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Dominica: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Financing Assurances Review—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Dominica

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and financing assurances review, the following documents have been released and are included in this package:

- the staff report for the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and financing assurances review prepared by a staff team of the IMF, following discussions that ended on **February 12, 2004,** with the officials of Dominica on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 10, 2004**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the **views of the Executive Board as expressed during its March 24, 2004** discussion of the staff report that completed the review.

- a statement by the Executive Director for Dominica.

The document listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Dominica*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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DOMINICA

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Financing Assurances Review

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by José Fajgenbaum and Matthew Fisher

March 10, 2004

- **Poverty Reduction and Growth Facility.** The Executive Board approved a three-year PRGF arrangement for SDR 7.7 million (94 percent of quota) on December 19, 2003. At the same time, the second review under the SBA was completed and the arrangement was cancelled. The PRGF-supported program aims at restarting growth and reducing unemployment-related poverty through a significant strengthening of the fiscal position and an ambitious structural reform agenda, including a comprehensive debt restructuring. The I-PRSP was endorsed by the Boards of the World Bank and the IMF on December 29 and the first loan of SDR 2.4 million under the PRGF arrangement was disbursed shortly thereafter.

- **Recent Developments.** The economy has bottomed out, inflation remains under control and policy performance continues to be strong. A budgetary crisis has been averted so far and external financing shortfalls have been reversed. Prime Minister Skerrit, appointed following the sudden death of Prime Minister Charles in early January, reiterated the Governments' commitment to the program.

- **Key Issues**. There were no disagreements on the policy front and all performance criteria for end-December 2003 were observed. The structural benchmark under the cancelled SBA relating to the divesture of the National Commercial Bank for end-December was also observed. The mission assisted the authorities with preparations for the 2004/05 budget. The debt restructuring process is well underway, and early agreement on the debt restructuring will be crucial to secure adequate financing for the program. The debt negotiations could be complex and difficult. The mission identified the need for significant technical assistance in the next six months and coordinated efforts with the donor community.

- **Discussions.** These took place in Roseau on February 2–11. The mission met with Prime Minister Skerrit, the Cabinet, Program Coordinator, Lestrade, other senior officials and private sector representatives, including labor unions. Representatives from the ECCB participated in the discussions. The mission took part in a donors' meeting on February 5 and had a press conference on February 10. The staff team consisted of A. Santos (Head), R. Randall, P. Dyczewski, (all WHD), S. Seshadri (PDR), and A. Ivanova (FAD).

- **Publication.** The authorities agree to publish the staff report and the letter of intent.

List of Acronyms

CARTAC	Caribbean Regional Technical Assistance Center
CAS	Country Assistance Strategy
CDB	Caribbean Development Bank
CIDA	Canadian International Development Agency
CIRR	Commercial Interest Reference Rates
DFID	U.K. Department for International Development
DSS	Dominica Social Security
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
EFF	Extended Fund Facility
EU	European Union
FRL	Fiscal Responsibility Law
FSAP	Financial Sector Assessment Program
FY	Fiscal Year
GDDS	General Data Dissemination System
GFS	Government Finance Statistics
IFS	International Financial Statistics
I-PRSP	Interim Poverty Reduction Strategy Paper
IT	Indicative Target
JSA	Joint Staff Assessment
LEG	Legal Department
LOI	Letter of Intent
LPO	Local Purchase Order
MEP	Memorandum of Economic Policies
NCB	National Commercial Bank
NDC	National Development Corporation
NPC	Negative Pledge Clause
OECD	Organization for Economic Co-operation and Development
OECS	Organization of Eastern Caribbean Countries
PC	Performance Criteria
PDR	Policy Development and Review Department
PRGF	Poverty Reduction and Growth Facility
PSIP	Public Sector Investment Program
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
TMU	Technical Memorandum of Understanding
UNDP	United Nations Development Program
VAT	Value Added Tax
WB	World Bank
WHD	Western Hemisphere Department

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I. Recent Developments

1. **The political situation remains stable following the sudden death of Prime Minister Charles on January 6, 2004**. Parliament rapidly appointed Mr. Roosevelt Skerrit, the former Minister of Education, as the new prime minister. In the attached letter of intent, Prime Minister Skerrit reiterates his commitment to the program. There were only marginal changes in the cabinet, and national elections are expected by January 2005.

2. **The economy appears to have bottomed out, and there are indications of an early recovery.** Following an economic contraction of almost 10 percent in 2001–02, the economic decline appears to have ended. Data for the last quarter of 2003 indicate a modest recovery in manufacturing, construction, and tourism, partly offset by lower production levels in the banana sector. Other indications of the incipient recovery are buoyant tax collections, and rapid import growth. Exports (except for bananas) are also beginning to rebound. On the negative side, credit to the private sector continues to contract—although at a slower rate—due to weak business demand. The revised program for 2003 was based on the assumption that real GDP could fall by 1–3 percent, but the most recent data suggest that the economic decline has been arrested and that real GDP was flat in 2003.

3. **Inflation rose due mostly to one-off price adjustments, as demand remained weak**. Inflation picked up from ½ percent in 2002 to just under 3 percent in 2003. The main reason for this uptick in inflation is related to the tax measures adopted in the context of the 2003/04 budget, and the electricity tariff adjustment in August 2003, following the elimination of duty-free concessions to the electricity company.

4. **Performance under the program continues to be strong**. Policy implementation has strengthened significantly since the modification of the Stand-By Arrangement (SBA) in July 2003. All performance criteria under the PRGF-supported program for end-December 2003 were observed. In particular, the overall fiscal target was observed with large margins. It is estimated that the overall fiscal position was roughly in balance in the second half of 2003. This positive performance reflected better-than-expected improvements in tax collections (including on tax arrears), and a significant but temporary expenditure compression. In addition, the structural benchmark for end-December under the cancelled SBA related to the divesture of the National Commercial Bank (NCB) was observed.[1]

[1] The government sold 2 percent of its NCB shares in December, reducing its ownership from 51 to 49 percent and the number of government-appointed Directors from 4 to 3 (while the number of Directors increased from 7 to 8). The bank was renamed the National Bank of Dominica.

5. **Approval of the PRGF catalyzed significant external resources**. Following the approval of the PRGF on December 19 and the World Bank and IMF endorsement of the I-PRSP on December 29, the EU disbursed the remaining tranche of its grant (about US$1 million) and the CDB disbursed the second tranche of its budgetary support loan (US$1 million). In addition, the World Bank approved the Economic Recovery Support Operation (ERSO) loan on January 29, 2004 (aimed at strengthening the public administration and the financial system). The management of the World Bank agreed to present this operation to their Board despite an apparent violation of the negative pledge clause on Dominica's IBRD loans. The last tranche of the CDB loan (US$1 million) is expected to be released shortly, and the Fund will make available US$0.5 million upon completion of this review.

Dominica: External Support 2003/04
(In millions of U.S. dollars)

	Committed	Disbursed 1/	Balance
IMF	5.6	4.7	0.9
Barbados 2/	4.7	4.7	--
Trinidad and Tobago 2/	4.0	4.0	--
European Union	3.3	3.3	--
World Bank	3.0	3.0	--
CDB	3.0	2.0	1.0
Bahamas	1.5	1.5	--
ECCB	1.0	1.0	--
Total	**26.1**	**24.2**	**1.9**

Source: Dominican authorities.
1/ Preliminary as of end-January 2004.
2/ Bond roll over.

6. **The debt restructuring process is progressing as envisaged**. Following the creditors' meeting in Barbados on December 17, the authorities and their debt advisors had a roadshow during January 19–23 in Dominica, Barbados, St. Lucia, and Trinidad and Tobago to meet with the wide spectrum of creditors (including domestic) and exchange views. Based on these discussions, options will be presented to creditors in mid-March with the aim of finalizing the deal by early-April. The authorities and staff have also been in contact with the Paris Club Secretariat to inform them about their strategy. Dominica has had preliminary contacts with the United Kingdom and France regarding a meeting of the "Friends of Dominica" group, as there are too few bilateral creditors for a full meeting of the Paris Club. The staff attaches great importance to proceeding expeditiously with a multilateral resolution to Dominica's official bilateral debt. Specific debt proposals have been exchanged with the CDB.

7. **Market reaction to the announcement of the debt strategy has been benign**. Domestically, the situation has been managed very well. Deposits have been stable and there have been no pressures on domestic banks. Regionally, there is no evidence of financial turbulence related to this announcement. Reactions among creditors have been mixed. While individual creditors understandably are disappointed, on the whole they recognize that the debt situation is unsustainable and that a restructuring is necessary. Most creditors have been pleased with Dominica's approach to the debt restructuring as best practices are being adopted in dealing with creditors, including transparency and inter-creditor equity. Nevertheless it should be recognized that it may be difficult to secure agreement on a restructuring that includes sufficient relief to restore sustainability.

II. Policy Discussions

8. **There was broad agreement that the program is achieving its goals**. The authorities reiterated their commitment to the program, and were pleased with recent macroeconomic outcomes. They also reaffirmed their medium-term objectives of restoring economic growth and sustainability. They were encouraged with the progress made thus far in the debt negotiations, and the recent strengthening of the fiscal position. The authorities also expect unemployment-related poverty to be reduced once the economy starts growing.

A. Macroeconomic Framework

9. **The authorities were encouraged by the stronger-than-envisaged performance but considered it premature to change the macroeconomic framework**. While the authorities were pleased with the apparent bottoming out of the economy, they felt it was too soon to change the program assumptions. The mission agreed with the authorities' assessment. Furthermore, the recent encouraging developments on the growth front enhanced the credibility of the macroeconomic framework and increased the chances of success. There was agreement that the price adjustments observed since August 2003 had only a temporary impact on measured inflation, and that the inflation objective of 1½ percent for 2004 remained feasible.

Dominica: Macroeconomic Framework, 2002-2004

	SBA			PRGF
		Prog. 1/	Est.	Prog.
	2002	2003		2004
(In percent)				
GDP growth	-4.7	-1 to -3	0.0	1.0
Inflation	0.5	0.5	2.9	1.5
Current account/GDP	-15.0	-15.1	-16.9	-15.4
(In percent of GDP, fiscal year)				
Structural primary balance	-4.5	-3.0	-2.0	0.5
Overall fiscal balance	-7.1	-7.7	-5.5	-5.5
Public debt (NFPS)	111.5	113.6	114.6	...

Sources: Dominican authorities; and Fund staff estimates.
1/ As modified in July, IMF Country Report 03/293.

B. Fiscal Policy

10. **While the fiscal margins observed through end-2003 are expected to narrow somewhat, the targets for the first half of 2004 remain comfortably feasible**. The overperformance on the overall fiscal target for end-December 2003 has been due to a combination of higher-than-anticipated revenues and lower-than-programmed expenditures. However, these factors are not expected to continue. In particular:

- ***On the revenue side***, there has been a significant collection of tax arrears, which accumulated since the outset of the contractive economic phase and cannot be sustained as the stock of tax arrears has declined to low levels. At the same time, some of the projected gains in nontax revenues may not materialize due to a dispute with the largest telephone company over the level of license fees following the liberalization of the telecommunications sector.

- ***On the expenditure side***, there has been budgetary sequestration mostly on expenditures related to goods and services and the savings of the last six months are likely to be temporary as the budget is fully implemented. The legally authorized expenditure limits are likely to be used once the budgetary allocations are assigned to the proper spending units.

All in all, the staff estimates that for FY 2003/04 there will be a small primary surplus, which is consistent with the program.

11. **The authorities are conducting preparatory work for the 2004/05 budget and reaffirmed their commitment to a primary surplus of ½ percent of GDP**. The budget is expected to be submitted to parliament in mid-June. This is going to be a complex budget not only because of the agreed fiscal measures, amounting to 2½ percent of GDP (see IMF Country Report No. 04/6), but also because of the interaction with the structural reform agenda. In this regard, the proper and timely design and execution of the public sector reform will be key to the success of the budget. The mission and the authorities recalibrated fiscal projections for 2004/05 and reached the conclusion that the objective of reaching a primary surplus of ½ percent of GDP continues to be feasible, provided that the agreed fiscal measures are adopted.

12. **Progress in reducing tax exemptions has been in line with the program, although there is room for improvement in the mechanisms used for granting these exemptions,** notwithstanding the creation of a committee to oversee their approval.[2] This is a complex area where the mission and the authorities are discovering that the distinction between discretionary and statutory tax exemptions is at times blurred. In several cases, the committee's recommendations against granting a tax exemption was legally challenged and eventually reversed. The mission gathered all the relevant information and is coordinating with FAD policy recommendations on how best to address the situation. The authorities are expected to present solutions to the problem in the context of the comprehensive review of discretionary and statutory tax exemptions expected by June, a benchmark under the program (Box 1).

13. **The rate of implementation of the public sector investment program has been strong.** This is a positive development as an accelerated public investment (mostly financed with external grants and soft loans) has helped to bring the economy back from the severe contraction. The program allows public investment to be 1 percent of GDP higher than budgeted to reach a maximum of 8 percent of GDP, which is likely to materialize. Consistent with sustainability, the focus of the fiscal program will switch to a primary balance objective,

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[2] In fact there were only a few discretionary tax exemptions given under the narrow program definitions (see the Technical Memorandum of Understanding, IMF Country Report No. 04/6). This is in line with the measure adopted in December 2003 to comply with the prior action for the approval of the PRGF.

which allows higher public sector investment while requiring that it be offset by higher revenues or lower current expenditures. To this end, the program adjustor for up to 1 percent of GDP for investment outlays will no longer apply after June 2004.

14. **The debt restructuring will ease recent financing constraints.** Despite the fiscal overperformance, the financing situation became difficult in December 2003 owing to delays in donor financing, and a couple of debt service payments (to Venezuela and Taiwan) were delayed for a few weeks. The delays were covered by grace periods in the loan agreements, or not considered to be arrears by the creditor, and therefore they were not deemed to be arrears for program purposes. Thus, the continuous performance criterion on nonaccumulation of external arrears was observed. The external support unlocked by the PRGF was available only at the end of December and in January. A similar situation could emerge in the second half of April if the debt restructuring is not completed. The authorities remain confident that the debt deal could be finalized before these financing pressures are manifested.

C. Monetary Issues

15. **Liquidity conditions in the banking system remain abundant but need to be monitored closely**. The authorities indicated that they would follow liquidity developments in the banking system, while acknowledging the limited role of the government on monetary policy in the context of a currency union. The authorities support the recommendations made by the FSAP mission designed to strengthen the ECCB's regulatory and enforcement powers (Box 2). The announcement of the debt restructuring did not have a significant impact on the functioning of the financial system, as noted above, but the situation needs to be monitored closely. In fact, deposits continued growing and liquidity remains ample as credit demand remains low due to the weak economy. As a consequence, the higher deposits are invested abroad, increasing banks' net foreign asset position. Thus, banks are capable of withstanding some tightening of liquidity conditions. The capital of the banking system is not expected to be eroded as a result of the debt restructuring.

16. **The authorities saw some scope for the ECCB to ease its interest rate policy to facilitate the economic recovery and reduce capital inflows**. There is an increasing awareness that the ECCB minimum deposit rate is creating a floor on interest rates in the region at a time interest rates in the U.S., are at historical lows. The positive spread in interest rates in favor of the Eastern Caribbean dollar creates an incentive for capital flows to the region that cannot be discouraged because the minimum deposit rate imposes a binding floor on the structure of interest rates. The relatively high domestic interest rate creates a recessive bias in the economy as investment is discouraged and growth is reduced. The interest rate disparity could erode the profitability of the banking system as banks increase their net foreign asset position rather than intermediate the deposits domestically, due to weak credit demand. The authorities intend to express their views at the next meeting of the ECCB's monetary council.

D. External Issues

17. **The program's financing assurances are provided by the prospect of having a comprehensive debt restructuring**. The staff estimates that there are enough resources to cover the financing needs through late-March or early-April. There is a residual financing gap of US$21 million for the rest of 2004 that is expected to be covered by the debt restructuring (IMF Country Report No. 04/6). The authorities expect to finalize a consensual debt restructuring by early-April while servicing their obligations during this time, as envisaged under the program. Progress has been made toward completing the debt restructuring and the authorities continue to negotiate in good faith with all creditors. In the staff's view, the authorities have followed best practices in dealing with creditors.

18. **The authorities will need to follow strict borrowing policies to ensure that sustainability is preserved**. Once a successful debt restructuring is achieved and sustainability is regained, the authorities would need to adopt a rigorous debt management policy. While access to capital markets is not expected any time soon, there will continue to be significant donor flows for project financing. The authorities would need to prioritize the public investment program and implement only those projects with high social returns.

19. **This staff report does not include a debt sustainability scenario as the debt negotiations have not been concluded**. The authorities have determined that the debt situation is not sustainable, an assessment with which the staff concurs (IMF Country Report No. 04/6). Sustainability will be regained only after the successful completion of the debt restructuring, provided that the authorities continue with their fiscal adjustment efforts. Preliminary calculations suggest that significant amounts of debt reduction in net present value terms would be required to regain sustainability. The staff will present a debt sustainability analysis once the terms of the debt restructuring are known.

E. Structural Reform

20. **The heavy structural reform agenda that needs to be implemented in the next few months requires significant technical assistance**. The main structural reform area pertains to fiscal issues. A donors' meeting was organized in Roseau on February 5 with the purpose of coordinating the necessary technical assistance from the different agencies. Donors agreed that while the number of benchmarks was low, the agenda was ambitious but necessary, as the reforms envisaged were quite substantive. Donors acknowledged that, because of the broad range of reforms, it would be difficult to provide the necessary technical assistance at such short notice. However, the authorities are committed to the reform agenda and efforts will be made to provide the required assistance so as to be able to implement all agreed reforms. The authorities have appointed an official to coordinate this assistance and liaise with aid agencies to ensure that the program remains on track.

- ***Public sector reform***. The objective of this reform is to reduce the wage bill by 10 percent in nominal terms over the next two fiscal years (through labor retrenchment). This is perhaps the single most important reform in the program, as it integrates key structural and macroeconomic areas. This reform needs to be ready by June 2004 so that it can be implemented with the 2004/05 budget. A benchmark under the program is to conduct a study by end-March 2004 outlining the process by which the target of a 5 percent reduction in the wage bill for 2004/05 will be achieved. The European Union (EU) is taking the lead in providing technical assistance; they are financing two resident experts in this area and will provide a grant of US$8 million to finance severance packages for retrenched workers. The World Bank and the United Kingdom Department for International Development (DFID) is also providing technical assistance and helping to coordinate efforts in this difficult reform area.

- ***Tax policy***. The objective of this reform is to rationalize tax exemptions and incentives in order to broaden the tax base. There is an increasing awareness that this is a more complex reform area than initially thought. A benchmark under the program is to conduct a review of all statutory and discretionary tax exemptions by end-June 2004. The Fund is taking the lead in providing advice in this area, and policy recommendations will be sent to the authorities shortly for their consideration. The EU will also provide some assistance.

Dominica: Structural Reform Agenda for 2004

Reform Area	Conditionality (Date)	Objective	Technical Assistance Provider
1. Public Sector Reform	Benchmark (March)	Reduce wage bill 10% in two years	EU WB
2. Tax Policy	Benchmark (June)	Rationalize tax exemptions	IMF EU
3. Pension Reform	Benchmark (June)	Increase retirement age for public servants to 60 years	IMF UNDP CARTAC
4. Tax System	Benchmark (September)	Introduce the VAT by FY 2005/06	CARTAC IMF
5. Budgetary Procedures	Performance Criteron (July)	Budget consistent with program; and 3-year budget	DFID CIDA CARTAC
6. Fiscal Responsibility Law	Measure	Guide fiscal policy over business cycle	IMF CARTAC
7. Institutional Strengthening	Benchmark (September)	Improve framework for electricity sector	WB

Sources: Dominican authorities and Fund staff.

- ***Pension reform***. The objective of this reform is to review the financial position of the social security system and to increase the retirement age of civil servants from 55 to 60 years. A benchmark under the program is to submit legislation to parliament to increase that retirement age by end-June 2004. The Fund is taking the lead in coordinating efforts and providing advice; FAD has been studying the situation and will be preparing a policy note to assist the authorities. The United Nations Development Program (UNDP) will also provide some support in this area, and the Caribbean Regional Technical Assistance Center (CARTAC) is organizing a seminar in April on the subject.

- ***Tax system***. The objective of this reform is to conduct preparatory work for the introduction of the VAT in 2005. The budget for 2004/05 will announce the adoption of the tax the following fiscal year. A benchmark under the program is the approval by cabinet of key parameters for the tax by end-September 2004. CARTAC and FAD are taking the lead in providing technical assistance in this area. The preparatory work is already well advanced, and the authorities intend to step up their efforts to remain on schedule.

- ***Budgetary procedures***. The objective of this reform is to design a 2004/05 budget that is consistent with the program, and that introduces three-year rolling budgetary projections to better reflect medium-term policy intentions. Approval of the 2004/05 budget consistent with the program is a structural performance criterion for end-July 2004. It was acknowledged that while the cash management system had been effective, there was room for improvement. DFID is taking the lead in providing technical assistance on the three-year rolling budgetary projections and cash management system, while the Canadian International Development Agency (CIDA) and CARTAC are providing some additional support.

- ***Fiscal Responsibility Law (FRL)***. The objective of this reform is to guide fiscal policy over the business cycle and prevent an unsustainable accumulation of debt. The introduction of a FRL was initially scheduled for the 2005/06 budget but, during the Board discussion in December 2003, a strong case was made for the advancement of this measure to the 2004/05 budget to increase credibility for the debt deal and reduce political uncertainty. The authorities have agreed to bring this reform forward to the extent possible. The mission is taking the lead in coordinating efforts and providing advice to the authorities while CARTAC is also expected to be involved.

- ***Institutional strengthening***. The objective of this reform is to improve the regulatory framework for electricity supply. A benchmark under the program is the adoption of amendments to this regulatory framework by end-September 2004. The World Bank is taking the lead in providing technical assistance in this area.

21. **The authorities embraced this ambitious structural reform agenda as a necessary course of action to address the complex problems faced by Dominica**. While there is room for prioritizing, the authorities are of the view that it would be best to try to accomplish all the reforms initially at once, so that the 2004/05 budget is laid on a sound foundation to ensure the return to sustainability.

F. Program Related Issues

22. **The new letter of intent reaffirms the new cabinet's commitment to the program**. The authorities felt that there have been enough assurances provided to society and creditors about their commitment to the program despite the changes in the leadership of the country. However, in order to reiterate that commitment, Prime Minister Skerrit has written a simple

letter of intent which reaffirms the commitment of the Government of Dominica to the PRGF-supported program.

23. **Some progress has been made in the preparation of the full Poverty Reduction Strategy Paper (PRSP)**. The interim paper (I-PRSP) was endorsed by the World Bank and IMF Boards in late December 2003. Work continues on the consultative process and the preparation of the full paper. However, the conditions for sustained growth and permanent poverty reduction will be established only after the restructuring deal has been secured, a budget for 2004/05 according to the program has been presented to parliament, and the heavy structural reform agenda begins to be implemented. The work on the PRSP continues, albeit at a slower pace, given the capacity constraints in public administration. The authorities remain confident that the full PRSP will be finalized by end-2004 as originally envisaged.

III. STAFF APPRAISAL

24. **The program had a good start, reflecting the authorities' commitment and determination.** The authorities should be commended for their continued strong performance under difficult conditions, following the modification of the Stand-By Arrangement in July 2003. All performance criteria and benchmarks have been observed since then, including those covered under the first PRGF review. There have certainly been several encouraging developments, including the bottoming out of the economy, the recovery in tax collections and regained control over the budgetary process. However, there are many challenging tasks ahead that will require careful implementation as the structural reform agenda interacts more closely with the macroeconomic program.

25. **The implementation of the debt strategy continues to be at the top of the list in measures that need to be implemented in the very short run**. The staff is encouraged to see that the authorities and their advisors have adopted best practices in facing this complex restructuring negotiation that involves different classes of creditors, while continuing to service their debt obligations. The debt restructuring will provide the required financing under the program and will be an important factor in regaining sustainability.

26. **A continuation of the fiscal consolidation efforts would be key to the success of the program**. The authorities' renewed commitment to a primary surplus of ½ percent of GDP for the 2004/05 budget, as envisaged in the program, is a critical step towards reaching a primary surplus of 3 percent of GDP by 2006/07 and thereby ensure the return to a sustainable situation. To this end, it is important that all measures envisaged under the program are implemented in the context of the 2004/05 budget and that the authorities continue conducting a tight fiscal policy, as programmed.

27. **On the structural reform agenda, the key issue is the public sector reform**. This is an extremely complex reform that will require careful coordination of a wide variety of issues ranging from managerial criteria and the legal basis for the retrenchment and compensation to ensure proper financing for the reform. The authorities are fully aware of the importance of this reform to the success of the program and are paying special attention

to its proper implementation, including by having weekly meetings to monitor progress and resolve possible bottlenecks.

28. **The prioritization of tasks and provision of technical assistance will be critical to the success of the program**. The donor community recognizes the level of complexity in the reform agenda and the authorities' limited implementation capacity. Against that background, it becomes indispensable that appropriate technical assistance is provided on a timely and coordinated basis to enhance the chances of program success.

29. **The many risks mentioned on previous occasions continue to be valid**. However, to the extent that the program continues performing, the risks are mitigated. Continued strong program performance and implementation of the debt strategy would significantly reduce those risks. On the latter, additional efforts are needed to ensure its success. Financing assurances under the program are at risk in the event the debt restructuring is not completed. At the same time, there is political uncertainty, as there could be elections in January 2005. Similarly, there are legal challenges to the 5 percent wage cut of last July and there might be further challenges to future policies. There is a need to establish priorities in the structural agenda to avoid the risk of the agenda not being implemented. However, the policies included in the program are necessary and need to be pursued with determination.

30. **In view of the strong performance and the renewed commitment to the program, the staff supports completion of the first review and the financing assurances review under the PRGF**. Given the positive performance under the program, the observance of all performance criteria, the expectation that future targets will be achieved, the request for technical assistance to implement the reform agenda and the negotiations in good faith with creditors, the staff supports the authorities' request for completion of the first review and disbursement of the second loan under the PRGF.

Box 1: Dominica—Tax Exemptions

Exemptions have significantly eroded Dominica's tax base. The average effective rate of tax on consumption of non-oil products—the ratio of revenues to consumption—was about 6 percent over the last three years, far lower than the statutory consumption tax rate of 25 percent. While this difference can be partly explained by tax evasion on domestic consumption, most is attributable to the erosion of the tax base through import concessions (since an important portion of Dominica's consumption is imported). Another striking indicator of the degree of proliferation of tax exemptions is the revenue loss from indirect tax concessions at the border, estimated at 5 percent of GDP (equivalent to about 30 percent of tax revenue collected on international transactions).

Dominica's legislation contains multiple provisions for direct and indirect tax concessions. Provisions for tax exemptions are scattered in over 10 different pieces of legislation. The most important in terms of revenue loss is the Fiscal Incentives Act, which aims at promoting economic growth and development and is based on the Harmonization of Fiscal Incentives agreement between the countries of the Caribbean Common Market. Only under this law revenue foregone from concessions on consumption tax, import duties and other taxes at the border comprised 1.4 percent of GDP in 2003. At the same time, entitlement to most of the concessions is not clearly defined in the law and requires approval by either the minister of finance or the cabinet. All this makes the administration and monitoring of tax exemptions difficult and opens opportunities for abuse.

The authorities face serious challenges in administering and monitoring tax exemptions. The ministry of finance reviews about 40 applications for tax exemptions every month, and few people in the ministry are fully familiar with the relevant legislation. There is essentially no monitoring of tax exemptions, partly because of administrative capacity constraints and partly due to the poor coordination between the responsible institutions. For instance, the National Development Corporation (NDC), which provides recommendations on granting concessions under the Fiscal Incentives Act, has to advise customs about the cases when import concessions are abused and the duty needs to be reinstated; in practice, NDC rarely follows up on exemptions granted and the submission of income statements by the enterprises granted tax holidays is not enforced.

Box 2: Dominica—FSAP Principal Findings and Key Recommendations

I. Principal Findings:

The Financial System Stability Assessment identified the following significant threats to the financial stability of the Eastern Caribbean region as a whole, which are even more pronounced in the case of Dominica:

A. Commercial Banks

The region's banks are characterized by "an unacceptably high" level of nonperforming loans, with the weakest banks—now on the ECCB's watch list—accounting for approximately 41 percent of banking assets.

While often exceeding Basle norms, the quality of the capital of local banks is uncertain, owing to: under provisioning of nonperforming loans, recording of accrued interest on government loans in arrears as income, and assignment of zero risk weights to public sector loans in arrears.

There are identifiable weaknesses in the current commercial bank regulatory and supervisory framework, which should be addressed in part by the proposed amendments to the Uniform Banking Act and commercial bank prudential regulations. However, there is also a need to strengthen the ECCB's on- and off-site monitoring capabilities as well as its supervisory enforcement powers.

B. Nonbank financial institutions (NBFI) and offshore banks

Although of lesser systemic importance, the supervision of NBFIs is currently the responsibility of the individual member countries' registrar of cooperatives, and supervisory framework lacks harmonization. Offshore banks are currently regulated and supervised by the individual ministries of finance, and effective regulation is hampered by data constraints and by weak on- and off-site inspection programs.

II. Main Recommendations:

A. ECCB Priorities

The ECCB was urged to take immediate action in the following areas: (a) reprioritizing of its resources and work program to focus on the regulation and supervision of domestic banks, especially with respect to on-site inspection; (b) developing a more structured program of supervision tailored to the risks inherent in each institution; (c) strengthening prudential regulations by: setting minimum capital commensurate with the risks of each institution; revising guidelines on the accrual of interest; and providing regulations on market (e.g. foreign exchange) risk; (d) mitigating the union-wide risks posed by government bank borrowing by assigning risk-weights for the purpose of establishing minimum capitalization and requiring provisioning on nonperforming government debts; and (e) enhancing crisis prevention through the strengthening of early warning systems and better crisis containment with the creation of an operational crisis contingency framework that is endorsed by all members.

B. Measures t Refine the Regulatory Architecture for the Remainder of the Financial System

There is currently a proposal to establish a Single Regulatory Unit within each country, to supervise nonbank financial institutions and offshore banks, with the exception of any large institutions of potentially systemic importance—such as large credit unions (e.g., the Roseau Co-operative Credit Union in Dominica, with assets of approximately EC$170 million), and some building societies. It is also recommended that the regulation of insurance companies could be strengthened by increased cross-border regulatory cooperation.

Table 1. Dominica: Quantitative Performance Criteria (PC) and Indicative Targets (IT)
Under SBA and PRGF for 2003 1/

	SBA									PRGF			
	July 31			September 30			December 31						
	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Mar. 31 (PC)	Jun. 30 (PC)	Sept. 30 (IT)	Dec. 31 (IT)
I. Performance Criteria													
(In millions of Eastern Caribbean dollars)													
Central government overall balance 2/ 3/	-30.4	-15.9	14.5	-36.3	-18.6	17.7	-51.7	-11.8	39.8	-33.5	-39.2	-57.8	-61.3
Central government primary balance 2/	...	...	...	...	...	...	...	...	...	0.0	0.8	0.9	1.0
Central government wage bill	37.5	36.9	0.6	55.8	54.8	1.0	84.0	81.3	2.7	83.2	108.6	134.4	160.2
Banking system net credit to central government 4/	15.0	8.6	6.4	10.4	4.6	5.8	8.4	-16.3	24.7	3.0	3.0	3.0	3.0
Net changes in central government arrears to private domestic parties 5/	15.0	-2.5	17.5	15.0	-4.7	19.7	15.0	-5.6	20.6	15.0	15.0	15.0	15.0
(In millions of U.S. dollars)													
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year 2/ 6/	19.5	1.6	-17.9	22.0	4.7	17.3	28.9	19.9	9.0	30.0	33.0	33.0	33.0
Net changes in the oustanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 5/ 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net changes in external payments arrears of the central government 5/ 7/	0.0	0.0	0.0	0.0	-0.6	0.6	0.0	-0.7	0.7	0.0	0.0	0.0	0.0
II. Indicative Targets													
(In millions of Eastern Caribbean dollars)													
Central government revenues	58.9	69.0	10.1	89.3	103.5	14.2	140.5	156.9	16.4	148.5	197.4	245.1	302.0
Central government primary savings	-11.8	3.9	15.7	-11.9	13.8	25.7	-9.5	23.1	32.6	0.0	10.6	14.3	24.4

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Cumulative from March 31, 2003 for period ending December 31, 2003. Cumulative from June 30, 2003, beginning January 1, 2004.

2/ Limits will be adjusted downward (upwards) to the extent that project financing falls short of (exceeds) programmed amounts. Upward adjustments will not exceed US$1.9 million by end-July 2003, US$2.6 million by end-September 2003, and US$3.9 million by end-December 2003.

3/ Indicative target beginning March 31st.

4/ Limits on banking system net credit to the central government will be adjusted upward to the extent that there are shortfalls in external nonproject financing that are outside the control of the authorities. These upward adjustments will not exceed US$2.6 million by end-July 2003, US$4.0 million by end-September 2003, and US$4.0 million by end-December 2003. Limits on banking system net credit to the central government will be adjusted downward to the extent that external nonproject financing exceeds programmed amounts.

5/ These performance criteria will be monitored on a continuous basis.

6/ For the definition of external debt, see paragraph 16 of the Technical Memorandum of Understanding.

7/ External arrears accumulated prior to the Executive Board discussion on July 25th were waived; no arrears have been accumulated since then.

Table 2. Dominica: Structural Performance Criteria and Structural Benchmarks for the PRGF Arrangement through December 2004

Structural Reform Measure under Original Program	Completion Date	Category	Status
Tax policy			
Significant reduction of discretionary tax exemptions.	...	Prior Action	Done
Civil service reform			
Study outlining the process for redcution in the wage bill for FY2004/05 by 5 percent through attrition.	End-March 2004	Benchmark	In progress
Tax policy and administration			
Conduct a review of all statutory tax exemptions with a view to assessing their effectiveness and justification, and to prevent abuses.	End-June, 2004	Benchmark	In progress
Pension reform			
Submit legislation to Parliament proposing a phased increase in the retirement age for public employees to 60 years.	End-June, 2004	Benchmark	In progress
Budget approval			
Approval of FY2004/05 budget, consistent with the program.	End-July 2004	Performance Criterion	In progress
Tax policy			
Announcement in the budget for FY2004/05 the adoption of the VAT by mid-2005. Cabinet approval of key parameters such as the base, the rate, registration threshold, filing frequency, and refund system.	End-September 2004	Benchmark	In progress
Institutional strengthening			
Improve the regulatory framework for electricity supply, following the recommendations of technical assistance mission.	End-September 2004	Benchmark	In progress

Sources: Dominican authorities and Fund staff.

Table 3. Dominica: Selected Economic and Financial Indicators

	2000	2001	2002	Prog. 1/ 2003	Est. 2003	Proj. 2004
(Annual percent change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	1.4	-4.2	-4.7	-1.0	0.0	1.0
GDP deflator (factor cost)	0.6	1.2	-0.4	1.5	1.5	1.5
Nominal GDP (at factor cost)	2.0	-3.0	-5.1	0.5	1.5	2.6
Nominal GDP at market prices	1.3	-2.7	-6.2	1.6	1.3	3.1
Consumer prices (end of period)	1.1	1.9	0.5	2.5	2.9	1.5
Money and credit						
Net foreign assets of the banking system 2/	-12.8	6.6	19.9	4.0	16.9	-3.7
Net domestic assets of the banking system 2/	13.4	0.9	-11.3	-1.0	-15.9	6.8
Of which						
Net credit to the nonfinancial public sector 2/	5.7	5.6	-7.0	0.1	-5.9	5.9
Credit to the private sector 2/	7.3	-3.1	-1.3	-0.8	-2.3	2.4
Liabilities to the private sector (M2)	0.6	7.4	8.5	3.0	1.0	3.1
Balance of payments						
Merchandise exports, f.o.b.	-2.3	-18.9	-3.7	-6.7	-6.5	3.0
Merchandise imports, f.o.b.	7.3	-11.6	-12.1	5.0	10.0	0.9
Terms of trade	-5.3	1.5	0.1	…	…	…
Real effective exchange rate (end-of-period; depreciation -) 3/	4.8	3.7	-6.4	…	-5.4	…
(In millions of U.S. dollars)						
Merchandise exports, f.o.b.	54.7	44.4	42.8	39.9	40.0	41.2
Merchandise imports, f.o.b.	130.4	115.3	101.4	106.4	111.5	112.5
Current account balance 4/	-52.5	-47.6	-37.0	-42.1	-42.8	-39.1
Capital account balance 5/	50.3	49.5	48.5	43.6	44.2	13.5
Overall balance	-2.2	1.9	11.4	1.5	1.5	-25.6
(In percent of GDP, unless otherwise specified)						
Savings and investment						
Gross domestic investment	24.8	21.2	10.6	13.0	14.4	16.4
Public	16.7	15.3	6.6	7.0	7.4	8.9
Private	8.1	5.9	4.0	6.0	7.0	7.5
Gross national saving	5.3	3.0	-4.3	-3.7	-2.5	1.4
Public 4/	-0.6	-2.4	-3.0	-2.9	-2.1	-0.7
Private	5.8	5.4	-1.4	-0.8	-0.7	2.1
Central government 6/						
Savings	5.3	-3.0	-0.6	1.1	2.2	1.2
Of which						
Primary	10.7	2.4	5.1	7.2	8.2	7.5
Grants	9.4	1.7	4.5	5.7	5.4	3.5
Capital expenditure and net lending	16.6	5.7	5.1	7.0	8.0	7.0
Primary balance	-5.9	-3.3	-1.6	0.2	0.2	0.5
Overall balance	-10.9	-8.6	-7.1	-5.6	-5.5	-5.5
Nonfinancial public sector debt (gross) 6/	87.4	95.4	111.5	114.7	114.6	...
External 7/	59.1	71.0	84.1	89.8	88.1	...
Domestic	28.2	24.4	27.4	25.0	26.5	...
External sector						
Current account balance 4/	-19.5	-18.2	-15.0	-16.7	-16.9	-15.0
External public debt service 8/	7.4	10.8	12.3	20.9	20.9	14.5
Amortization	3.1	4.5	4.9	12.3	12.3	7.1
Interest	4.3	6.4	7.5	8.6	8.6	7.5
Memorandum items:						
Nominal GDP at market prices (EC$ millions)						
Calendar year	726.4	706.8	680.5	683.0	689.1	710.3
Net international reserves						
(U.S.dollars millions; end-of-period) 9/	29.0	30.4	43.6	45.1	45.1	45.4

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates.

1/ IMF Country Report 04/6.
2/ Change relative to the stock of M2 at the beginning of the period.
3/ 12-month change for end-November 2003.
4/ Includes public current transfers of 1.3 percent of GDP for the 2003 program.
5/ Including errors and omissions.
6/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.
7/ Including external financing gap.
8/ In percent of exports of goods and nonfactor services.
9/ Imputed reserves at the ECCB.

Table 4. Dominica: Summary Accounts of the Central Government 1/

				Prog. 2/	Rev. Proj.	Prog. 2/	Rev. Proj.
	2000/01	2001/02	2002/03	2003/2004		2004/2005	
	(In millions of Eastern Caribbean dollars)						
Total revenue and grants	**271.5**	**209.7**	**224.1**	**237.2**	**237.8**	**233.8**	**234.8**
Current revenue	200.5	197.1	191.9	196.3	198.4	207.3	200.2
Capital revenue	3.0	0.9	1.3	1.5	1.8	1.6	2.1
Grants	68.0	11.8	30.9	39.3	37.5	24.9	32.5
Total expenditure 3/	**350.3**	**269.3**	**261.3**	**276.3**	**276.4**	**273.2**	**274.5**
Current expenditure	230.1	229.7	226.6	227.7	220.6	223.4	216.7
Wages and salaries	116.2	116.5	116.1	108.6	108.6	103.2	103.2
Interest	36.0	36.9	37.6	40.5	40.3	43.1	43.2
Domestic	20.2	19.3	17.8	18.1	17.8	15.9	21.0
External	15.7	17.5	19.8	22.4	22.4	27.2	22.2
Others	77.9	76.3	72.8	78.6	71.8	77.2	70.3
Capital expenditure and net lending	120.2	39.6	34.7	48.6	55.8	49.8	57.8
Overall balance	**-78.8**	**-59.5**	**-37.2**	**-39.2**	**-38.6**	**-39.5**	**-39.7**
Statistical discrepancy 4/	18.7	8.2	-11.5	...	...	...	...
Financing	**60.1**	**51.3**	**48.7**	**18.4**	**18.4**	**-26.1**	**-19.1**
Net foreign financing	42.7	25.6	44.9	28.8	28.8	-26.1	-20.2
Disbursements	...	31.9	47.7	65.6	66.7	19.9	20.2
Amortization	...	6.3	6.5	39.7	39.7	46.0	40.4
Other	...	0.0	3.8	2.9	1.8	0.0	0.0
Net domestic financing	17.4	25.7	3.8	-10.4	-10.4	0.0	1.1
Bank	11.2	16.3	-6.9	-10.5	-10.4	0.0	0.0
Nonbank	6.2	9.5	10.7	0.1	0.0	0.0	1.1
Gap	**0.0**	**0.0**	**0.0**	**20.8**	**20.1**	**65.5**	**58.8**
(In percent of GDP)							
Total revenue and grants	**37.6**	**30.2**	**32.7**	**34.2**	**34.0**	**32.6**	**32.5**
Current revenue	27.8	28.4	28.0	28.3	28.4	28.9	27.7
Capital revenue	0.4	0.1	0.2	0.2	0.3	0.2	0.3
Grants	9.4	1.7	4.5	5.7	5.4	3.5	4.5
Total expenditure 3/	**48.5**	**38.8**	**38.2**	**39.8**	**39.5**	**38.1**	**38.0**
Current expenditure	31.9	33.1	33.1	32.8	31.5	31.2	30.0
Wages and salaries	16.1	16.8	17.0	15.7	15.5	14.4	14.3
Interest	5.0	5.3	5.5	5.8	5.8	6.0	6.0
Domestic	2.8	2.8	2.6	2.6	2.5	2.2	2.9
External	2.2	2.5	2.9	3.2	3.2	3.8	3.1
Others	10.8	11.0	10.6	11.3	10.3	10.8	9.7
Other transfers	3.7	3.1	3.3	3.1	2.8	3.0	2.7
Capital expenditure and net lending	16.6	5.7	5.1	7.0	8.0	7.0	8.0
					-0.1		
Overall balance	**-10.9**	**-8.6**	**-5.4**	**-5.6**	**-5.5**	**-5.5**	**-5.5**
Statistical discrepancy 4/	2.6	1.2	-1.7	...	...	...	...
Financing	**8.3**	**7.4**	**7.1**	**2.7**	**2.6**	**-3.6**	**-2.6**
Net foreign financing	5.9	3.7	6.6	4.2	4.1	-3.6	-2.8
Disbursements	...	4.6	7.0	9.5	9.5	2.8	2.8
Amortization	...	0.9	1.0	5.7	5.7	6.4	5.6
Other	...	0.0	0.6	0.4	0.3	0.0	0.0
Net domestic financing	2.4	3.7	0.6	-1.5	-1.5	0.0	0.2
Bank	1.5	2.3	-1.0	-1.5	-1.5	0.0	0.0
Nonbank	0.9	1.4	1.6	0.0	0.0	0.0	0.2
Gap	**0.0**	**0.0**	**0.0**	**3.0**	**2.9**	**9.1**	**8.1**
Memorandum items:							
Savings (incl. grants)	5.3	-3.0	-0.6	1.1	2.2	1.2	2.2
Primary savings (before grants)	1.3	0.7	0.6	1.5	2.8	4.0	4.0
Primary balance (incl. grants) 5/	-5.9	-3.3	-1.6	0.2	0.2	0.5	0.5
Total debt service to government revenue	...	24.7	23.7	36.2	41.4	42.9	42.0
Nominal GDP at market prices (EC$ millions)	722.4	693.7	684.8	693.5	699.7	716.3	722.7

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal years beginning July 1.
2/ IMF Country Report 04/6.
3/ On a due basis.
4/ Difference between identified financing and overall balance.
5/ Starting from FY 2002/2003 the primary balance is computed using overall deficit measured from below-the-line.

Table 5. Dominica: Summary Accounts of the Banking System

	2000	2001	2002	Prel. 2003	Prog. 2004	Rev. Proj. 2004
(In millions of Eastern Caribbean dollars, end of period)						
I. Consolidated Banking System 2/						
Net foreign assets	**65.2**	**96.1**	**196.7**	**289.4**	**225.8**	**268.6**
Net domestic assets	**405.8**	**409.8**	**352.5**	**265.1**	**357.5**	**302.9**
Net credit to the nonfinancial public sector	75.8	102.3	66.8	34.6	67.3	67.3
Of which						
Central government	70.3	92.3	56.2	38.4	59.8	59.8
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-49.5	-84.4
Credit to the private sector	454.1	439.6	433.2	420.6	442.2	433.7
Other items (net) 3/	-88.3	-94.4	-101.0	-108.3	-102.6	-113.7
Broad money 4/	**471.0**	**506.0**	**549.2**	**554.5**	**583.3**	**571.6**
II. Operations of the Eastern Caribbean Central Bank						
Imputed net international reserves	**78.2**	**82.1**	**117.8**	**121.7**	**126.0**	**122.7**
Net domestic assets	**10.9**	**10.2**	**13.4**	**4.9**	**16.3**	**4.9**
Monetary base	**89.1**	**92.3**	**131.2**	**126.6**	**142.3**	**127.6**
Currency in circulation	35.4	34.6	35.5	34.2	37.7	35.2
Commercial bank reserves	53.6	57.7	95.7	92.4	104.5	92.4
III. Commercial Banks						
Net foreign assets	**-12.9**	**14.0**	**79.0**	**167.7**	**99.8**	**146.0**
Net claims on ECCB	**51.2**	**58.5**	**98.2**	**85.6**	**104.2**	**88.2**
Net domestic assets	**397.3**	**398.9**	**336.6**	**267.0**	**341.5**	**302.1**
Net credit to the nonfinancial public sector	65.0	92.1	53.4	29.7	52.1	29.7
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-49.5	-84.4
Credit to the private sector	454.1	439.6	433.2	420.6	442.2	433.7
Other (net)	-86.0	-95.2	-103.5	-101.5	-103.3	-76.8
Private sector deposits 4/	**435.6**	**477.4**	**513.7**	**520.3**	**545.5**	**536.3**
IV. Consolidated Banking System						
(Annual percentage change)						
Credit to the private sector	8.2	-3.2	-1.4	-2.9	3.1	3.1
Private sector deposits	0.3	9.6	7.6	1.3	3.1	3.1
Broad money 5/	0.6	7.4	8.5	1.0	3.1	3.1
(Contributions to liquidity growth) 5/						
Net foreign assets	**-12.8**	**6.6**	**19.9**	**16.9**	**1.3**	**-3.7**
Net domestic assets	**13.4**	**0.9**	**-11.3**	**-15.9**	**1.8**	**6.8**
Net credit to the nonfinancial public sector	5.7	5.6	-7.0	-5.9	0.0	5.9
Credit to the private sector	7.3	-3.1	-1.3	-2.3	2.4	2.4
Memorandum items:						
Interest rates 6/						
Deposits (3-month time—maximum rate)	6.0	6.0	6.0	6.0	…	…
Lending: Minimum rate	9.5	9.5	8.5	8.0	…	…
Maximum rate	20.8	20.8	20.8	18.2	…	…

Sources: Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ IMF Country Report 04/6.
2/ The projection for 2003 reflects actual data through October 2003.
3/ Includes interbank float.
4/ Including deposits denominated in U.S. dollars.
5/ Change relative to broad money at the beginning of the period.
6/ Commercial banks; end-of-period rates, percent per annum.

Table 6. Dominica: Balance of Payments

	2000	2001	2002	Est. 2003	Prog. 1/ 2004	Rev. Proj. 2004
	(In millions of U.S. dollars)					
Current account balance	**-52.5**	**-47.6**	**-37.0**	**-42.8**	**-40.3**	**-39.1**
Trade balance	-75.6	-70.9	-58.6	-71.6	-65.4	-70.4
Exports (f.o.b.) 2/	54.7	44.4	42.8	40.0	41.1	41.2
Imports (f.o.b.)	130.4	115.3	101.4	111.5	106.4	112.5
Services balance	37.1	25.0	25.2	29.7	32.3	35.7
Exports of services	89.7	76.7	74.7	85.9	81.7	90.2
Travel	48.2	46.3	44.2	50.8	48.7	53.4
Other	41.6	30.4	30.5	35.0	33.0	36.8
Imports of services	52.7	51.7	49.4	56.1	49.3	54.5
Net income	-32.0	-19.2	-20.1	-17.2	-20.1	-17.9
Interest payments (public sector)	-6.2	-7.7	-8.8	-8.0	-11.1	-10.1
Other income	-25.8	-11.5	-11.3	-9.3	-9.0	-7.9
Net current transfers	18.1	17.5	16.4	16.2	12.9	14.5
Private	10.6	11.5	12.0	13.0	12.9	14.5
Public	7.4	5.9	4.4	3.2	0.0	0.0
Capital and financial account	**53.2**	**41.2**	**27.3**	**18.8**	**15.9**	**13.5**
Capital account	10.9	18.0	13.3	11.3	15.3	17.5
Public capital transfers	9.6	15.3	10.5	8.3	12.3	14.5
Private capital transfers	2.7	2.7	2.7	2.9	3.0	3.0
Financial account	42.3	23.2	14.1	7.5	0.6	-4.0
Public sector	21.2	23.0	25.2	8.9	-10.3	-6.1
Budgetary flows (net)	23.9	24.6	24.4	8.9	-10.3	-6.1
Disbursements	28.4	30.0	30.1	24.0	10.4	12.8
Repayments	4.5	5.4	5.7	15.1	20.7	18.9
Nonbudgetary flows (net)	-2.7	-1.6	0.8	0.0	0.0	0.0
Private sector	22.7	0.2	-11.1	-1.3	11.0	2.2
Direct investment	10.8	11.9	13.2	20.7	13.2	20.7
Commercial banks	19.7	-10.0	-24.0	-32.9	-1.2	8.1
Other private flows	-7.8	-1.7	-0.3	10.9	-1.1	-26.6
Errors and omissions	**-2.9**	**8.3**	**21.2**	**25.4**	**0.0**	**0.0**
Overall balance	**-2.2**	**1.9**	**11.4**	**1.5**	**-24.4**	**-25.6**
Overall financing	**2.2**	**-1.9**	**-11.4**	**-1.5**	**24.4**	**25.6**
Net international reserves	2.2	-1.9	-11.4	-1.4	-1.6	-0.4
Gross reserves	2.2	-1.9	-14.3	-2.8	-1.6	-0.4
Reserve liabilities (IMF)	0.0	0.0	2.8	1.3	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	26.0	26.0
Arrears	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	26.0	26.0
	(In percent of GDP)					
Memorandum items:						
Current account balance	-19.5	-18.2	-15.0	-16.9	-15.4	-15.0
External public debt 3/	53.7	64.6	77.4	87.4	91.5	90.0

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ IMF Country Report 04/6.
2/ Includes stores and bunkers.
3/ Includes external financing gap.

Table 7. Dominica: Financial and External Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	Prog. 1/ 2003	Prel. 2003	Proj. 2004
Financial indicators							
Broad money (percent change, 12-month basis) 2/	10.4	0.6	7.4	8.5	3.0	1.0	3.1
Private sector credit (percent change, 12-month basis) 2/	2.4	8.2	-3.2	-1.4	-1.0	-2.9	3.1
Unsatisfactory assets/total loans 2/	17.9	17.4	22.6	19.2	...	22.2	...
General and specific provisions for loan losses/unsatisfactory assets 2/	37.3	40.0	30.2	36.7	...	33.8	...
Specific provisions for loan losses/unsatisfactory assets 2/	33.5	33.3	26.2	32.6	...	28.6	...
Total capital/risk weighted assets (locally incorporated banks) 2/	38.2	30.8	35.4	34.1	...	29.3	...
Tier 1 capital/risk weighted assets (locally incorporated banks) 2/	35.2	27.4	34.1	32.9	...	29.1	...
Three-month treasury bill rate (end of period) 3/	6.4	6.4	6.4	6.0	6.4	6.3	6.3
Three-month treasury bill rate (real) 3/ 4/	6.4	5.3	4.5	5.5	3.9	3.4	4.8
External indicators							
Exports of goods and services (percent change, 12-month basis in U.S. dlrs.)	3.4	-7.9	-16.2	-3.0	0.2	7.2	4.4
Imports of goods and services (percent change, 12-month basis in U.S. dlrs.)	4.9	1.4	-8.8	-9.7	4.3	11.2	-0.4
Current account balance 5/	-12.9	-19.5	-18.2	-15.0	-16.7	-16.9	-15.0
Capital and financial account balance 6/	14.2	18.7	18.9	19.2	17.2	17.3	5.1
Net official reserves (in millions of U.S. dollars, end of period) 7/	31.5	29.0	30.4	43.6	45.1	45.1	45.4
Net reserves to broad money (percent, end of period) 7/	18.2	16.6	16.2	21.4	21.5	21.9	21.5
Public sector external debt	48.4	53.7	64.6	77.4	88.1	87.4	...
External debt (end of period) to exports of goods and services (percent) 8/	82.7	100.8	140.8	163.2	0.0	176.9	...
External interest payments to exports of goods and services (percent) 8/	1.7	4.3	6.4	7.5	6.8	6.3	...
External amortization payments to exports of goods and services (percent) 8/	3.3	3.1	4.5	4.9	12.8	12.0	...
Exchange rate (per U.S. dlrs, end of period)	2.7	2.7	2.7	2.7	2.7	2.7	...
REER appreciation (end of period; depreciation -) 9/	0.8	4.8	3.7	-6.4	…	-5.4	...

Sources: Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ IMF Country Report 04/6.
2/ Data for 2003 as of September 2003.
3/ Data for 2003 as of June 2003.
4/ Treasury bill rate adjusted by end-of-period inflation.
5/ Includes public current transfers for 2002 and projected public current transfers for 2003.
6/ Includes errors and omissions.
7/ Imputed reserves at the ECCB.
8/ Refers to public sector debt.
9/ 12-month change for end-November 2003.

Table 8. Dominica: Medium-Term Projections

	2001	2002	Est. 2003	Projections 1/ 2004	2005	2006
(Annual percentage change)						
National income and prices						
GDP at constant (1990) prices	-4.2	-4.7	0.0	1.0	2.0	2.0
Implicit GDP deflator (factor cost)	1.2	-0.4	1.5	1.5	1.5	1.5
(In percent of GDP, unless otherwise stated)						
Saving and investment						
Gross domestic investment	21.2	10.6	14.4	16.4	16.9	17.9
Public	15.3	6.6	7.4	8.9	7.9	8.9
Private	5.9	4.0	7.0	7.5	9.0	9.0
Gross national saving	3.0	-4.3	-2.5	1.4	4.7	8.7
Public	-2.4	-3.0	-2.1	-0.7	0.4	1.4
Private	5.4	-1.4	-0.7	2.1	4.3	7.3
Central government finances 2/						
Central government saving (excluding grants)	-4.7	-5.1	-3.2	-2.3	-1.0	-0.1
Current revenue	28.4	28.0	28.4	28.9	27.7	27.7
Current expenditure	33.1	33.1	31.5	31.2	28.7	27.8
Overall balance (after grants)	-8.6	-5.4	-5.5	-5.5	-4.2	-3.3
Grants	1.7	4.5	5.4	3.5	3.5	3.5
Capital spending	5.7	5.1	8.0	7.0	7.0	7.0
Primary balance	-3.3	-1.6	0.2	0.5	2.0	3.0
Balance of payments						
External current account	-18.2	-15.0	-16.9	-15.0	-12.2	-9.2
Of which						
Exports of goods and services	46.3	46.6	49.3	49.9	51.1	51.9
Imports of goods and services	63.8	59.8	65.7	63.5	61.7	60.7
Capital and financial account 3/	18.9	19.2	17.3	5.1	4.8	2.4
Overall balance	0.7	4.3	0.4	-9.9	-7.3	-6.8
Identified financing	-0.7	-4.5	-0.6	-0.2	-0.6	-0.6
Financing gap 4/ 5/	0.0	0.0	0.0	9.9	7.8	7.3
Public sector debt and debt service						
Public sector debt 2/	95.4	111.5	114.6	...	...	...
External	71.0	84.1	88.1	...	...	...
Domestic	24.4	27.4	26.5	...	...	...
External debt/exports 6/	153.5	180.6	178.7	...	...	...
External debt service/exports 6/	10.8	12.3	20.9	14.5	13.4	13.7

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Projections assume an adjustment scenario.
2/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.
3/ Including errors and omissions.
4/ Excludes projected public current transfers for 2003–08. Gaps are expected to be filled by a combination of sustained fiscal adjustment, stuctural reform, privatization, exceptional donor financing and implementation of a comprehensive debt strategy.
5/ Excludes US$10.2 million in debt assumed to be rolled over.
6/ Exports of goods and services.

Table 9. Dominica: Nonfinancial Public Sector Debt Structure at End-December 2003

	Debt Stocks			
	In millions of EC$	In millions of US$	In percent of GDP	Share of Total Debt
Domestic debt	**182.4**	**67.5**	**26.5**	**22.0**
Commercial banks	112.0	41.5	16.3	13.5
NCB	77.4	28.7	11.2	9.3
Others	34.7	12.8	5.0	4.2
ECCB	16.2	6.0	2.3	1.9
Private	54.1	20.1	7.9	6.5
External debt	**646.8**	**224.9**	**88.1**	**78.0**
Multilateral	309.4	114.6	44.9	37.3
CDB	192.5	71.3	27.9	23.2
World Bank	71.8	26.6	10.4	8.7
IMF	20.0	7.4	2.9	2.4
Others 1/	25.1	9.3	3.6	3.0
Bilateral	138.8	51.4	20.1	16.7
France	31.1	11.5	4.5	3.7
Taiwan	32.1	11.9	4.7	3.9
United Kingdom 2/	27.6	10.2	4.0	3.3
Others 3/	48.1	17.8	7.0	5.8
Commercial	182.4	52.8	20.7	22.0
Citicorp	45.5	16.9	6.6	5.5
Royal Merchant Bank	82.6	30.6	12.0	10.0
Intercommercial Bank	5.4	2.0	0.8	0.7
Others	9.2	3.4	1.3	1.1
Arrears	16.2	6.0	2.4	2.0
Total	**829.2**	**292.4**	**114.6**	**100.0**
Memorandum item:				
Enlarged debt of the NFPS 4/	911.2	337.5	132.2	
Of which				
Domestic debt	304.1	112.6	44.1	

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes EIB, IFAD and OPEC.
2/ Loan provided by Societe Generale and guaranteed by the U.K. government. The guarantee has been exercised.
3/ Includes Barbados, Belize, Grenada, Kuwait, St. Vincent and the Grenadines, Trinidad and Tobago and Venezuela.
4/ This definition of the debt adds Dominica Social Security's claims on the central government to the public sector debt.

Table 10. Dominica: Schedule of Purchases Under the Stand-By Arrangement and the Poverty Reduction and Growth Facility

Date	Purchases (in millions) US$ 1/	SDR	As Percent of Quota	Conditions
2002	**2.973**	**2.050**	**25.0**	
August 28	2.973	2.050	25.0	Board approval of SBA (first credit tranche)
2003	**4.757**	**3.281**	**40.0**	
July 28	0.446	0.308	3.8	First review under the SBA; and adoption of prior actions
September 15	0.446	0.308	3.8	End-July 2003 performance criteria
Decemeber 19	0.446	0.308	3.8	Second review under the SBA; and end September 2003 performance criteria
Decemeber 19	3.419	2.358	28.8	Board approval of PRGF; and adoption of prior actions
2004	**1.786**	**1.232**	**15.0**	
March 24	0.447	0.308	3.8	First review under the PRGF; and end-December 2003 performance criteria
June 15	0.447	0.308	3.8	Second review under the PRGF; and end-March 2004 performance criteria
September 15	0.447	0.308	3.8	Third review under the PRGF; and end-June 2004 performance criteria
December 15	0.447	0.308	3.8	End-September 2004 performance criteria
2005	**3.567**	**2.460**	**30.0**	
March 15	0.892	0.615	7.5	Fourth review under the PRGF; and end-December 2004 performance criteria
June 15	0.892	0.615	7.5	End-March 2005 performance criteria
September 15	0.892	0.615	7.5	Fifth review under the PRGF; and end-June 2005 performance criteria
December 15	0.892	0.615	7.5	End-September 2005 performance criteria
2006	**2.378**	**1.640**	**20.0**	
April 30	1.189	0.820	10.0	Sixth review under the PRGF; and end-December 2005 performance criteria
October 31	1.189	0.820	10.0	Seventh review under the PRGF; and end-June 2006 performance criteria
Total	**15.46**	**10.66**	**130.0**	
SBA	4.31	2.97	36.3	
PRGF	11.15	7.69	93.8	
Memorandum item:				
Quota (in millions)	11.89	8.20	100.0	

Source: Fund staff estimates.

1/ For illustrative purposes only, SDR amounts have been coverted into U.S. dollars at an US$/SDR exchange rate of 1.45.

Table 11. Dominica: Indicators of Capacity to Repay the Fund, 2003-08

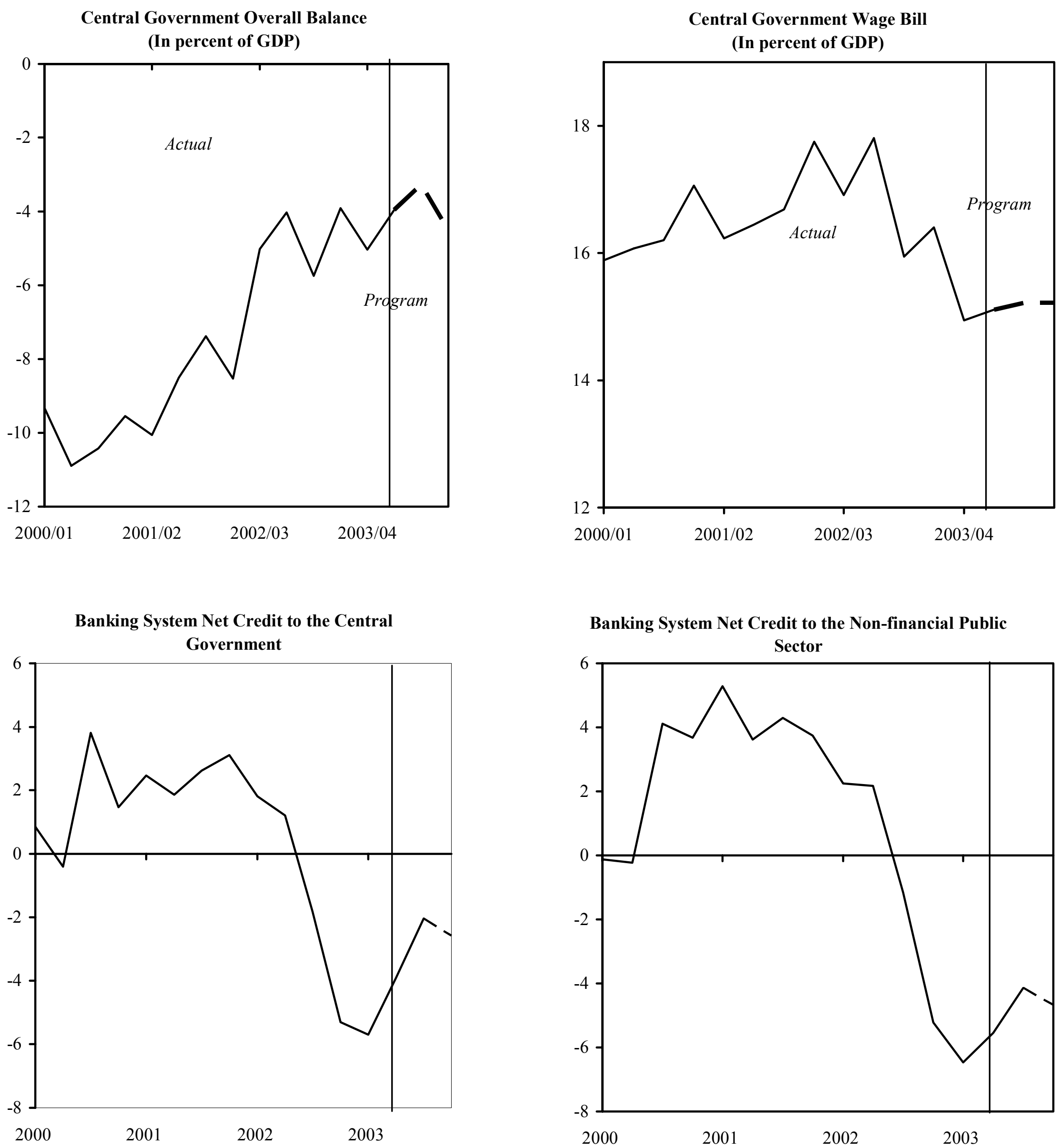
		Projections				
	2003	2004	2005	2006	2007	2008
Fund repurchases and charges 1/						
In millions of SDRs	0.1	0.1	0.4	1.2	1.3	0.4
In millions of U.S. dollars	0.1	0.1	0.6	1.8	2.0	0.6
In percent of exports of goods and services	0.1	0.1	0.4	1.2	1.3	0.4
In percent of debt service	0.6	0.5	1.9	5.6	6.1	1.9
In percent of quota	1.2	1.2	4.9	14.6	15.9	4.9
In percent of imputed net official reserves	0.3	0.3	1.3	3.7	3.9	1.1
Fund credit outstanding 1/						
In millions of SDRs	5.3	6.6	8.7	9.3	8.1	7.7
In millions of U.S. dollars	7.5	9.8	13.1	13.9	12.1	11.5
In percent of exports of goods and services	5.9	7.5	9.4	9.5	8.0	7.3
In percent of debt service	32.4	33.8	41.7	43.5	37.9	37.0
In percent of quota	65.0	80.0	106.4	113.0	98.3	93.4
In percent of imputed net official reserves	16.5	21.6	27.8	28.5	24.0	22.0
Memorandum items:						
Exports of goods and services (millions of U.S. dollars)	125.9	131.4	139.1	146.4	151.8	157.4
Debt service (millions of U.S. dollars) 1/	23.0	29.0	31.3	32.0	32.0	31.2
Quota (millions of SDRs)	8.2	8.2	8.2	8.2	8.2	8.2
Quota (millions of U.S. dollars)	11.5	12.2	12.3	12.3	12.3	12.3
Imputed net official reserves (millions of U.S. dollars)	45.1	45.4	47.1	48.8	50.6	52.4
GDP (millions of U.S. dollars)	255.2	263.1	272.2	281.9	291.8	302.1
U.S. dollars per SDR 2/	0.715	0.670	0.667	0.666	0.665	0.665

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Including hypothetical purchases under Stand-By Arrangement and PRGF, not shown in the BoP projections.

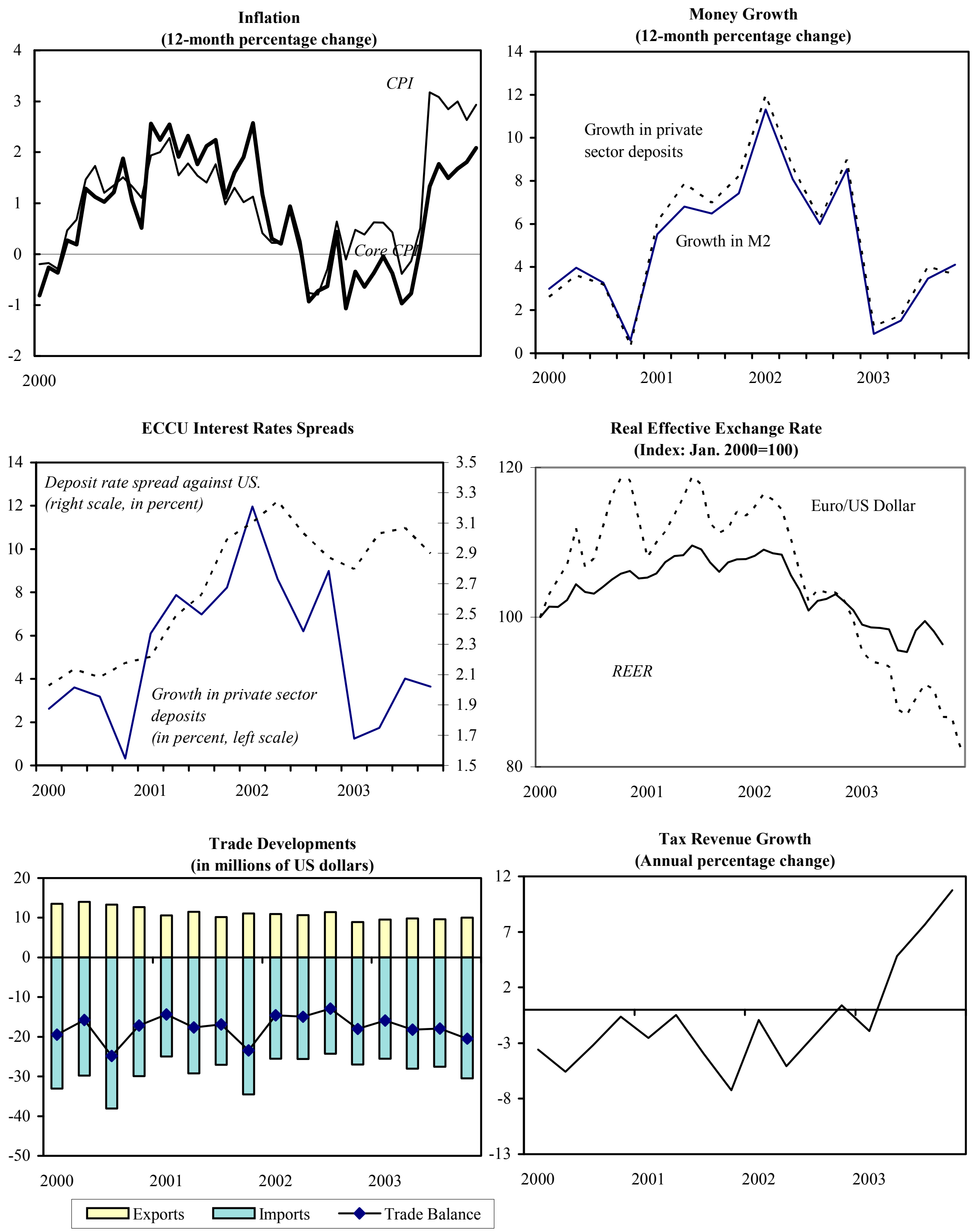
2/ For the projection period: WEO assumptions of January 2004.

Figure 1. Dominica: Performance Under the Program



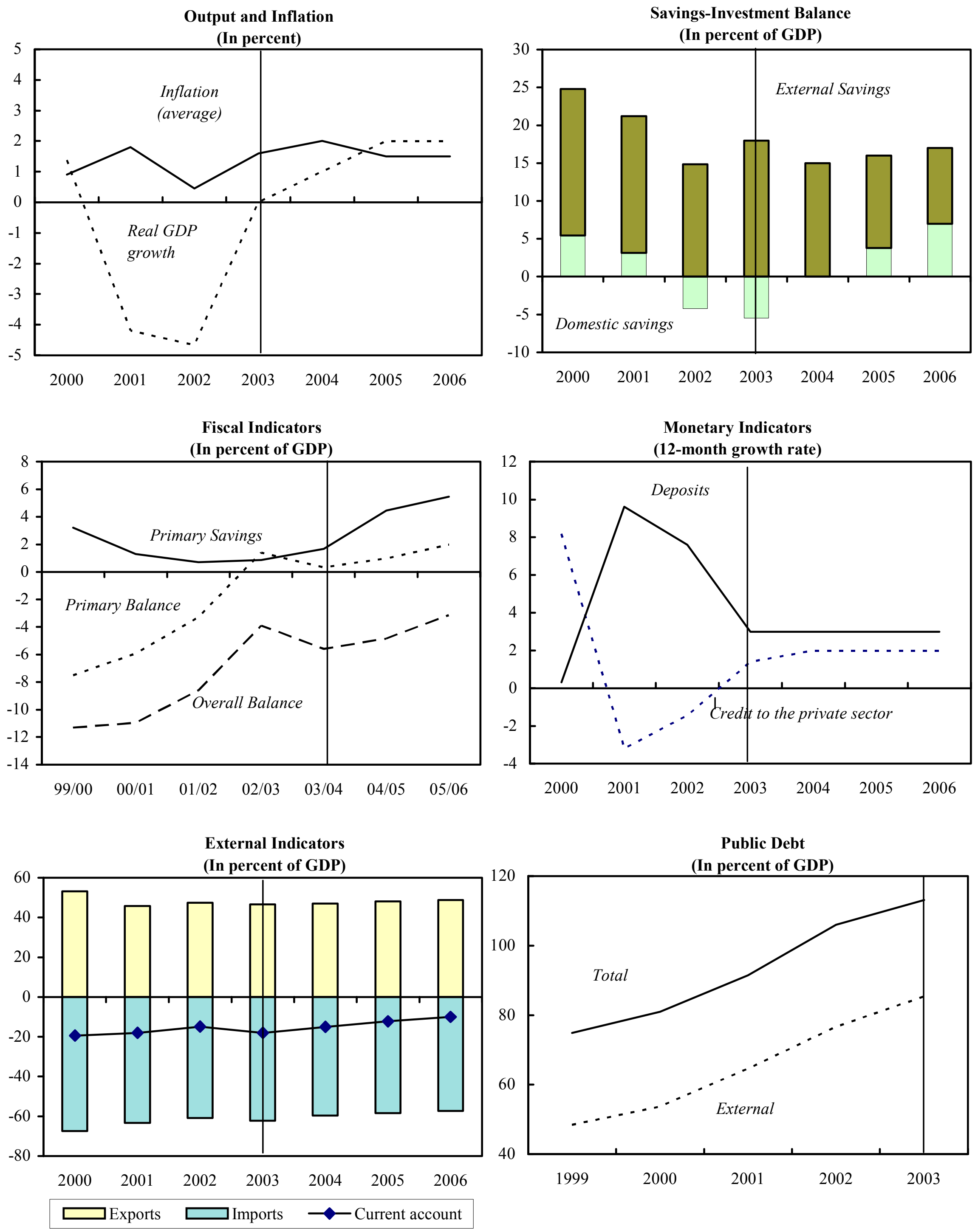
Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

Figure 2. Dominica: Macroeconomic Performance



Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

Figure 3. Dominica: Recent Economic Developments



Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

Dominica: Fund Relations

(As of January 31, 2004)

I. Membership Status Joined 12/12/78; Article VIII

II. General Resources Account	**SDR Million**	**Percent of Quota**
Quota	8.20	100.00
Fund holdings of currency	11.16	136.15
Reserve position in Fund	0.01	0.11

III. SDR Department	**SDR Million**	**Allocation**
Net cumulative allocation	0.59	100.00
Holdings	0.02	3.73

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
PRGF Arrangements	2.36	28.76
Stand-by arrangements	2.97	36.25

V. Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	12/29/03	12/28/06	7.69	2.36
Stand-By	08/28/02	01/02/04	2.97	2.97
SAF	11/26/86	11/25/89	2.80	2.80
Stand-By	07/18/84	07/17/85	1.40	0.97
EFF	02/06/81	02/05/84	8.55	8.55

VI. Projected Obligations to the Fund[3]:

			Forthcoming		
	2004	**2005**	**2006**	**2007**	**2008**
Principal	0.00	0.26	1.10	1.23	0.38
Charges/Interest	0.08	0.08	0.07	0.05	0.03
Total	**0.08**	**0.34**	**1.17**	**1.28**	**0.41**

* Less than SDR 50,000.

VII. Exchange Rate Arrangement: Dominica is a member of the Eastern Caribbean Currency Union, which has a common central bank (the Eastern Caribbean Central Bank) and currency (the Eastern Caribbean dollar). Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

[3] Obligation basis.

VIII. **Safeguards Assessment**: Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB), of which Dominica is a participating government, is subject to a full safeguards assessment.

The on-site safeguards assessment was completed on February 20, 2003, and concluded that the ECCB has in place appropriate mechanisms to manage resources, including Fund disbursements and that the vulnerabilities that remain do not present an undue risk. The safeguards assessment proposed specific measures to address these vulnerabilities and implementation by the ECCB is currently in progress.

IX. **Article IV Consultation**: The last Article IV consultation was concluded by the Executive Board on August 28, 2002 (IMF Country Report No. 02/223); the relevant documents are IMF Country Report Nos. 02/223 and 02/224. Dominica is on the standard 24-month cycle.

X. **Technical Assistance:** FAD missions visited Roseau to provide technical assistance on tax policy and administration, with special emphasis on VAT implementation (2002 and 1999), on urban property taxation (1997), and on tax policy and administration, and expenditure control (1995).

XI. **FSAP:** A joint IMF/World Bank team performed an assessment of the financial sector of the member states of the ECCB, in two missions—September 1–19 and October 20–31, 2003. The principal objective of the missions was to assist the authorities in assessing the development needs and opportunities for the financial sector and identifying potential vulnerabilities of financial institutions and markets to macroeconomic shocks, as well as the risks to macroeconomic stability from weaknesses and shortcomings in the financial sector.

Dominica: Relations with the Caribbean Development Bank (CDB)

(As of January 31, 2004)

The CDB has approved loans and grants for Dominica totaling approximately US$140.1 million. Of this amount US$136.5 million represented loans aimed at boosting real sector activity, particularly in agriculture, manufacturing and tourism. Significant resources were also dedicated towards improving road access, sea defenses and other physical infrastructure. A large portion of loans to the productive sector was channeled to the private sector through the Dominica Agricultural, Industrial and Development Bank (DAIDB).

In 2003, CDB completed a detailed poverty assessment in Dominica. Inter alia, this will serve to inform Government strategic interventions aimed at sustained poverty reduction. Moreover, CDB in collaboration with other development partners, has provided critical budget support to Dominica through an Economic Stabilization Loan. This intervention seeks to facilitate an orderly adjustment process in Dominica and will also allow for the formulation of a longer-term structural adjustment strategy.

Ongoing capital projects financed by CDB include the Fourth Consolidated Line of Credit, Roseau Water and Sewerage Project, Seventh Consolidated Line of Credit, OECS Solid Waste Project, and Eco-tourism project, and the Seventh Consolidated Line of Credit to DAIDB for on-lending to the productive sectors and to students.

Dominica: Financial Relations with CDB
(In millions of U.S. dollars)

ITEM	1999	2000	2001	2002	2003
Cumulative Total Credit Approved	96.21	113.20	118.63	128.01	136.18
Cumulative Disbursements	72.79	82.73	94.56	101.54	110.58
Disbursements	5.51	9.94	11.83	6.98	9.04
Outstanding Debt	44.69	51.41	60.39	65.02	71.50
Amortization	2.73	2.73	2.70	2.59	2.79
Interest	1.14	1.35	1.61	1.89	2.01

Dominica: Relations with the World Bank[4]

(As of January 31, 2004)

The World Bank role in Dominica: The Bank will continue to collaborate with the Fund and other donors in supporting the authorities efforts in stabilizing macroeconomic conditions and in restarting economic growth and reducing poverty. The Bank will lead the policy dialogue on key structural reforms, including public expenditure, public sector reform, social protection, and on the environment for private sector development.

Bank-Fund collaboration in specific areas: The World Bank and the IMF will continue to collaborate on the financial sector, on the medium-term structural reform agenda and in providing a wide range of technical assistance to Dominica on macroeconomic management issues jointly with the Caribbean Regional Technical Assistance Center (CARTAC).

Bank Group strategy: The World Bank's strategy for Dominica is a part of the Country Assistance Strategy (CAS) for the Eastern Caribbean (OECS) sub-region, presented to the Bank Board on June 4, 2001. The CAS which covers FY 2002–06, proposes new commitments of around US$110 million for the five borrowing member states of the OECS (Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines). The main goals of the strategy are to reduce income insecurity and vulnerability at the national and household levels, and build human and institutional capacity to meet the challenging economic and social environment facing these small states.

Ongoing projects: There are currently three ongoing World Bank projects in Dominica (as well as other OECS borrowing countries) with total commitments of approximately US$7.5 million.

(i) The *OECS Telecommunications Reform Program*, approved in FY 1998 seeks to introduce pro-competition reforms in the telecommunications sectors and increase the supply of informatics-related skills in the OECS borrowing countries. The project has helped these countries establish a regional regulatory authority, negotiate with the sub-regional telecommunications monopoly, and lower telephone rates. Dominica's share of the US$6.0 million loan is US$1.2 million.

(ii) The *OECS Emergency Recovery Project*: This project was approved in FY 2002 to help mitigate the impact of the September 11 attack on the tourism sector. The project supports improvements to airport and sea port security arrangements. The World Bank's assistance for this sub-regional program is US$21 million, including US$3.2 million for Dominica.
Upcoming projects: The Bank is currently preparing two projects for Dominica.

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[4] Source: World Bank. Contact person : Ms. Camille Nuamah 473-2195

(iii) The *Economic Recovery Support Operation*—an adjustment operation for US$3.1 million—supporting reforms in the areas of public expenditure, financial and debt management, financial sector, and port operations, petroleum pricing and the design and implementation of a broad public sector reform strategy. This operation was approved by the Board of Directors on January 29, 2004.

Upcoming projects:

The Bank is currently preparing the Dominica component of the *Caribbean HIV/AIDS Prevention and Control Project,* which is expected to presented for approval in FY 2005.

Analytical and Advisory Services: During FY 2003, the Bank prepared a Dominica-specific Country Financial Accountability Assessment, Country Procurement Assessment Report and Social Protection Review. A public expenditure review for Dominica, is underway in the context of the ongoing OECS Analysis of Fiscal Issues. The Bank is also providing technical assistance to support reforms in the petroleum, electricity and financial sectors.

Key aspects of the Bank's Caribbean research and technical assistance program include:

(i) a Bank-wide program on small states and providing research and technical assistance on key vulnerability issues in the Caribbean—such as macroeconomic volatility and income security, catastrophic insurance, natural hazard risk mitigation strategies, institutional arrangements for environmental management in the OECS, and on the measurement of poverty and social welfare;

(ii) a study of Growth and Competitiveness in the OECS, scheduled for completion during FY 2005; and

(iii) an ongoing Financial Sector Assessment Program (FSAP) in collaboration with the IMF.

Financial Relations
(In millions of U.S. dollars)

Gross Disbursements and Debt Service During Fiscal Year

	1997	1998	1999	2000	2001	2002	2003	2004
Total disbursements	0.5	1.9	1.4	2.1	0.5	1.7	2.7	3.1
Repayments	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6
Net disbursements	0.5	1.8	1.3	1.9	0.4	1.6	2.3	2.5
Cancelled	0.0	0.0	0.0	0.0	0.0	1.0	2.3	0.0
Interest and fees	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.4

Roseau, Dominica
March 8, 2004

Ms. Anne Krueger
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Krueger:

1. The economic program had a good start. There are indications that the sharp economic decline of the last few years has been arrested and that an incipient recovery is underway. Our tax collections remain stronger than anticipated and our expenditures were kept in check, allowing us to regain control over the budgetary situation. Market sentiment has strengthened, liquidity in the financial system remains adequate, and deposits continue growing. Exports in several industries are recovering while imports remain strong. All performance criteria for end-December 2003 under the PRGF-supported program have been observed. We request completion of the first review under the PRGF.

2. We made further progress in implementing our debt strategy. A road show was conducted in January to seek creditors' support for our restructuring plans. We exchanged views with creditors on the possible features of a debt restructuring. We are in contact with our official bilateral creditors. We have engaged the Caribbean Development Bank with a specific debt restructuring proposal. We expect to present to our creditors concrete restructuring proposals by mid-March, trying to preserve to the extent possible, inter-creditor equity. Given the severe financing constraints we face, we expect to finalize our debt restructuring exercise by early-April.

3. A donors' meeting took place in Roseau in early-February 2004. Donors were briefed on the status of the program and project execution. The meeting served to coordinate the necessary technical assistance to implement our ambitious structural reform agenda. We reiterated to the donor community, our commitment to implement the investment program approved in the budget. Given the need to accommodate future projects within the fiscal and borrowing limits established by the program, we will scrutinize projects to ensure that only those with the highest social benefit are carried out.

We strongly reiterate our commitment to the policies described in our letter and memorandum of economic policies of December 10, 2003. The Government will continue the usual close and fruitful dialogue with the Fund and stands ready to adopt the necessary measures to achieve the objectives of the program. We have authorized the Fund to use this letter to signal the seriousness of our commitment to the program, to our creditors and the entire international community.

Sincerely yours,

/s/

Honorable Roosevelt Skerrit
Prime Minister and Minister of Finance and Planning

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 04/58
FOR IMMEDIATE RELEASE
March 24, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review of Dominica's PRGF Arrangement

The Executive Board of the International Monetary Fund (IMF) completed today the first review under the SDR 7.69 million (about US$11.3 million) Poverty Reduction and Growth Facility (PRGF) arrangement for Dominica. In addition, the Executive Board completed the financing assurances review under Dominica's PRGF arrangement, which is required in accordance with the IMF Guidelines on Conditionality to ensure adequate safeguards of IMF resources.

Completion of these reviews makes SDR 308,000 (about US$455,000) immediately available to Dominica, and would bring total disbursements under the arrangement to SDR 2.67 million (about US$3.9 million). The current PRGF arrangement was approved on December 29, 2003 for a period of three years (see Press Release No. 03/228).

The PRGF is the IMF's credit facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

In commenting on the Executive Board's decision, Agustín Carstens, Deputy Managing Director, and Acting Chair said:

"The Dominican authorities' implementation of the economic program, supported first by an extended Stand-by Arrangement and currently by the Poverty Reduction and Growth Facility, has been strong. On the macroeconomic front, inflation remains low and there are indications of an early recovery of economic activity. The authorities need to persevere with fiscal consolidation, implementation of the comprehensive reform agenda, and efforts to restructure the external debt in order to bring Dominica back to a sustainable growth path.

"The authorities are strengthening their fiscal consolidation efforts. The fiscal targets of the program have been observed with wide margins, although this outturn reflects special budgetary developments that are not expected to be sustained. The authorities are preparing a budget for FY 2004/05 that will include front-loaded measures to improve the fiscal balance, and they are committed to continued fiscal adjustment over the medium term. Attainment of fiscal sustainability will also require vigorous implementation of fiscal reforms, including downsizing the civil service, rationalizing the pension system, streamlining tax exemptions, introducing the value added tax, implementing the Fiscal Responsibility Law, and improving the budgetary framework. The authorities plan to undertake a comprehensive review of tax exemptions by end-June 2004.

"Dominica's economic growth prospects are likely to depend mostly on investment and export growth. Thus the authorities are placing considerable emphasis on structural reforms to improve the investment climate, enhance competitiveness, deregulate the economy, and strengthen the financial sector. As the reform agenda is demanding and capacity constraints faced by the authorities are pressing, Dominica will continue to rely substantially on timely and coordinated technical assistance. It will also be essential that the reforms be properly prioritized and sequenced.

"The authorities have entered into good faith negotiations with Dominica's external creditors, based on international best practices. With the help of their debt advisors, they are putting together a comprehensive debt restructuring proposal as a first step toward achieving debt sustainability. The negotiations with creditors are expected to be concluded shortly. A rigorous debt management policy is needed to prevent the re-emergence of debt sustainability problems.

"The structural reform agenda will be implemented in tandem with the authorities' poverty reduction strategy, as articulated in their Interim Poverty Reduction Strategy Paper, with a view to preserving essential social spending and reducing unemployment-related poverty. Progress has been made toward preparation of a full Poverty Reduction Strategy Paper, which is expected to be finalized by end-2004," Mr. Carstens said.

Statement by Ian E. Bennett, Executive Director for Dominica
March 24, 2004

While the economic situation in Dominica remains fragile, the PRGF arrangement continues to provide a solid foundation for macroeconomic stability and is off to a promising beginning. Economic indicators point to a bottoming out of the severe economic retrenchment of recent years; an early recovery is underway. Economic activity is on the rise in manufacturing, construction, and tourism sectors (although production in the banana sector continues to adjust). Moreover, larger than expected tax collections and rapid import growth are further indications of an incipient recovery. While not all numbers are in, it now looks like growth was flat for 2003, as opposed to the projected decline of between 1 and 3 percent.

My Dominican authorities are well aware, however, that they will need to follow through on an ambitious and comprehensive set of fiscal and structural reforms to sustain and give further momentum to the economic recovery. It is, therefore, important to note that, notwithstanding the sudden death of Prime Minister Charles shortly after the program's approval, the political situation in Dominica has remained stable; a prompt and orderly transition took place and the government's commitment to the PRGF program remains firm. Indeed, program implementation has, thus far, been commendable as reflected by the observance of all end-December performance criteria.

Debt Restructuring

The government and its creditors, including the IMF, World Bank, and the Caribbean Development Bank (CDB), have agreed that Dominica's debt burden, which stands at nearly 115 percent of GDP, is unsustainable. The Executive Board concurred with this assessment at its meeting on December 19th, 2003. Therefore, the overriding immediate-term priority is to decisively resolve the debt overhang problem, which has seriously undermined Dominica's growth potential.

Thus far, the debt restructuring process is proceeding as envisaged and an exchange offer will be made available to private creditors shortly. The authorities have been negotiating in good faith with their creditors and are committed to upholding the principles of transparency and inter-creditor equity. In particular, the government has engaged in discussions with the CDB on a specific debt restructuring proposal, and consultations with private and bilateral creditors are proceeding. While they are hopeful that a comprehensive debt deal can be finalized by mid April –thus avoiding the re-emergence of acute financing pressures– there is still a risk that the agreement may fall short of what is needed to restore sustainability despite the authorities' best efforts. The international communities' continued support of the authorities' debt restructuring efforts, particularly bilateral creditors, will be critical in moving this process forward and securing restructuring terms that are consistent with the sustainability assumptions within the program.

Fiscal Adjustment

Even if the debt strategy is successfully implemented, Dominica's debt dynamics will remain fragile for some time to come. Fiscal consolidation will, therefore, remain a program centerpiece. The government is committed to the objective of moving to a 3 percent primary surplus in 2006/07. If achieved, this would constitute an overall 7½ percent swing in the structural primary balance since embarking on the predecessor SBA in 2002. The authorities are currently on track to post a ½ percent primary surplus in FY2004.

The proposed fiscal package places a heavy emphasis on expenditure measures that will secure permanent gains consistent with long-term sustainability. In addition to maintaining an expenditure freeze on non-interest current spending, the government is set to increase the retirement age and decrease the wage bill by 5 percent, based on reductions in the number of employees. On balance, the government intends to reduce the public wage bill by a total of 10 percent in the next two fiscal years through comprehensive public sector reform. This is on top of the 5 percent nominal wage cut that was introduced in the 2003/04 budget.

On the revenue side, while progress has been made to eliminate discretionary tax exemptions, there is still room for improvement. As elaborated in Box 1 of the staff report, managing tax exemptions is a complex area. The distinction between statutory and discretionary exemptions is at times blurred which, when combined with inherent capacity constraints, implies that monitoring and enforcement is extremely difficult. The authorities are resolved to address inefficiencies and will present possible solutions in June. As part of this effort, they would welcome input from FAD.

Financial Sector and Monetary Issues

Preserving domestic financial sector stability throughout the debt restructuring period and beyond is a key priority. Thus far, market reaction to the debt announcement has been benign and liquidity remains abundant. Indeed, domestic bank deposits have been stable and there is no evidence to indicate financial turbulence at a regional level. And, while a restructuring of domestic bank claims is a part of the debt strategy, the authorities are mindful of the need to strike a delicate balance to prevent an excessive and destabilizing erosion of balance sheets.

On balance, the authorities are confident that financial sector stability will be preserved, but intend to be proactive in terms of ongoing initiatives to further strengthen domestic financial institutions. Indeed, they endorse the recommendations coming out of the regional FSAP concerning the need to strengthen the Eastern Caribbean Central Bank's (ECCB) prudential regulations and step up its monitoring activities. For Dominica's part, the government has divested its majority share of the National Commercial Bank (now renamed the National Bank of Dominica) and reduced the number of government-appointed Directors on its board to improve governance. Moreover, a strategy is being worked out to advance a new round of on-site inspections of systemically important non-bank financial institutions.

On monetary policy issues, Dominica is constrained given its participation in the Eastern Caribbean Currency Union. Nevertheless, the authorities are of the view that eliminating the ECCB's minimum savings deposit rate could strengthen monetary management while at the same time remove a recessionary bias in the economy. They will express these views at the next meeting of the ECCB monetary council.

Structural Reform Agenda

The structural reform agenda is largely embodied in the package of measures that underpin fiscal objectives, including pension and public sector reform. Mindful of the need for fiscal sustainability, the authorities also intend to: *i)* increase the efficiency of the tax system by introducing a VAT as early as 2005; *ii)* strengthen budgetary procedures by making use of three-year rolling budgetary projections; and, *iii)* bring forward (to the extent possible) the introduction of a fiscal responsibility law to guide policy over the business cycle and to safeguard fiscal sustainability.

Conclusion

Dominica has made strides in terms of reorienting fiscal policy and advancing structural reform to restore macroeconomic stability. This has paid early dividends, which in turn has strengthened the authorities' resolve to persevere and implement the full set of reforms under the PRGF. My Dominican authorities will continue to consult with civil society and domestic stakeholders to strengthen this growing national consensus, including through discussions to finalize the Poverty Reduction Strategy Paper. The government is hopeful that the IMF Board will continue to endorse Dominica's ongoing efforts to engineer a smooth economic transformation by supporting the completion of the First Review of the PRGF. Finally, my Dominican authorities would like to express their gratitude to the IMF and the donor community more generally, for the provision of timely financial support and technical assistance in support of structural adjustment.