayed well within the program limits, due primarily to a buoyant revenue performance and lower than anticipated public sector investment outlays.

4. Despite this encouraging performance in the first half of 1985, the aforementioned increase in deposits will be absorbed in the second half of 1985 by payments associated with restructuring of external debt and by the larger than programmed transfers from the Government to the Dominican Electricity Corporation (CDE) and the Sugar Company (CEA) on account of

the drought which the country suffered between January and July, the fall in sugar prices and the reduction in the import quota in the preferential U.S. market. In addition, the financial position of the public sector will be worsened if the Congress again refuses to pass tax measures submitted by the Government to finance the 1986 budget. At the same time, the Government is aware that the export tax was introduced on a strictly temporary basis in 1985, and as a result, the announcement of a substantial reduction of this tax in the first quarter of 1986 has already been made. The authorities are implementing a number of policy measures that will result in a substantial reduction in claims on budgetary resources. Underscoring this policy objective, the Government will submit to Congress a budget for 1986 in which all foreign exchange transactions will be recorded at the unified exchange rate. Consequently, the budget will absorb the additional cost of such operations within the framework of a stabilizing fiscal policy. To assure this objective, the Government in the preparation of the budget has directed that all government agencies cut expenditures on goods, services and current transfers by 30 percent.

5. The Dominican Electricity Corporation (CDE) will continue with the programmed monthly increases in electricity tariffs and will concentrate its limited resources on improving its cash flow in order to cover its oil bill and the service of its external debt, so that virtually no use will be made of the export tax revenue in 1986. Moreover, the CDE will try to expedite the flow of foreign resources necessary to carry out its investment program and at the same time to recover the significant losses now suffered because of the poor condition of the system of transmission lines. In regard to the latter, preliminary discussions with the World Bank have been initiated with a view toward the rehabilitation of transmission lines in the 12 main cities. Throughout the remainder of the program, expenditure control will be maintained so that domestic financing is not substituted for the shortfall in foreign resources.

6. The subsidization policy of the Price Stabilization Institute (INESPRE) is being reviewed. The commercialization of sugar was transferred recently to the State Sugar Company (CEA). In addition, the operating losses of INESPRE have been reduced reflecting profits realized from its temporary imports of food stuffs. Consequently, the Government will limit budgetary transfers to the amount which has already been given in the first eight months of the year. In the future, the Government will continue to exercise strict control over INESPRE's operations and will take necessary pricing and administrative measures to curtail its claims on budgetary resources.

7. The government-owned sugar company (CEA) has been confronting serious liquidity problems on account of the historically low level of world sugar prices and the reduction of the U.S. sugar import quota, factors aggravating the already deteriorated financial situation of the company. Emergency measures have, therefore, become necessary to reduce

CEA losses. In August 1985, the full benefits of domestic commercialization of sugar at the wholesale level passed from INESPRE directly to CEA. The retail prices of processed sugars were raised by between 67 percent and 76 percent in order to lower losses and to insure that CEA can continue operating. The Government has ordered that in the last four months of the year, the expenditures of the six least efficient mills are to be reduced by 50 percent and by 25 percent for the six most efficient mills and that CEA's 1985/86 crop be reduced by the equivalent of 100,000 tons of sugar. Finally, the Government is undertaking to eliminate the subsidy on molasses. We estimate that these measures will alleviate the immediate liquidity problems of CEA but in order to assure a permanent solution, the Government will continue its efforts to restructure the company with a view to promote diversification out of sugar. Meanwhile, the rescheduling of CEA's short-term debt has become indispensable for the company to continue operating normally.

8. The operations of the CORDE enterprises as a whole have continued to improve and are expected to show a surplus in 1985. However, the Flour Mill (Molinos Dominicanos) continues to be affected by the policy of subsidizing consumption of wheat flour. The authorities are reviewing the elimination of this subsidy prior to the second review of the program.

9. The aforementioned measures will assure the realization of the fiscal adjustment objectives in 1985 and will allow us to continue the stabilization process in 1986. However, we are aware that the liquidity position of the Government will be extremely tight at the end of 1985, because of the accumulation of debt service payments in the second half of the year. For this reason, the Government will continue to maintain tight fiscal discipline, especially with respect to salaries.

10. The Central Bank is expected to continue to sustain losses on account of interest payments related to the 1983 debt rescheduling. Thus, the Central Bank will continue to have recourse to the export tax in 1986 to cover such debt service payments; however, should these obligations once again be assumed by the Government, the revenue from the export tax will pass directly to the budget. In addition, the authorities are concerned about the increasing size of the informal financial market due in part to obsolete monetary legislation which is impeding the development of an appropriate interest rate structure. Consequently, the Central Bank has requested technical assistance from the International Monetary Fund aimed at identifying the mechanisms to bring the informal financial entities under the control of the monetary authorities. Finally, the Monetary Board has recently passed a resolution whereby the Central Bank will avoid accepting additional exchange risks on foreign loans which it intermediates.

11. The Central Bank will continue its policy of nonintervention in the foreign exchange market for the purpose of influencing the level of the exchange rate. The setting of the exchange rate used for central bank

purchases and sales based on a five-day moving average of market exchange rates does not reflect with precision market conditions at a time when the peso has been appreciating. Therefore, it has been decided to move to a system whereby the last actual market rate known will be utilized for foreign exchange transactions of the Central Bank. For purposes of customs valuation, the market exchange rate will continue to be used to liquidate import duties.

12. The adjustment process has been assisted by the completion of the negotiations on debt relief with official bilateral creditors under the auspices of the Paris Club and with the commercial banks. The terms obtained for 1985 were in line with those contemplated at the time the financial program was formulated but exceeded expectations for 1986 and beyond. Accordingly, the balance of payments financing gap originally in prospect for 1985 before debt rescheduling appears to be fully covered.

13. The Government will continue to monitor closely developments in the country's debt situation. While a respite has been obtained in servicing the external debt in the medium term, the need to make provision for the eventual payment remains. The performance criteria established for medium- and long-term debt disbursements will be maintained. However, owing to technical considerations, we are requesting that the performance criterion related to short-term external debt be modified as set out in paragraph 7 of the Technical Memorandum.

14. Substantial progress has been achieved in the settlement of external payments arrears. The authorities will reduce arrears further during the second half of 1985 through cash payments of at least US$40 million. It is estimated that, as a result of reduction of arrears through cash payments and through renegotiations with the Paris Club and the commercial banks, the outstanding level of external payments arrears will be less than US$100 million by the end of 1985, compared with US$507 million at the end of 1984.

15. The performance criteria for end-September and end-December 1985 are specified in in the Technical Memorandum attached to this letter.

16. The authorities of the Dominican Republic believe that the measures described are adequate to attain the objectives of the program of adjustment described in EBS/85/75 (3/27/85) and they will take any additional measures deemed necessary. Furthermore, the authorities of the Dominican Republic will consult periodically with the Fund, in accordance with the Fund's policies on such consultations, to examine the progress that has been made in implementing the program and the achievement of its objectives. In particular, the Dominican Republic will review with the Fund

before February 28, 1986, the implementation of the economic program described herein and the evolution of economic activity during the second half of 1985, and economic policies to be pursued for the remaining period of the arrangement.

Sincerely yours,

Hugo Guiliani Cury
Governor, Central Bank

Orlando Haza
Technical Secretary
of the President

Manuel Cocco
Secretary of Finance

Milton Messina
Economic Counselor of
the President

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum specifies the nature of the quantitative performance criteria established for the remainder of the stand-by program and provides additional details on certain measures contained in the letter of intent of October -- ,1985. Except when modified by this memorandum, the understandings, definitions, and specifications set forth in the technical memorandum attached to the letter of intent of February 28, 1985 continue to apply.

1. The proceeds of the temporary foreign exchange taxes, which are being credited to a special account in the Central Bank, are to be distributed in the following manner: (a) to compensate the Central Bank for the interest it pays on the foreign debt it assumed under the 1983 rescheduling agreement with commercial banks, estimated at US$70.8 million (RD$219.5 million) in 1985, and for the interest it is owed on its holdings of central government bonds estimated RD$48.8 million in 1985; (b) to compensate the Electricity Company (CDE) for part of the additional oil import and debt service costs arising from the unification of the exchange system, determined by the amount by which the actual exchange rate exceeds RD$1.8 per U.S. dollar and estimated at RD$250 million in 1985; and (c) to compensate the nonfinancial public sector (excluding the CDE) for its additional debt service costs with the residual amount.

In the first quarter of 1986, the exchange tax on receipts from traditional exports and services will be reduced from 36 percent to 20 percent. The Central Bank will continue to be compensated for the afore-mentioned obligations, while the compensation to the CDE will be reduced to no more than RD$60 million as further increases in electricity tariffs take effect and cost-reducing measures are put into place. Again, any remaining proceeds of the surcharge will be used to compensate the nonfinancial public sector (excluding the CDE).

2. In order to bring budgetary procedures in line with the unified foreign exchange system, the budget which the Government will present to the Congress for 1986 will register all foreign exchange operations at an accounting exchange rate of RD$3.0 per U.S. dollar. However, because of legal considerations a special budgetary appropriation will be created to absorb the incremental foreign exchange costs in excess of a rate of RD$1 per U.S. dollar.

3. The stock of combined net credit of the Central Bank and the Banco de Reservas to the public sector, which is now estimated to have been RD$1,810.8 million on December 31, 1984 and had fallen to RD$1,603.1 million on June 30, 1985, shall not exceed RD$1,750.0 million on September 30, 1985 and RD$1,810.8 million on December 31, 1985 (Table 1). The ceilings on such credit will be reduced to the extent that ESF grant counterpart funds are disbursed to public sector entities net of any subsequent repayments, in the full amount of such net disbursements. In addition, inasmuch as funds are transfered to the Central

Government's deposit account from the counterpart deposits for the ESF grant on a net basis, the ceilings will be adjusted downwards.

4. The net domestic assets of the Central Bank, which declined by RD$309.4 million during the period January-June 1985 and stood at RD$1,501.9 million on June 30, 1985, will decline by no less than RD$180.0 million during the period January-September 1985 and by no less than RD$207.4 million during the period January-December 1985 (Table 2). These ceilings will be adjusted pari passu with the adjustment specified in paragraph 5 below.

5. The net foreign assets of the Central Bank which were negative US$335.9 million on December 31, 1984 and negative US$285.7 million on June 30, 1985, will not be less than negative US$335.0 million on September 30, 1985 and will not be less than negative US$266.6 million on December 31, 1985 (Table 3). In the period January-August 1985, the Central Bank liquidated an amount of US$20.8 million of letters of credit in arrears but not included in the Bank's foreign reserve liabilities. The above targets for the Central Bank's net foreign assets will be reduced by the amount of any payments of such arrears up to a maximum of US$14 million in the period September-December 1985.

6. External payments arrears, including arrears to Paris Club creditors and commercial banks, are now estimated to have been US$506.6 million on December 31, 1984 and US$441.5 million on June 30, 1985. The reduction of such arrears through cash payments, which amounted to US$65.1 million in the period January-June 1985, will not be less than US$74.0 million in the period January-September 1985 and will not be less than US$105.0 million in the period January-December 1985 (Table 4). It is estimated that more than US$300 million of such arrears will be rescheduled as a result of the agreements reached in 1985 with Paris Club creditors and commercial banks. External payments arrears outstanding on December 31, 1985, excluding those being rescheduled under the afore-mentioned agreements, will be eliminated through cash payments in the course of 1986.

7. The ceilings that shall apply from December 31, 1984 through December 31, 1985 to disbursements of nonconcessional external public and publicly guaranteed debt are specified in Table 5.

Table 1. Dominican Republic: Quarterly Ceilings on Combined Central Bank and Reserve Bank Net Credit to the Public Sector 1/

(In millions of Dominican pesos)

	1984	1985			
	Dec. 31	Mar. 31	June 30	Sept. 30 2/	Dec. 31 2/
Net credit to the public sector	1,810.8	1,738.9	1,603.1	1,750.0	1,810.8

1/ December 31, 1984 through June 30, 1985 are actual figures.

2/ The ceiling will be adjusted to reflect the full amount of any revisions in the outstanding stock as of December 31, 1984. In addition, the ceiling will be adjusted for any net use by the public sector of ESF grants which are classified outside the ceiling, and for any net transfers from the ESF grant counterpart deposit account to the Central Government's deposit account.

Table 2. Dominican Republic: Cumulative Reduction of Net Domestic Assets of the Central Bank, 1985 1/

(In millions of Dominican pesos)

	Outstanding December 31, 1984	1985			
		Mar. 31	June 30	Sept. 30 2/	Dec. 31 2/
Net domestic assets	1,632.2	-118.3	-309.4	-180.0	-207.4

1/ Defined as the difference between the currency issued and the net foreign assets of the Central Bank (converted into pesos at an average of the rates at which transactions actually took place during the period). December 31,1984 through June 30, 1985 are actual figures

2/ This ceiling will be adjusted to take account of any further payment of letters of credit for which there is no corresponding reserve liability to a maximum of RD$40 million.

Table 3. Dominican Republic: Quarterly Targets for Net Foreign Assets of the Central Bank, 1985 1/

(In millions of U.S. dollars)

	1984	1985			
	Dec. 31	Mar. 31	June 30	Sept. 30 2/	Dec. 31 2/
Net foreign assets	-335.9	-345.3	-285.7	-335.0	-266.6

1/ December 31, 1984 through June 30, 1985 are actual figures.
2/ The ceiling will be adjusted to the extent that unpaid letters of credit, which do not have corresponding reserve liabilities, are liquidated to a maximum of US$14 million.

Table 4. Dominican Republic: External Payments Arrears, 1984-85

(In millions of U.S. dollars)

	Outstanding Dec. 31, 1984	Cumulative Cash Reduction in 1985		
		June 30	Sept. 30	Dec. 31
Arrears	506.6 1/	65.1 2/	74.0	105.0

1/ Excludes certain potential obligations that could arise from the Monetary Board's Resolution of May 10, 1984 and on which a decision has not been made as yet.
2/ Actual figure.

Table 5. Dominican Republic: Ceilings on Disbursements Under Nonconcessional External Public and Publicly Guaranteed Debt

(In millions of U.S. dollars)

Maturities (Years)	Dec. 31, 1984-Dec. 31, 1985
0-1 year (net)	--
Disbursements during the year 1/	
Over 1 year, and no more than 12 years	198.5
Of which: Over 1 year, and no more than 5 years	64.2

1/ Excludes restructurings and/or refinancings.