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Dominica: 2001 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of Dominica

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Dominica, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 30, 2001** 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 May 21, 2001.** 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.

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its June 15, 2001 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the authorities of Dominica.

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DOMINICA

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the
2001 Consultation with Dominica

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May 21, 2001

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Executive Summary

Over the past several years, output and employment growth have been sluggish, reflecting a difficult restructuring process associated with the retrenchment of the banana industry, and the low productivity of public investment. Real GDP is estimated to have grown by less than 1 percent on average in 1999–2000, compared with an average of 2½ percent during 1996–98.

The public finances have deteriorated sharply in recent years as capital expenditure has increased, while saving has been declining and foreign grants have fallen from their levels of the mid-1990s. The overall deficit of the consolidated public sector more than doubled to about 11 percent of GDP in FY 1999/2000 (year ending June 30) and public savings fell by half to 1¼ percent of GDP, mainly reflecting the deterioration in central government finances in the run-up to the national elections of January 2000. Central government saving turned negative in FY 1999/2000, reflecting the lack of buoyancy of the tax system and the fact that domestic fuel prices were kept unchanged, while the government wage bill and debt service obligations increased strongly. The rising overall deficit of the central government was financed by increasing recourse to the banking system and external commercial borrowing, as well as substantial accumulation of domestic arrears, particularly to the social security system. An increased negative level of central government saving and a smaller overall deficit (due to lower investment expenditure) are projected for FY 2000/01.

Dominica has the potential to achieve and maintain a growth rate of at least 3 percent over the medium and long term on the basis of a restructured banana industry, and expanding tourism, other service exports, and nontraditional agriculture. However, achieving such an outcome will be a challenge in the context of the recent deterioration of banana export prices and the continuing erosion of the preferential access to the EU market for banana exports. Moreover, it will require major political resolve to correct the growing financial imbalances that are beginning to crowd out private investment, and to implement the medium term measures necessary for sustained growth.

In the near term, policies should be geared toward reversing the trend in government saving and attaining a viable fiscal position. The tax system buoyancy needs strengthening by phasing out tax concessions, fully adjusting fuel prices to reflect import costs, and further simplifying indirect taxation, while moving toward adopting the VAT. Current outlays need to be tightened, and in particular, restraint on wage increases will be crucial. There is a need to tighten selection criteria on public investment projects and to focus on those projects that are financed on a concessional basis and support economic restructuring and growth.

Supervision of nonbank financial institutions needs to be strengthened. The authorities should also proceed with their plans to strengthen the regulatory and supervisory framework of the offshore financial sector and to follow up on the Module I self assessment.

I. Introduction

1. The consultation discussions with Dominica were conducted in Roseau during March 15–30, 2001. The staff met with the prime minister, the minister of finance, other senior government officials, and representatives of labor unions and the private sector.[1]

2. Dominica is on the standard 12-month consultation cycle. In concluding the 1999 Article IV consultation on January 10, 2000, Executive Directors emphasized that achieving the authorities' medium-term objectives of sustained growth of output and employment would require raising public saving to help fund needed investments and promoting efficient private sector activity through structural reforms. They underscored the need for current expenditure restraint, particularly in the wage bill, as well as for streamlining tax exemptions. They also urged the authorities to scale down their ambitious public investment program to a more manageable level and to minimize borrowing on commercial terms. Directors stressed the need for accelerating structural reforms in the areas of price decontrol, trade liberalization, civil service reform, and privatization. Directors encouraged the authorities to maintain close surveillance over the financial system and, in particular, urged strengthening of the supervision of nonbank and offshore financial institutions.

3. Dominica is one of eight eastern Caribbean islands with a common central bank, the Eastern Caribbean Central Bank (ECCB), and a common currency, the Eastern Caribbean dollar, which has been pegged to the U.S. dollar since 1976. Dominica has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions. Relations with the Fund, the World Bank, and the Caribbean Development Bank (CDB) are summarized in Appendices I to III.

4. Dominica provides the core minimum data to the Fund. However, deficiencies in the quality, timeliness, and coverage of the data hamper adequate monitoring of economic developments. The periodicity of national accounts and external sector data is insufficient and the coverage of government finance data is incomplete. Moreover, the reporting of these statistics is irregular (Appendix IV).

[1] The staff team comprised Messrs. Salehizadeh (Head), Mendis, Pearson, Shah, and O. Williams, and Ms. Herrera (Assistant) (all WHD). The team was assisted by Ms. Blanchard from the Eastern Caribbean Central Bank (ECCB) and Mr. Durant from the Caribbean Development Bank (CDB). Messrs. van Beek and Guzman (both WHD), Mr. Bernes, the Executive Director for Dominica, Mr. Nelmes (OED), and Mr. Samuel, Senior Director of the ECCB, participated in the final discussions.

II. Background and Recent Developments

5. **Over the past several years, output and employment growth have been sluggish**, reflecting a difficult restructuring process associated with the retrenchment of the banana industry (due to the steady erosion and uncertainties over preferential access to the European Union market), and the low productivity of public investment. **Following a sharp decline in output growth in 1999 to less than 1 percent** (from an average of 2½ percent during 1996–98), **real GDP is estimated to have grown by only ½ of 1 percent in 2000**, because of declines in banana and manufacturing outputs as well as low growth in most of the other sectors (Table 1 and Figure 1). The growth of output in recent years appears to have been insufficient to reduce unemployment,[2] while the contraction of the banana industry has intensified poverty in rural areas.[3]

6. **Inflation in the ECCB member countries tends to be in line with that in the United States** and other major countries, mainly reflecting the openness of the economy and the monetary discipline associated with the regional currency union. Measured by the 12–month change in the CPI, inflation in Dominica increased from zero at end-1999 to 1 percent at end-2000. The low inflation rates in 1999–2000 also reflected the fact that domestic fuel prices were not increased, despite the rise in international oil prices.

7. **The public finances have deteriorated in recent years** as capital expenditure has increased sharply, while saving has been declining and foreign grants have fallen from their levels of the mid-1990s. The overall deficit of the consolidated public sector more than doubled to about 11 percent of GDP in FY 1999/2000 (year ending June 30) and public savings fell by half to 1¼ percent of GDP, mainly reflecting the deterioration in central government finances in the run-up to the national elections of January 2000 (Table 2). Central government saving turned negative in FY 1999/2000, reflecting the lack of buoyancy of the tax system (owing mainly to substantial tax exemptions) and the fact that domestic fuel prices were kept unchanged[4], while the government wage bill and debt service obligations

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[2] The last published labor force survey pointed to an unemployment rate of about 23 percent in December 1997. A draft survey in late 1999 (unpublished) shows a reduction in the unemployment rate to about 16 percent. However, the reliability of both estimates is questionable. Most observers believe that unemployment is between 20 and 30 percent.

[3] The number of active banana farmers has declined from over 5,000 in the early 1990s to less than half that level in recent years, pushing many of them below the poverty line.

[4] The consumption tax on imports of petroleum products—the "fuel tax"—is the residual between the domestic retail price and the cost of imported fuel (including profit margins for distributors and retailers). Thus, rising international petroleum prices and constant domestic prices have eroded the yield from this tax, resulting in a decline in tax receipts on international transactions (by ¾ percent of GDP in 1999/00 and a projected further decline of 1¼ percent of GDP in the current fiscal year).

increased strongly. At the same time, capital expenditures rose sharply, partly reflecting land purchases for the construction of a new international airport. The rising overall deficit of the central government was financed by increasing recourse to the banking system and external commercial borrowing, as well as substantial accumulation of domestic arrears, particularly to Dominica Social Security (DSS).[5]

8. **The financial performance of the rest of the public sector** is dominated by the operations of the DSS and the Dominica Banana Marketing Corporation (DBMC). The overall surplus of the DSS averaged about 1¼ percent of GDP during 1997/98–1999/2000; it is expected to decline to ¾ percent of GDP in the current fiscal year, largely because of the government's arrears noted above. The DBMC's current account deficit increased from an average of 1 percent of GDP in 1997/98–1998/99 to 1½ percent of GDP in 1999/00, as it did not adjust prices paid to farmers in line with the decline in the international market price for bananas. As the DBMC only recently adjusted downward prices paid to farmers, the deficit for the current fiscal year is projected to remain at 1½ percent of GDP.

9. **The public finances have remained weak in FY 2000/01**, mainly reflecting increasing debt service obligations and in spite of the reduced capital spending in the face of financing constraints. Based on the preliminary data for the first half of the fiscal year (July–December 2000), an increased negative level of central government saving is projected for 2000/01 (causing the overall public sector saving to turn negative), while the overall deficit is expected to be smaller than the previous year due to lower investment expenditure.

10. During 2000 **broad money** increased by only ½ percent, reversing the trend of 1998-99 when it grew at a faster rate than nominal GDP (Table 3). Banking system credit to the private sector rose by 7¼ percent (in relation to broad money at the beginning of period), up from 2¼ percent in 1999, mainly due to an increase in retail trade and consumer-based loans. Net credit to the nonfinancial public sector rose by 3¾ percent, up from 2½ percent in 1999, reflecting the deterioration of the public finances. To meet credit demands, domestic banks borrowed increasingly from other banks in the ECCB area and drew down foreign assets, causing a substantial decline in the net foreign assets of the banking system. The share of nonperforming loans in the total loan portfolio of banks, which had increased from 10 percent at end-1995 to 15 percent at end-1998 (mostly as a result of the difficulties in the banana industry), declined to 14 percent (Table 4). At the same time, provisioning for nonperforming loans increased from 16 percent of such loans at end-1996 to 48 percent at end-2000.

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[5] Government arrears to the DSS reached the equivalent of 4¼ percent of GDP by end-2000 (compared to an average of less than 3 percent of GDP in 1998–99), consisting of automatic salary/wage deductions—"contributions"—not transferred to the DSS (about 3 percent of GDP) and debenture interest obligations (about 1¼ percent of GDP).

11. **The external current account deficit**, which averaged about 8 percent of GDP during 1997–98, increased to an average of about 16 percent of GDP in 1999–2000, owing to a decline in banana exports, stagnating tourism receipts, and a large increase in imports (Table 5). An increased surplus in the capital and financial account, reflecting heavy government borrowing and a substantial increase in foreign direct investment, financed the large current account deficit in 1999 and allowed a small increase in imputed net international reserves. In 2000, although the surplus in the capital and financial account rose further, mainly owing to large private inflows, imputed reserves declined by a small amount.[6]

12. **The external value of the Eastern Caribbean dollar** as measured for Dominica appreciated by 4.8 percent in real effective terms during 2000, reflecting mainly the appreciation of the U.S. dollar vis-à-vis other major currencies (Figure 2). The real appreciation of the currency has reached close to 16 percent since the low point in 1995. Reflecting recent government borrowing, mainly due to two overseas bond placements in 1999, the stock of public and publicly guaranteed external debt increased from the equivalent of 37 percent of GDP at end-1998 to about 56 percent of GDP at end-2000, and external debt service rose from 5 percent of exports of goods and services in 1998 to 7 percent in 2000. Since 1999, the stock of external arrears has been virtually eliminated (Table 6).[7]

13. Little progress was made on **structural reforms** during 1999–2000. The authorities postponed the planned privatization of a development bank and deferred scheduled reductions in the common external tariff (CET) under the CARICOM agreement of 1992[8] due to concerns about the possible impact on industry and on government revenue.

III. Policy Discussions

14. Policy discussions were framed in a medium-term context aimed at increasing Dominica's growth rate to at least 3 percent per annum (on the basis of a restructured banana industry, and expanding tourism, other service exports, and nontraditional agriculture), and focused on the risks to economic growth and stability posed by the continuing weakness of public finances. A higher rate of growth would help create an upward trend in income per

[6] The overall balance of payments surplus in 2000 was reflected in an increase in government foreign assets.

[7] The arrears reflected past cash-flow difficulties of the central government, and were owed on contributions to international and regional institutions. Since the arrears were owed entirely by the government, they did not represent exchange restrictions subject to the Fund's approval under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

[8] Dominica lowered its maximum CET rate to 25 percent in January 1999, two years behind the scheduled implementation date for Phase III of the CARICOM agreement. The final reduction under Phase IV (to 20 percent) was scheduled for January 1998, but has not been implemented yet.

capita and reduce unemployment and poverty. **However, achieving such an outcome will be a challenge in the context of the recent deterioration of banana export prices** and the continuing erosion of the preferential access to the EU market for banana exports, and in light of the existence of a number of structural impediments to growth (including a difficult terrain and diseconomies of small scale, as well as high costs of banana production, transportation, and telecommunications). **Moreover, the current level of the fiscal deficit is beginning to crowd out private investment** in the nontraditional agriculture and tourism sectors, **and is threatening the government's ability to fund key projects in economic and social infrastructure**, and meet its commitments to pensioners.

15. The authorities broadly agreed with the staff that, in the near term, policies should be geared toward reversing the trend in government saving and attaining a sustainable fiscal position, with public investment focused on projects financed on a concessional basis that support economic restructuring and growth. At the same time, structural reforms should be accelerated to improve investment efficiency and strengthen external competitiveness. However, they were noncommittal as to the implementation of the complete set of the necessary policies. The mission noted that the credibility of the authorities' medium term strategy was seriously jeopardized by lack of implementation.

A. Fiscal Policy

16. **The mission stressed the need to reverse the trend in the saving position of the central government**, and to attain a saving level of around 2½–3 percent of GDP over the next three years (implying an adjustment of 4 percentage points of GDP over the projected level for the current fiscal year). This saving level—which is consistent with the government's own medium term objectives[9]—would help sustain investment outlays of about 6 percent of GDP[10] (necessary to upgrade physical and social infrastructure) within the framework of a deficit fully covered with grants and concessional financing. This would permit a reversal of the increase in the debt to GDP ratio observed in recent years. Achieving the targeted increase in saving would require actions on both the revenue and expenditure fronts.

17. On the **revenue** side, the mission proposed a number of measures, both to enhance revenue immediately and to bolster economic efficiency and export competitiveness. These measures comprise: (i) increasing fuel prices by about 30 percent to reverse the decline of the yield of the consumption tax on petroleum imports (the yield of this tax has declined to

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[9] See *Dominica, Medium-Term Strategy, 2000–2002*, presented at the June 2000 meeting of the Consultative Group for Cooperation in Economic Development. The above-mentioned saving objective is contained in the "alternative" fiscal projections (implying the implementation of necessary policies).

[10] This implies investment outlays of 8–9 percent of GDP for the consolidated public sector.

1.7 percent of annual GDP from 3 percent of GDP in FY 1997/98—before the sharp fall in international fuel prices in FY 1998/99); (ii) phasing out the existing extensive array of tax concessions which, as in other ECCB member countries, continue to hinder revenue performance (revenue loss in 2000 due to tax concessions is estimated at 5 percent of GDP); (iii) strengthening efforts to reduce the high level of tax arrears (estimated at around 5 percent of GDP); (iv) ensuring that the intended lowering of the CET maximum rate in July 2001 is revenue neutral; and (v) adopting the VAT as the main tool for indirect taxation, as recommended by of the 1999 FAD technical assistance mission.

18. On the **expenditure** side, the mission recommended: (i) a public sector wage freeze in the context of the ongoing wage negotiations for the next three years,[11] as well as a freeze of hiring except in the education and health sectors; (ii) launching of a civil service reform program over the medium-term to reduce the size of the government employment and improve efficiency in the provision of government services; (iii) clearing arrears to the social security system (amounting to more than 4 percent of GDP) that threaten the liquidity and solvency of the system; and (iv) improving the quality and focus of the public investment program by restricting it to projects financed with concessional resources to restructure the banana sector and on essential economic and social infrastructure. In this connection, the mission urged the authorities to ensure that the new airport project, which is intended to be built and operated by the private sector, does not involve government liabilities or guarantees. The mission also recommended that the construction of a large sports stadium be postponed and plans for other stadiums be abandoned.[12]

19. While the authorities broadly agreed with the thrust of the mission's assessment, they were noncommittal on the implementation of most of the staff's recommendations. They were particularly concerned about the economic and social impact of increasing fuel prices, and did not seem disposed to taking this measure. On collecting tax arrears, as the authorities appeared inclined to implementing a tax amnesty program, the mission stressed that any such program should be well defined and well publicized as a one-time operation. The authorities are also planning to review tax concessions, particularly the discretionary ones. While agreeing with the merits of a VAT, they said that its adoption may require a concerted regional approach with other ECCB members, and the prior strengthening of administrative capacity. On wages, the authorities indicated that in the on-going negotiations, the public service unions had asked for an increase of 15 percent over three years, but the government has offered zero wage increase for the first two years and a 1 percent increase for the third year; the unions have rejected this offer but negotiations are continuing. As for hiring, the

[11] The government wage bill currently amounts to more than 50 percent of current government outlays or 15½ percent of GDP, the highest in the ECCB area.

[12] In addition to a large sports complex which will accommodate football games, the government is planning to construct two smaller stadiums, one for netball and the other for cricket games.

authorities indicated that they had already put in place strict controls. On the new airport project, while the authorities agreed on the need for private sector involvement, they did not commit to eschewing government guarantees. As for the plans for additional sports stadiums, the authorities indicated that there were possibilities for concessional financing including grants.

B. Financial Sector Issues

20. Under the fixed exchange rate system, the ECCB conducts its credit operations with the objective of maintaining strong foreign exchange cover for currency issue (currently close to 100 percent), leaving little scope for credit policy at the national level. The ECCB maintains a uniform reserve requirement of 6 percent on all bank deposits.[13] Interest rates are freely determined, except for a statutory 4 percent floor on passbook savings maintained since 1984 aimed at benefiting small savers. The authorities support the continuation of these regional arrangements, the participation in which has served Dominica well.

21. The ECCB is the regulatory and supervisory authority of banks in the region, and in its judgment, the banking system in Dominica[14] remains basically sound.[15] The staff expressed concern that the government-owned National Commercial Bank (NCB), which has 40 percent of banking system deposits, has extended large amounts of credit to the government (in violation of the existing prudential norms on lending to a single borrower),[16] as well as to the distressed banana sector. In order to secure the NCB's soundness, and reduce systemic risk, the staff urged the authorities to refrain from further borrowing from the NCB, and to begin to lower the government's indebtedness so that the NCB could soon comply with prudential guidelines. It is also essential that loan loss provisions continue to be increased.

[13] For a description of the key aspects of ECCB credit policy and recent efforts to develop regional interbank and governments' securities markets, see SM/01/62.

[14] Dominica's banking system comprises five commercial banks (four of which are branches of Canadian and European banks), and a development bank.

[15] The ECCB is constrained by law from disclosing individual bank soundness indicators, and this restriction prevents a proper assessment of compliance with the Basle Core Principles. Recognizing this limitation, the ECCB Monetary Council (composed of the finance ministers of the member countries) has agreed to seek appropriate legislative amendments to permit such disclosure.

[16] The ECCB prudential norms for commercial banks (in line with the Basel Committee guidelines) require the loans to a single borrower be limited to less than 25 percent of capital.

22. Dominica's nonbank financial institutions have grown rapidly in recent years, and remain under the central government's supervision.[17] While these institutions are required to submit their financial statements on a regular basis, they are not subject to on-site inspection. The staff stressed again the importance of strengthening **supervision of nonbank financial institutions**, possibly under the purview of the ECCB. The ECCB is currently considering a number of initiatives, on a regional basis, aimed at: (i) ensuring that these institutions meet capital adequacy standards and are subject to on-site inspection; (ii) strengthening their regulations and supervision according to international best practices; and (iii) possibly, extending to them the application of reserve requirements. The staff urged the authorities to support these initiatives.

23. The authorities reiterated their intention to strengthen the regulatory and supervisory framework of the **offshore financial sector**.[18] They noted that Dominica was the first ECCB member country to hand over the supervision of offshore banks to the ECCB, and that recent amendments to offshore legislation as well as the pending establishment of a Financial Intelligence Unit to address money laundering issues are expected to ensure that the regulation and supervision of the sector will be consistent with international best practices. The authorities also plan to follow up the current Module I self assessment exercise of the offshore sector with subsequent modules in the process toward completion of the ECCB-region FSAP now scheduled for 2002.

C. External Sector Prospects and Policies

24. The projected external current account deficit in 2001, at 19 percent of GDP, although similar to the deficit in 2000, would be much higher than the average over the preceding four years.[19] The deficit is expected to be fully covered with grants, multilateral

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[17] Nonbank financial institutions comprise one finance company, 19 insurance companies, and 18 credit unions, with the latter holding 15 percent of deposits of the financial system. Insurance companies are under the supervision of the ministry of finance and credit unions are under the ministry of cooperatives.

[18] The offshore sector, which was established following the enactment of enabling legislation in 1996–97, is under the supervision and regulation of the ministry of finance. It comprises eight banks, about 6,600 business companies, 20 internet gaming companies, four insurance companies, two trust companies, and two management companies, and employs about 100 persons. The offshore sector also includes an "economic citizenship program", whereby Dominican citizenship is offered to investors. Government revenue from the sector amounted to EC$5.2 million in 2000, about half of the average during 1997–99, as the economic citizenship program was temporarily suspended following reported abuses.

[19] Much of the increase in the current account deficit in recent years has been due to excessive government spending, including nonproductive investment that has done little to improve competitiveness.

financing, and continued foreign direct investment.[20] Merchandise exports are expected to show little change following sharp declines in 1999 and 2000, and tourist earnings are expected to remain at about the same level as in recent years, while import growth is projected to slow reflecting the sluggishness of domestic activity. Dominica's public external debt is projected to increase to 64 percent of GDP by end-2001, and the debt service as a ratio of exports of goods and services would remain at 7 percent.

25. The authorities are aware that prospects for achieving a strong balance of payments position and sustaining output growth in the medium term will depend largely on strengthening competitiveness in the export and tourism sectors. In the context of the fixed exchange rate, this depends crucially on continued fiscal discipline, wage moderation, and increased factor productivity.

26. The authorities saw room for productivity gains through the ongoing restructuring in the banana sector (discussed below), reduction of telecommunication costs, continued tax and trade reforms, and improving the efficiency of public investment. In telecommunications, a recently signed agreement between the Organization of the Eastern Caribbean States (OECS) and the telecommunication monopoly operating in the OECS countries, together with new regulations by the newly established Eastern Caribbean Telecommunications Authority (ECTEL), are expected to enhance competition and lower costs.[21] In the trade policy area, the authorities intend to complete the final phase of the reduction of the CARICOM CET (with the lowering of the maximum tariff rate to 20 percent) in July 2001. However, since various import tariffs remain at rates above the maximum,[22] the average tariff rate is not expected to decline significantly, and the Fund's index of trade restrictiveness will probably remain at 5 (moderately restrictive). The staff urged the authorities to advance further with trade liberalization by narrowing the dispersion of tariff rates, continuing the process of phasing out import licensing, and reducing the existing customs service charge to the approximate cost of processing import transactions, as required by WTO guidelines.

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[20] As in other ECCB countries, the size of Dominica's external current account deficit moves closely with the level of capital inflows. The import requirements of investment expenditure are very high because of the narrowness of the economic base, while the (imputed) official reserves have traditionally been maintained stable in relation to monetary aggregates.

[21] With the support of the World Bank's OECS Telecommunications Reform Project, ECTEL was established in May 2000 with the aim of harmonizing the regulatory framework and enhancing competition in this sector in the region.

[22] The maximum tariff does not apply to agricultural products and arms/ammunition, which continue to be subject to maximum rates of 40 percent and 70 percent, respectively.

27. As other ECCB countries, Dominica retains the policy of requiring approval by the ministry of finance of all single outward remittances above EC$250,000 (US$93,000) for capital and nontrade current transactions. The authorities stressed the fact that the ministry of finance routinely approves all bona fide requests above this threshold, and that the gradual phasing out of the exchange controls is expected in the period ahead.

D. Structural and Social Issues

28. The authorities expressed cautious optimism about the ongoing restructuring toward a streamlined and more efficient banana industry. They believe that output could stabilize at present levels or increase somewhat with current efforts at increasing productivity, but acknowledged that further absorption of excess labor into other agricultural activities will be necessary over the next several years. In this connection, resources provided under the EU's Special Framework of Assistance (SFA) will target efficient farms for investment in irrigation and drainage and other infrastructure works. Concurrently, parallel programs will be in place to shift displaced farmers into nontraditional areas of agriculture and to minimize the social fallout from the restructuring of the industry.

29. The mission urged the authorities to consider the **privatization** of the two state-owned banks (NCB and AIDB), and to abolish the Dominica Export Import Agency's (DEXIA) monopoly on the importation of sugar and bulk rice. The mission recommended that any proceeds that may be obtained from the privatization of public assets be used to reduce public debt or placed in a special fund, with the yield from its investments (rather than the proceeds themselves) used for budgetary support. The mission also recommended the elimination of the remaining price controls, most of which (except those on cement and fuels) are not being enforced. However, the authorities were noncommittal on these recommendations.

30. With assistance from the CDB and the World Bank, the government is implementing a number of **programs for reducing poverty, protecting the environment, and improving education and health services.** The mission encouraged the authorities to review the effectiveness of these programs to ensure that the objectives of the programs will be achieved.

E. Regional Issues

31. The mission shared the authorities' view that participation in the regional monetary and exchange arrangements has served Dominica well, maintaining confidence through the stability of the exchange rate and domestic prices. However, in light of the recent appreciation of the currency in real effective terms and the continuing changes in the external environment, the staff stressed that maintaining the currency union arrangement has raised the premium on the domestic policies required for enhancing competitiveness and achieving sustained growth. The increasing fiscal policy weaknesses in Dominica, as well as a number of other ECCB member countries, were therefore particularly worrisome. In this connection, the mission emphasized the importance of the implementation of the fiscal reform program

put forward by the ECCB,[23] as well as other regional policy initiatives noted above (i.e., those related to the soundness and supervision of the financial system and the offshore sector, and those affecting competitiveness).

IV. Medium-Term Outlook

32. The staff has developed two illustrative medium-term scenarios (Tables 7 and 8). These represent the continuation of present trends and policies (baseline), and the implementation of a comprehensive adjustment program, the elements of which were mentioned above (alternative). Under the baseline projections, continued weaknesses in the public finances are expected to result in low domestic saving and investment and, therefore, sluggish real GDP growth (1 percent per annum in 2001–05). In this case, the current account deficit would decline to about 15 percent of GDP as exports and tourism receipts are projected to increase by about 2 percent and 4 percent per annum, respectively, while imports would grow by 1 percent per year.

33. The staff's alternative projections assume the strengthening of public finances, in line with the June 2000 medium-term economic strategy paper, the completion of trade reform and privatization programs, and the gradual improvement of social conditions through effective implementation of current social and poverty reduction programs. Growth of tourism is assumed to rise gradually from 3 percent in 2001 to about 7 percent in 2005, on the basis of a slight increase in regional market share. Under this scenario, real GDP growth would rise to about 3½ percent in 2005, with the external current account deficit declining to 15½ percent of GDP. The current account deficit would be financed with capital account surpluses, as private inflows increase in response to the improved conditions for private investment. As regards the banana industry, higher productivity and quality improvements are expected to result in modest increases in output from the current level (by about 3½ percent per year).

34. The sensitivity of the medium-term projections to weaker prospects in the banana and tourism sectors was tested. On the assumption of a sharp fall in banana export prices that cannot be fully absorbed by increases in productivity, and with an accompanying decline in banana output, real GDP growth would be about 1 percentage point less than in the alternative scenario, reaching 2½ percent in 2005. Furthermore, an economic slowdown in the United States and Europe is expected to lower the growth of tourism and services exports; growth in these sectors by one percentage point lower than in the alternative scenario would slow overall output growth by about ½ of 1 percentage point. Lower GDP growth rates associated with declines in the banana and tourism sectors' growth, would result in smaller external current account deficits as imports growth would be slower and private investment and capital inflows would be less buoyant.

[23] See SM/01/62 for a description of this program.

V. STAFF APPRAISAL

35. Dominica's recent economic performance has been very disappointing. The economy has undergone several years of sluggish growth, resulting from the retrenchment of the banana industry following the erosion of preferential access to the European market and lackluster performance of other sectors. The public finances have weakened, with central government saving turning negative in the last fiscal year and the overall deficit of the consolidated nonfinancial public sector more than doubling. The deficit has been financed by recourse to the banking system and external commercial borrowing, as well as accumulation of domestic arrears, especially to the social security system.

36. While the fiscal deterioration began during the last years of the previous administration, the current government (which assumed office in February 2000) has yet to take major steps to reverse the process, despite its avowed intention to raise public sector saving to sustain the necessary public infrastructure and social investments within a sound fiscal framework. The staff is very concerned about the risks posed to economic growth and stability by the continuing weakness of the public finances, and believes that strong fiscal consolidation is the necessary context for improving Dominica's growth prospects over the next several years based on further developing non-banana exports, while enhancing the efficiency of a streamlined banana industry.

37. In order to strengthen public saving, efforts should be made to raise the buoyancy of the tax system. Key elements would be adjusting domestic fuel prices immediately (as other ECCB members have done) and, in the future, permitting these prices to fully reflect movements in import prices; phasing out the extensive array of tax concessions; strengthening tax administration and reducing the high level of tax arrears; and further simplifying indirect taxation, while moving toward the adoption of a value-added tax, possibly in the context of a region-wide project.

38. A cautious expenditure policy will be crucial to support fiscal consolidation. Current outlays of the central government need to be contained, in particular through a prudent wage policy based on merit and economy-wide productivity gains. It would be important to exercise utmost restraint on wage increases in the context of the ongoing three-year wage negotiations, as these usually provide a signal for economy-wide wage setting behavior. Reducing public employment through attrition and moving forward with civil service reform, while providing incentives to recruit and retain qualified staff, would help increase efficiency in the provision of services within a streamlined public sector. The authorities are also advised to monitor carefully the selection of projects for inclusion in the public investment program and to choose only those that are financed on a concessional basis and aimed at redressing the main impediments to growth.

39. Although the banking system remains sound in the judgment of the regional central bank, the ECCB, the staff is concerned about the risks to some financial institutions stemming from their heavy exposure to the financially weak public sector and to the distressed banana industry. In order to reduce systemic risk, the central government should

refrain from further borrowing from the state-owned commercial bank, and begin to lower its indebtedness, so that the bank could soon comply with prudential regulations. Also, supervision of nonbank financial institutions needs to be strengthened, including through the transfer of supervisory responsibilities to the ECCB, and it would be important that the authorities move forward with the implementation of the recent ECCB initiatives of extending to these institutions the principles and practices currently applied to banks.

40. The authorities have expressed their intention to strengthen the regulatory and supervisory framework of the offshore financial sector. Dominica was the first ECCB member country to hand over the supervision of offshore banks to the ECCB, and recent amendments to offshore legislation as well as the pending establishment of a Financial Intelligence Unit to address money laundering issues are expected to ensure that the regulation and supervision of the sector will be consistent with international best practices. The authorities are encouraged to follow–up the current Module I self assessment exercise of the offshore sector with subsequent modules in the process toward completion of the ECCB-region FSAP scheduled for 2002.

41. Completion of ongoing structural reforms will be important in the period ahead to strengthen the basis for higher growth. The orderly restructuring of the banana sector toward a streamlined and more efficient industry needs to be completed. This requires the support of public investment in irrigation and other infrastructure to help increase productivity, while improving the provision of social services to facilitate the absorption of released labor in other activities. In the trade policy area, the staff advises the authorities that, following the expected implementation in the near term of the final phase of the CET, trade reform should be further advanced by completing the process of phasing out remaining import licenses and moving toward establishing a low and uniform tariff rate. The authorities are also advised to consider the privatization of the two state-owned banks and to use the privatization receipts to reduce the public debt.

42. Dominica has made some progress in the provision of core statistics to the Fund. However, data deficiencies continue to hamper surveillance, and additional efforts are needed to improve data, in particular on national accounts and government finances. Dominica participates in the General Data Dissemination System (GDDS) and has developed plans for improving the quality and availability of key macro-economic statistics. The staff encourages the authorities to provide adequate resources to the Central Statistical Office in order to establish a solid foundation for effectively absorbing technical assistance in statistics, which may be available from the bilateral and multilateral sources, including through the forthcoming Caribbean Regional Technical Assistance Center (CARTAC).

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

Table 1. Dominica: Selected Economic and Financial Indicators

	1997	1998	1999	Prel. 2000	Proj. 2001
(Annual percent change)					
Output and prices					
Real GDP	2.0	2.4	0.9	0.5	1.0
Of which : Bananas	-10.0	-17.6	-4.4	-2.7	-4.0
GDP deflator (factor cost)	1.2	2.5	2.3	1.5	1.5
Nominal GDP at market prices	3.2	5.0	3.2	2.1	2.5
Consumer prices (end of period)	2.2	1.5	0.0	1.1	1.5
Money and credit					
Net foreign assets of the financial system 1/	-2.0	7.0	8.1	-12.6	-0.5
Net domestic assets of the financial system 1/	5.5	4.4	2.3	13.2	1.2
Of which :					
Credit to the public sector (net) 1/	1.6	-2.5	2.4	3.7	-0.8
Credit to the nonfinancial private sector 1/	6.1	7.6	2.3	7.3	2.3
Liabilities to the private sector (M2)	3.5	11.4	10.4	0.6	0.7
External sector					
Merchandise exports, f.o.b.	1.9	17.9	-13.5	-10.4	1.0
Merchandise imports, f.o.b.	3.8	5.0	3.5	3.8	2.1
Terms of trade	2.5	2.6	-12.5	-16.3	...
Real effective exchange rate	11.4	-3.8	0.7	4.8	...
(In millions of U.S. dollars)					
Merchandise exports, f.o.b.	53.5	63.1	54.6	48.9	49.4
Merchandise imports, f.o.b.	104.0	109.2	113.0	117.3	119.8
Current account balance	-25.9	-14.5	-29.4	-54.9	-52.2
Capital and financial account balance 2/	26.9	18.3	37.2	58.1	52.7
Overall balance	0.9	3.8	7.8	3.2	0.5
(In percent of GDP, unless otherwise specified)					
Investment and savings					
Gross domestic investment	31.2	27.0	28.5	29.3	27.8
Private	24.6	19.5	16.9	16.3	16.1
Public	6.6	7.5	11.6	13.0	11.7
Gross national saving	20.7	21.3	17.4	9.0	8.9
Private	17.9	19.0	15.6	8.8	8.9
Public	2.8	2.3	1.8	0.2	0.0
Nonfinancial public sector 3/					
Current account balance	3.4	2.1	2.4	1.2	-0.6
Overall balance (after grants)	-0.8	-2.9	-4.9	-10.9	-8.8
Central government 3/					
Current account balance	1.1	0.2	0.7	-0.3	-1.1
Overall balance (after grants)	-2.0	-3.7	-7.7	-10.5	-7.7
External sector and debt					
Current account balance	-10.6	-5.7	-11.1	-20.3	-18.9
Gross public sector debt	64.1	64.2	76.7	86.0	92.7
External	37.5	36.7	50.6	56.2	64.3
Domestic	26.6	27.5	26.1	29.8	28.4
External debt service 4/	7.6	5.1	5.5	7.0	7.0
Principal	5.8	3.6	3.3	3.2	3.1
Interest	1.8	1.5	2.2	3.8	3.9
Memorandum items:					
Nominal GDP at market prices (EC$ millions)					
Calendar year	659.0	692.2	714.4	729.2	747.2
Fiscal year	648.7	675.6	703.3	721.8	738.2
Net international reserves (US$ millions) 5/	23.9	27.7	31.6	29.4	28.0

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

1/ Change relative to the stock of M2 at the beginning of the period.
2/ Including errors and omissions.
3/ These data are presented on a fiscal year (July-June) basis. Figures shown for a given calendar year relate to the fiscal year ending on June 30 of that year.
4/ In percent of exports of goods and services.
5/ Imputed reserves at the ECCB.

Table 2. Dominica: Summary Accounts of the Nonfinancial Public Sector 1/

(In percent of GDP)

	1996/97	1997/98	1998/99	Prel. 1999/00	Proj. 2000/01
I. Consolidated Nonfinancial Public Sector					
Total revenue and grants	**39.9**	**37.0**	**39.3**	**37.2**	**37.2**
Current revenue	34.6	33.2	34.2	34.4	33.4
Of which : operating balance of nonfinancial public enterprises	0.8	0.3	0.3	-0.1	-0.3
Capital revenue	0.2	1.5	0.8	0.4	0.2
Grants	5.1	2.3	4.3	2.4	3.6
Total expenditure	**40.7**	**39.9**	**44.2**	**48.1**	**46.0**
Current	31.2	31.1	31.8	33.2	34.0
Of which: wages and salaries	16.3	15.7	15.8	16.4	16.3
Capital expenditure and net lending	9.5	8.8	12.3	14.8	12.0
Of which: Fixed capital formation	7.3	6.0	9.0	14.3	11.7
Current account balance	**3.4**	**2.1**	**2.4**	**1.2**	**-0.6**
Overall balance	**-0.8**	**-2.9**	**-4.9**	**-10.9**	**-8.8**
Statistical discrepancy 2/	0.9	0.0	1.5	-2.1	0.0
Financing (net)	**-0.1**	**2.9**	**3.4**	**13.0**	**8.8**
II. Central Government					
Total revenue and grants	**34.4**	**31.7**	**34.0**	**32.1**	**32.4**
Current revenue	29.1	28.0	29.1	29.4	28.6
Tax	23.7	23.7	24.7	25.1	24.2
Nontax	5.4	4.3	4.4	4.3	4.5
Capital revenue	0.2	1.5	0.8	0.4	0.2
Grants	5.1	2.2	4.1	2.4	3.6
Total expenditure	**36.4**	**35.4**	**39.4**	**42.6**	**40.1**
Current	28.0	27.8	28.4	29.6	29.8
Wages and salaries	15.4	14.8	15.0	15.6	15.5
Goods and services	5.3	5.7	5.7	5.2	4.6
Interest	2.6	2.6	2.5	3.9	5.2
Transfers	4.7	4.6	5.1	4.9	4.5
Capital expenditure and net lending	8.4	7.6	11.1	12.9	10.3
Of which: fixed capital formation	6.0	4.7	8.3	13.0	10.4
Current account balance	**1.1**	**0.2**	**0.7**	**-0.3**	**-1.1**
Overall balance	**-2.0**	**-3.7**	**-7.7**	**-10.5**	**-7.7**
Statistical discrepancy 2/	0.8	-1.1	2.3	-2.9	0.0
Financing (net)	**1.1**	**4.9**	**5.4**	**13.4**	**7.7**
External	-0.3	0.7	2.4	12.2	6.6
Domestic	-1.0	3.3	3.0	1.2	1.1
Privatization	2.5	0.8	0.0	0.0	0.0
III. Rest of the Nonfinancial Public Sector					
Revenue, transfers and grants	**9.5**	**7.5**	**8.3**	**6.5**	**6.0**
Revenue	6.0	5.6	5.7	5.4	5.1
Transfers from central government	3.5	1.9	2.5	1.0	0.9
Grants	0.0	0.0	0.2	0.0	0.0
Expenditure	**8.2**	**6.8**	**7.5**	**6.7**	**6.9**
Current	4.4	4.6	4.7	4.8	5.2
Capital	3.8	2.2	2.8	1.9	1.7
Current account balance	**1.6**	**1.0**	**1.0**	**0.6**	**-0.1**
Overall balance	**1.3**	**0.7**	**0.9**	**-0.2**	**-0.9**
Financing (net)	**-1.3**	**-0.7**	**-0.9**	**0.2**	**0.9**

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

1/ Fiscal years ending June 30.

2/ Difference beetween identified financing and overall balance.

Table 3. Dominica: Summary Accounts of the Banking System

	1997	1998	1999	2000	Proj. 2001
(In millions of Eastern Caribbean dollars, end of period)					
I. Consolidated Banking System					
Net foreign assets	**64.7**	**91.2**	**125.5**	**66.4**	**64.3**
Net domestic assets	**316.3**	**333.2**	**342.8**	**404.7**	**410.4**
Net credit to the nonfinancial public sector	47.5	37.9	48.1	74.7	71.0
Net credit to nonbank financial institutions	-60.2	-43.5	-43.9	-35.8	-37.0
Credit to the nonfinancial private sector	381.0	410.0	419.8	454.1	464.7
Other items (net)	-52.0	-71.2	-81.2	-88.3	-88.3
Broad money 1/	**381.0**	**424.3**	**468.3**	**471.1**	**474.7**
II. Operations of the Eastern Caribbean Central Bank					
Imputed net international reserves	**64.5**	**74.7**	**85.2**	**79.4**	**75.6**
Net domestic assets	**11.9**	**11.1**	**11.0**	**9.7**	**10.7**
Monetary base	**76.4**	**85.8**	**96.2**	**89.1**	**86.3**
Currency in circulation	28.2	29.1	34.0	35.5	35.6
Commercial bank reserves	48.2	56.7	62.2	53.6	50.7
III. Commercial Banks					
Net foreign assets	**0.2**	**16.5**	**40.3**	**-12.9**	**-11.3**
Net claims on ECCB	**44.9**	**53.4**	**62.2**	**51.2**	**48.3**
Net domestic assets	**307.6**	**325.4**	**331.7**	**397.3**	**402.0**
Net credit to the nonfinancial public sector	35.6	26.8	37.1	65.0	60.3
Net credit to nonbank financial institutions	-60.2	-43.5	-43.9	-35.8	-37.0
Credit to the nonfinancial private sector	381.0	410.0	419.8	454.1	464.7
Other (net)	-48.7	-67.9	-81.3	-86.0	-86.0
Private sector deposits 1/	**352.7**	**395.2**	**434.1**	**435.6**	**439.0**
IV. Consolidated Banking System					
(Annual percentage change)					
Credit to the nonfinancial private sector	6.3	7.6	2.4	8.2	2.3
Broad money 1/	3.5	11.4	10.4	0.6	0.7
(Contributions to liquidity growth) 2/					
Net foreign assets	**-2.0**	**7.0**	**8.1**	**-12.6**	**-0.5**
Net domestic assets	**5.5**	**4.4**	**2.3**	**13.2**	**1.2**
Net credit to the nonfinancial public sector	1.6	-2.5	2.4	3.7	-0.8
Credit to the nonfinancial private sector	6.1	7.6	2.3	7.3	2.3
Memorandum items:					
Velocity 3/	1.7	1.7	1.6	1.6	1.6
Interest rates 4/					
Deposits	4.9	4.2	4.0	4.0	...
Lending	12.0	11.4	11.4	11.4	...

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

1/ Including deposits denominated in U.S. dollars.
2/ Change relative to broad money at the beginning of the period.
3/ Nominal GDP at market prices divided by the average of the year-end stock of broad money for the current and previous year.
4/ Commercial banks; weighted averages of end-year rates per annum.

Table 4. Dominica: Indicators of External Vulnerability

	1997	1998	1999	Prel. 2000	Proj. 2001
Financial indicators					
Broad money (percent change, 12-month basis)	3.5	11.4	10.4	0.6	0.7
Private sector credit (percent change, 12- month basis)	6.3	7.6	2.4	8.2	2.3
Nonperforming loans (3 months and over)/ total loans (percent)	13.8	15.4	14.4	13.6	...
Capital/risk weighted assets (percent)	7.6	7.2	8.8	8.8	...
Three-month T-bill rate (end of period)	6.4	6.4	6.4	6.4	...
Three-month T-bill rate (real) 1/	4.2	4.9	4.8	5.3	...
External indicators					
Exports of goods and services (percent change, 12-month basis in US$)	12.9	10.7	1.1	-10.2	3.9
Imports of goods and services (percent change, 12-month basis in US$)	6.0	3.6	11.4	1.6	1.9
Current account balance (in percent of GDP)	-10.6	-5.7	-11.1	-20.3	-18.9
Capital and financial account balance (in percent of GDP)	15.0	4.7	15.8	23.4	19.1
Net official reserves (in US$ millions, end of period)	23.9	27.7	31.6	29.4	28.0
Net reserves to broad money (percent, end of period)	16.9	17.6	18.2	16.8	15.9
External debt (in percent of GDP, end of period)	37.5	36.7	50.6	56.2	64.3
External debt (end of period) to exports of goods and services (percent)	65.1	60.5	85.1	107.4	121.3
External debt service to exports of goods and services (percent)	7.6	5.1	5.5	7.0	7.0
External interest payments to exports of goods and services (percent)	1.8	1.5	2.2	3.8	3.9
External amortization payments to exports of goods and services (percent) 2/	5.8	3.6	3.3	3.2	3.1
Exchange rate (per US$, end of period)	2.7	2.7	2.7	2.7	...
REER appreciation (percent change, end of period)	11.4	-3.8	0.7	4.8	...

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

1/ Treasury bill rate adjusted by end of period inflation.
2/ Refers to public sector debt.

Table 5. Dominica: Balance of Payments

	1997	1998	1999	Prel. 2000	Proj. 2001
	(In millions of U.S. dollars)				
Current account balance	**-25.9**	**-14.5**	**-29.4**	**-54.9**	**-52.2**
Trade balance	-50.5	-46.1	-58.4	-68.4	-70.4
Merchandise exports (f.o.b.) 1/	53.5	63.1	54.6	48.9	49.4
Merchandise imports (f.o.b.)	104.0	109.2	113.0	117.3	119.8
Nonfactor services balance	31.1	33.9	37.3	32.4	35.8
Exports of NFS	83.3	87.9	98.2	88.2	90.9
Travel	48.3	46.5	48.8	47.3	48.6
Transport and communications	22.1	23.9	32.8	25.7	26.6
Other	12.9	17.5	16.6	15.3	15.7
Imports of NFS	52.2	54.0	60.9	55.8	55.0
Net factor services	-16.9	-15.5	-25.8	-30.2	-30.1
Of which:					
Interest payments	2.6	2.4	3.4	5.4	5.7
Net current transfers	10.5	13.2	17.4	11.3	12.4
Private sector	9.4	9.5	10.3	10.8	11.7
Public sector	1.1	3.8	7.1	0.5	0.7
Capital and financial account	**36.6**	**12.0**	**41.8**	**63.2**	**52.7**
Capital account	22.5	14.7	11.8	12.4	12.8
Of which:					
Public capital transfers	20.2	12.3	9.4	9.7	9.9
Private capital transfers	2.3	2.4	2.5	2.6	2.9
Financial account	14.0	-2.8	30.1	50.8	39.8
Public sector	-10.0	2.3	23.4	19.3	26.3
Official borrowing (net)	1.0	1.5	2.3	9.1	26.3
Disbursements	9.0	7.1	7.6	13.7	30.9
Repayments	8.1	5.6	5.2	4.5	4.6
Other	-11.0	0.8	21.1	10.1	0.0
Of which:					
Portfolio investment	-0.2	1.3	21.5	10.1	0.0
Private sector	24.1	-5.1	6.7	31.5	13.5
Direct investment	21.1	6.5	18.0	13.2	14.5
Other investment	2.9	-11.6	-11.3	18.3	-1.0
Of which:					
Commercial banks	3.4	-6.0	-8.8	19.7	-0.6
Errors and omissions	**-9.7**	**6.3**	**-4.6**	**-5.1**	**0.0**
Overall balance	**0.9**	**3.8**	**7.8**	**3.2**	**0.5**
Financing	**-0.9**	**-3.8**	**-7.8**	**-3.2**	**-0.5**
Change in reserve position with the IMF	-0.6	0.0	0.0	0.0	0.0
Change in public sector arrears	0.9	0.4	0.4	0.0	0.0
Change in government foreign assets (increase -)	-0.6	-0.4	-4.3	-5.4	-1.9
Change in imputed reserves (increase -)	-0.7	-3.8	-3.9	2.2	1.4
	(In percent of GDP)				
Memorandum items:					
Current account balance	-10.6	-5.7	-11.1	-20.3	-18.9
External debt	37.5	36.7	50.6	56.2	64.3

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

1/ Includes stores and bunkers.

Table 6. Dominica: Public and Publicly Guaranteed External Debt 1/

	1996/97	1997/98	1998/99	Prel. 1999/00	Proj. 2/ 2000/01
(In millions of U.S. dollars)					
Debt outstanding at end of year 3/	99.8	90.6	92.8	145.6	165.2
Drawings	7.5	10.4	8.2	58.6	25.2
Scheduled debt service	8.7	9.2	7.7	10.1	10.3
Principal	6.3	6.8	5.2	4.7	4.6
Interest	2.5	2.4	2.5	5.4	5.7
Debt service paid	10.6	9.1	8.2	10.1	10.3
Principal 4/	7.9	6.8	5.6	4.7	4.6
Interest	2.7	2.3	2.6	5.5	5.7
Debt forgiveness	0.0	10.9	0.0	0.0	0.0
Change in arrears	-1.8	0.1	-0.5	0.1	0.0
Valuation adjustment	-1.3	-1.8	-0.5	-1.1	-1.0
Stock of arrears (end of year)	0.5	0.6	0.1	0.2	0.0
Principal	0.4	0.4	0.1	0.1	0.0
Interest	0.1	0.2	0.1	0.1	0.0
(In percent; unless otherwise indicated)					
Memorandum items:					
Debt outstanding/GDP	41.6	36.2	35.6	54.5	60.4
Stock of arrears/GDP	0.2	0.2	0.0	0.1	0.0
Scheduled debt service/exports of goods and services	6.6	6.2	4.9	6.8	7.2
Average interest rate (percent per annum) 5/	2.7	2.4	2.8	4.6	3.7
GDP at market prices (millions of US $)	240.3	250.2	260.5	267.3	273.4

Sources: Dominican authorities; and Fund staff estimates and projections.

1/ Fiscal years ending June 30.
2/ Projections based on contracted debt.
3/ The decline in 1997/98 was aided by the substantial debt forgiveness (US$10.9 million) granted in October 1997 by the British government to Dominica (related to the Mauritius mandate).
4/ Excludes debt forgiveness.
5/ Average interest rate on actual interest payments.

Table 7. Dominica: Medium-Term Projections--Baseline 1/

	Average	Prel.	Projections				
	1998-99	2000	2001	2002	2003	2004	2005
	(Annual percentage change)						
National income and prices							
GDP at constant (1990) prices	1.7	0.5	1.0	1.0	1.0	1.0	1.0
Implicit GDP deflator (factor cost)	2.4	1.1	1.5	1.5	1.5	1.5	1.5
	(In percent of GDP, unless otherwise stated)						
Saving and investment							
Gross domestic investment	27.8	29.3	27.8	24.0	23.1	21.6	20.6
Private	18.2	16.3	16.1	16.0	15.6	14.6	14.1
Public	9.6	13.0	11.7	8.0	7.5	7.0	6.5
Gross domestic saving	19.4	9.0	8.9	7.0	6.5	5.9	5.8
Private	17.3	8.8	8.9	7.0	6.5	5.9	5.8
Public	2.1	0.2	0.0	0.0	0.0	0.0	0.0
Public sector finances 2/							
Overall balance (before grants)	-7.2	-13.3	-12.4	-8.0	-7.5	-7.0	-6.5
Grants	3.3	2.4	3.6	2.8	2.8	2.7	2.6
Central government saving	0.4	-0.3	-1.1	-1.5	-1.5	-1.5	-1.5
Current revenue	28.6	29.4	28.6	28.5	28.5	28.5	28.5
Current expenditure	28.1	29.7	29.8	30.0	30.0	30.0	30.0
Balance of payments							
External current account	-8.4	-20.3	-18.9	-16.9	-16.3	-15.7	-14.8
Of which:							
Exports of goods and services	60.1	52.3	53.1	53.4	54.2	55.2	56.3
Imports of goods and services	74.4	76.8	76.4	75.2	74.8	74.4	74.0
Capital and financial account 3/	10.6	21.5	19.0	14.8	13.8	12.7	11.5
Overall balance	2.2	1.2	0.2	-2.1	-2.5	-3.0	-3.3
Identified financing	-2.2	-1.2	-0.2	0.9	0.9	0.9	0.9
Financing gap	0.0	0.0	0.0	1.2	1.6	2.1	2.4
Public sector debt and debt service	**70.5**	**86.0**	**92.8**	**93.6**	**94.6**	**95.6**	**96.7**
External 4/	43.7	56.2	64.4	62.5	60.5	57.8	55.2
Domestic	26.8	29.8	28.4	31.1	34.1	37.8	41.5
External debt/exports 5/	72.8	107.4	121.9	117.0	111.4	104.8	97.8
External debt service/exports 5/	5.3	7.0	7.0	8.5	9.0	9.8	9.7

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

1/ Projections assume the continuation of present trends and policies.

2/ These data are presented on a fiscal year (July-June) basis. Figures shown for a given calendar year relate to the fiscal year ending on June 30 of that year.

3/ Including errors and omissions.

4/ Including financing gap.

5/ Exports of goods and services.

Table 8. Dominica: Medium-Term Projections--Alternative 1/

	Average	Prel.	Projections				
	1998-99	2000	2001	2002	2003	2004	2005
	(Annual percentage change)						
National income and prices							
GDP at constant (1990) prices	1.7	0.5	1.5	2.5	3.0	3.5	3.5
Implicit GDP deflator (factor cost)	2.4	1.1	1.5	1.5	1.5	1.5	1.5
	(In percent of GDP, unless otherwise stated)						
Saving and investment							
Gross domestic investment	27.8	29.3	28.5	29.0	29.5	30.0	30.0
Private	18.2	16.3	16.5	18.5	19.0	19.5	19.5
Public	9.6	13.0	12.0	10.5	10.5	10.5	10.5
Gross domestic saving	19.4	9.0	11.5	12.5	13.5	14.5	14.5
Private sector	17.3	8.8	10.5	11.0	11.0	11.0	10.5
Public sector	2.1	0.2	1.0	1.5	2.5	3.5	4.0
Public sector finances 2/							
Overall balance (before grants)	-7.2	-13.3	-10.9	-9.0	-8.0	-7.0	-6.0
Grants	3.3	2.4	3.6	3.0	3.0	3.0	3.0
Central government saving	0.4	-0.3	-1.1	0.5	1.8	2.5	3.0
Current revenue	28.6	29.4	28.6	30.0	31.0	32.1	33.2
Current expenditure	28.1	29.7	29.8	29.5	29.2	29.6	30.2
Balance of payments							
External current account	-8.4	-20.3	-18.0	16.5	-16.0	-15.5	-15.5
Of which:							
Exports of goods and services	60.1	52.3	54.8	56.8	58.6	60.2	61.9
Imports of goods and services	74.4	76.8	80.8	81.8	82.8	83.3	83.6
Capital and financial account 3/	10.6	21.5	18.8	17.7	17.2	16.7	16.7
Overall balance	2.2	1.2	0.8	1.2	1.2	1.2	1.2
Identified financing	-2.2	-1.2	-0.8	-1.2	-1.2	-1.2	-1.2
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public sector debt and debt service	**70.5**	**86.0**	**92.3**	**92.2**	**90.7**	**88.9**	**86.4**
External	43.7	56.2	64.0	68.6	69.1	66.8	63.2
Domestic	26.8	29.8	28.3	23.6	21.6	22.1	23.2
External debt/exports 4/	72.8	107.4	116.9	120.8	118.0	110.9	102.0
External debt service/exports 4/	5.3	7.0	6.7	7.9	8.9	9.3	8.9

Sources: Dominican authorities; ECCB; and Fund staff estimates and projections.

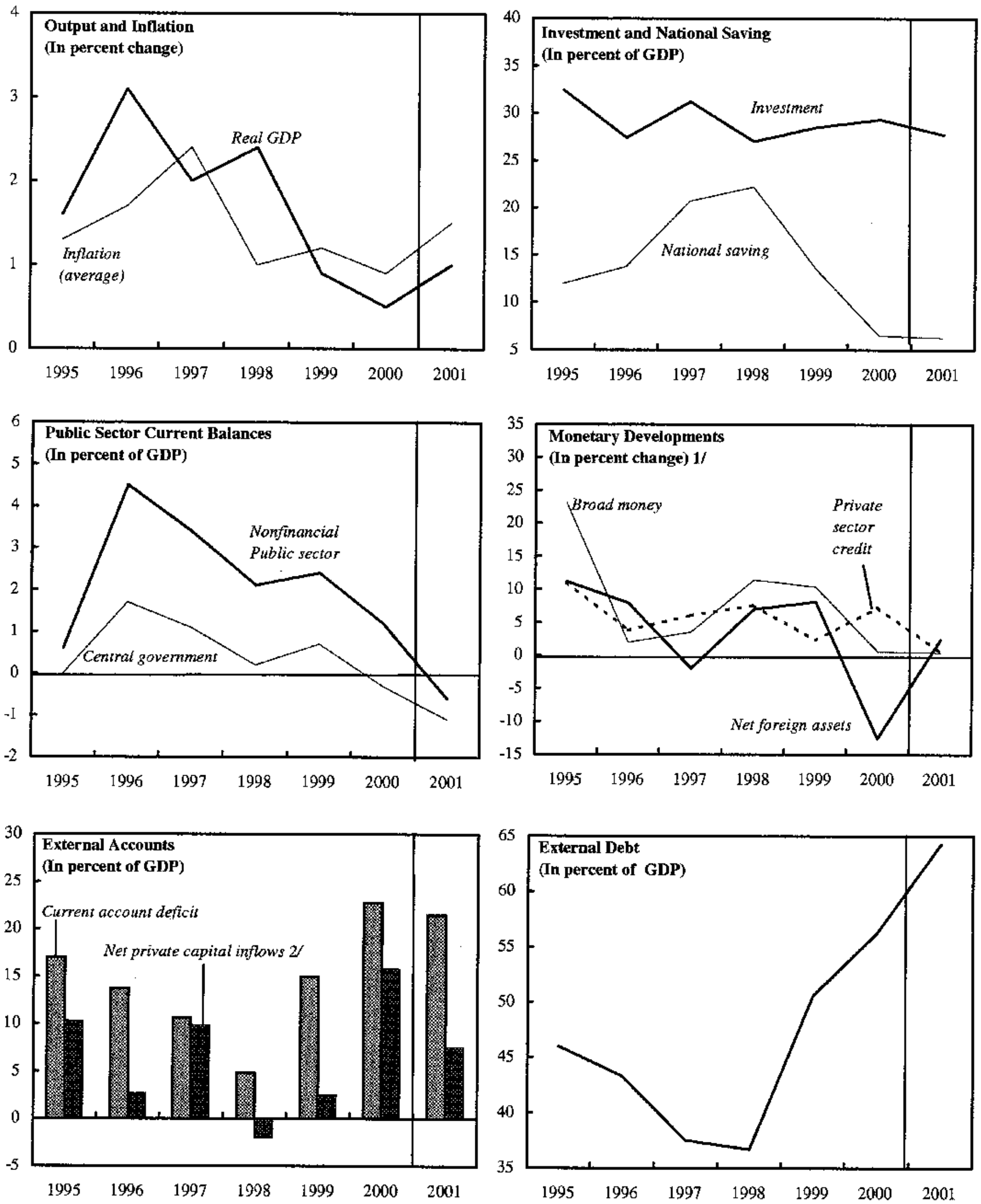
1/ Projections assume the adoption of recommended measures.

2/ These data are presented on a fiscal year (July-June) basis. Figures shown for a given calendar year relate to the fiscal year ending on June 30 of that year.

3/ Including errors and omissions.

4/ Exports of goods and services.

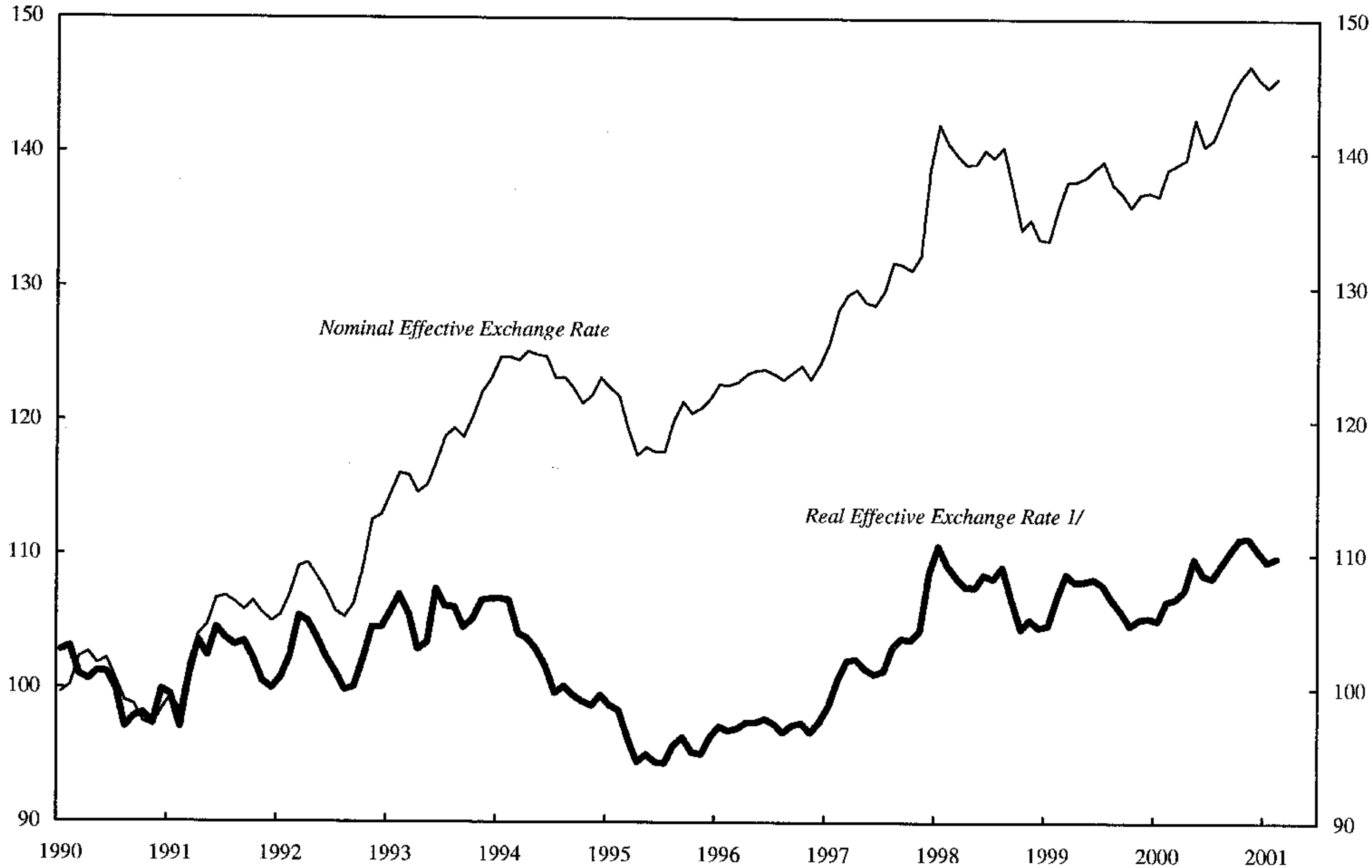
Figure 1. Dominica: Selected Economic Indicators



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

1/ Change relative to broad money at the beginning of the period.
2/ Excludes transfers.

Figure 2. Dominica: Exchange Rate Developments
(Index 1990=100)



Sources: IMF Information Notice System; and staff estimates.
1/ The real effective exchange rate is estimated as a trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. An increase means an appreciation.

Dominica: Fund Relations
(As of April 30, 2001)

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

II. General Resources Account	**SDR Million**	**Percent of Quota**
Quota	8.20	100.0
Fund holdings of currency	8.19	99.9
Reserve position in Fund	0.01	0.1

III. SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	0.59	100.0
Holdings	0.00	0.0

IV. Outstanding Purchases and Loans: None.

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
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: None.

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.

VIII. Article IV consultation: The last Article IV consultation was concluded by the Executive Board on January 10, 2000 (EBM/00/3); the relevant documents are SM/99/297 and SM/99/305. Dominica is on the standard 12-month cycle.

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

Dominica: Relations with the World Bank Group[24]
(As of February 21, 2000)

I. Projects

There are currently four ongoing World Bank projects in Dominica with net commitments of approximately US$14.3 million. Three of these projects are part of the OECS sub-regional programs of the World Bank.

The **Basic Education Reform Project**, approved in FY95[25] for US$6.1 million which will close on June 30, 2001, having disbursed the totality of the amount. The overall objective of this project was to develop further resource development to ensure that the requisite manpower exists to attain economic transition in Dominica. This project will be followed in early fiscal year 2002 by the OECS Education Reform Project.

The **OECS Solid Waste/Ship Generated Waste Management Project**, approved in FY95, aims to reduce public health risks and protect the environmental integrity of the OECS countries and their coastal and marine systems by improving solid waste management systems. The total regional financing for this project is US$41 million, of which the Dominica component is US$6.1 million (US$2 million from the World Bank).

The **OECS Telecommunications Reform Program**, approved in FY98 for US$6 million, has the objectives of introducing pro-competition reforms in the telecommunications sectors and of increasing the supply of informatics-related skills in five OECS borrowing countries: Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and the Commonwealth of Dominica. The project has helped the OECS countries negotiate with the sub-regional telecom monopoly and lower the long distance and regional telephone rates. Dominica's share of the loan is US$1.2 million.

The **Disaster Management Project**, approved in FY99, is part of a regional program for five OECS borrowing countries to fortify, reconstruct, or rehabilitate key economic and social infrastructure and facilities to minimize damage or disruption caused by future natural and man-made disasters and to speed emergency recovery following such disasters. Additionally, the project aims to strengthen countries' institutional capacities to prepare for and respond to disaster emergencies efficiently and effectively. The total program size is US$46 million, and the Dominica project is US$5.0 million.

Lending to Dominica in FY02 and early FY03 is expected to consist of a the sub-regional OECS Education Reform Project (US$18–20 million for three countries, Dominica, St. Kitts

[24] Source: World Bank.

[25] World Bank fiscal year begins July 1.

and Nevis, and St. Lucia), of which US$ 5.5 million will be allocated to Dominica, a US$6 million seven country sub-regional Catastrophe Reinsurance Program, of which about US$0.9 million will be apportioned to Dominica, and a regional CARICOM HIV/AIDS program, of which approximately US$2–3 million will be allocated to Dominica.

II. Financial Relations

(In millions of U.S. dollars)

Operations	Principal	Disbursed	Undisbursed
OECS Waste Management	2.0	0.4	1.6
OECS Telecommunication Reform	1.2	0.2	1.0
OECS Disaster Management	5.0	0.3	4.7
Basic Education Reform	6.1	5.3	0.8

Gross disbursements and debt service during fiscal year

	Actual						Projections	
	1995	1996	1997	1998	1999	2000	2001	2002
Total Disbursements	0.2	0.1	0.5	1.9	1.4	2.1	1.0	2.0
Repayments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3
Net Disbursements	0.2	0.0	0.5	1.8	1.3	1.9	0.9	1.7
Canceled	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest and Fees	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3

III. Economic and Sector Work

The Bank is working on several pieces of economic sector work of direct relevance to Dominica. These can be divided in three categories: First, the work on Small States that has led to sector work on catastrophic insurance, volatility of consumption, and information technologies. Second, the development of technical papers on four key themes—tourism and the environment, risk diversification, governance, and education—that were discussed together with the "*Caribbean Vision 2020,*" in the June 2000 Caribbean Group for Cooperation in Economic Development (CGCED) meeting. The Bank plans to operationalize, in collaboration with other agencies, the recommendations of these technical papers. Third, the Eastern Caribbean Regional Institutional Review, which aims to explore ways to enhance the institutional capacity of the OECS countries to provide good governance, deliver high quality public services, and meet emerging challenges effectively and at the lowest possible cost.

The World Bank is preparing its Country Assistance Strategy for the Eastern Caribbean, which will include efforts to improve portfolio and financial management, conduct procurement assessments to streamline procedures and strengthen the institutional capacities of government entities managing World Bank projects.

A Medium-Term Economic Strategy Paper for the period 2000–02 was prepared by the Government of Dominica in cooperation with the World Bank and the Caribbean Development Bank and was presented at the June 2000 meeting of the CGCED.

Dominica: Relations with the Caribbean Development Bank[26]

(As of February 28, 2001)

The CDB has approved loans and grants totaling US$137.1 million for Dominica. This represents approximately 7.1 percent of total CDB's approvals for member countries. Of this amount, 91.6 percent consisted of loans and 8.4 percent of grants.

Of total loan approvals amounting to US$125.6 million, US$66 million was lent for economic and social infrastructure projects, US$42.1 million for productive sector projects, and US$17.5 million for multi-sector projects. Power and energy projects received US$15.7 million (12.5 percent), transportation and communications US$10.4 million (8.3 percent), housing US$11.3 million, education US$8.7 million (6.9 percent), sea defenses US$7.5 million (5.9 percent) and water US$7.2 million (5.7 percent). Of those loans for productive sector projects, US$23.6 million (18.8 percent) was channeled towards the agricultural sector, reflective of the dominance of the sector in the economy. The remainder was allocated to manufacturing (US$15.4 million) and tourism (US$3.1 million). A significant portion of loans to the productive sector was channeled to the private sector through the Dominica Agricultural and Industrial Development Bank (DAIDB).

In support of GOCD's social enhancement initiatives, loans to the social sector were supplemented by grant resources. Of the US$11.5 million in grants to Dominica during 1970–2000, approximately 80 percent was provided under the Basic Needs Trust Fund (BNTF) for poverty reduction. The remaining grants were used to provide TA.

Ongoing projects financed by CDB include the Natural Disaster Management and Rehabilitation Project, for which US$9.5 million was spent to rehabilitate infrastructure damaged by Hurricane Lenny in 1999; and the Seventh Consolidated Line of Credit, which involved a loan of US$7 million to DAIDB for on lending to the productive sector and to students.

CDB Lending to Dominica

(As of Febraury 28, 2001)

By sector	US$ million	In percent
Agriculture, forestry, and fishing	23.6	18.8
Manufacturing	15.4	12.3
Tourism	3.1	2.4
Power and energy	15.7	12.5
Water	7.2	5.7
Transportation	10.4	8.3
Sea defense	7.5	6.0
Housing	11.3	9.0
Health	5.2	4.1
Education	8.7	6.9
Multi-sector	17.5	14.0
Total	125.6	100.0

[26] Source: Caribbean Development Bank.

Dominica: Statistical Issues

Dominica's statistical database is inadequate for meeting the authorities needs and for Fund surveillance. There are weakness in coverage, frequency, quality, and timeliness that continue to frustrate effective economic analysis and policy formulation. The weakest areas are the fiscal accounts, public debt, and the balance of payments. Only the balance sheet of the consolidated commercial banks, the balance sheet of the central bank, interest rates data, and the consumer price index are provided on a regular basis. Data on other key indicators usually are provided only during missions or upon special request.

The authorities are aware of the deficiencies in their statistical database and have chosen to participate in the General Data Dissemination System (GDDS). Metadata and plans for improving Dominica's statistical system are posted on the Internet on the IMF's Dissemination Standards Bulletin Board (http://dsbb.imf.org).

Real sector

CPI data are provided on a timely basis. Estimated data on nominal GDP (by activity) are available within a few months of the end of the year. Data on employment are very limited and there are no official data on producer prices or wages in the private sector.

Government finance

Data on central government operations are incomplete: some investment project spending is undertaken outside the consolidated fund, and also outside the consolidated fund are some loan and grant receipts as well as related on-lending and transfers to public enterprises. Only limited data on financing are available. Data for the rest of the public sector—Dominica Social Security and the public enterprises—are obtained directly from each entity during Fund missions. No government finance data are reported to STA for publication in the *Internal Financial Statistics* (*IFS*) or the *Government Finance Statistics* (*GFS*) *Yearbook*.

Monetary statistics

Monetary statistics are compiled by the ECCB on a monthly basis and reported to the Fund regularly. The monetary survey does not include the accounts of credit unions that accept demand deposits. The ECCB is aware of the need to improve coverage of the monetary statistics and is taking steps to collect data on credit unions. Data on the activities of offshore banks are not reported to the Fund.

Balance of payments

Balance of payments data are compiled by the ECCB on an annual basis and are not reported in the format recommended in the fifth edition of the IMF's *Balance of Payments Manual*. The latest data published in the *IFS* and *Balance of Payments Statistics Yearbook* are for 1998. Data for 1999 and revised data for the period from 1996 through 1998 have recently been reported by the ECCB, and are expected to be published in the June 2001 issue of the *IFS*. Transactions relating to the government's recent issue of bonds on the international market are yet to be captured fully in the balance of payments. The ECCB is aware of this deficiency and is working to correct it.

External debt

The Ministry of Finance maintains a database on public and publicly guaranteed external loans that provides detailed and reasonably current information on disbursements, debt service, and debt stocks. However, the database is incomplete in that it does not contain information on bonds placed abroad. Although external bonds data are maintained by the Treasury, the Ministry of Finance does not consolidate this information with the data on external loans to produce a more comprehensive database on external debt.

Dominica: Core Statistical Indicators
(As of May 8, 2001)

	Exchange Rates	International Reserves	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt
Date of latest observation	Fixed rate since 1976	12/2000	12/2000	12/2000	12/2000	1/2001	12/2000	1999	12/2000	1999	12/2000
Date received		2/20/2001	2/20/2001	2/20/2001	2/20/2001	3/31/2001	3/31/2001	1/15/2001	2/09/2001	1/15/2001	2/09/2001
Frequency of data series		Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly	Annual	Monthly
Frequency of reporting to IMF		Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	On request	Annual	On request	Annual	On request
Source of update		ECCB	ECCB	ECCB	ECCB	Central Statistical Office, Ministry of Finance	ECCB	ECCB	Ministry Of Finance	ECCB & Central Statistical Office, Ministry of Finance	Debt Unit Ministry of Finance
Mode of reporting		E - Mail	E - Mail	E - Mail	E - Mail	Fax	Fax	Mission/ E - Mail	Mission/ Mail	Mission/ E - Mail	Mission/ Mail/ Fax
Confidentiality		Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Restricted	Unrestricted	Restricted
Published data		Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/65
FOR IMMEDIATE RELEASE
July 13, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Dominica

On June 15, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Dominica.[1]

Background

Output and employment growth have been sluggish for the past several years, reflecting a difficult restructuring process associated with the retrenchment of the banana industry and the low productivity of public investment. In 1996–98 real GDP growth averaged 2½ percent, but slowed to ¾ of 1 percent in 1999–2000, reflecting declines in banana production and in manufacturing. The 12-month increase in consumer prices was 1 percent in 2000. Unemployment remains high.

The public finances have deteriorated in recent years as capital expenditure has increased sharply, while saving has been declining and foreign grants have fallen from their levels of the mid-1990s. The overall deficit of the consolidated public sector more than doubled to 11 percent of GDP in FY 1999/2000 (year ending June 30) and public savings (i.e., current account balance) fell by half to 1¼ percent of GDP, mainly reflecting a deterioration in central government finances. Central government saving turned negative, reflecting a lack of buoyancy in the tax system, while the government wage bill and debt service obligations increased substantially. The rising deficit of the central government was financed by increased recourse to the banking system and external commercial borrowing, as well as a substantial accumulation of domestic arrears, particularly to the social security system. In the current FY 2000/01, saving of the central government is projected to weaken further, while the overall deficit is expected to be smaller than the previous year due to lower investment expenditure.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 15, 2001 Executive Board discussion based on the staff report.

During 2000 broad money increased by only ½ percent, sharply down from an average increase of 11 percent in 1998–99. Banking credit to the private sector rose by 7¼ percent (in relation to broad money at the beginning of the period), up from 2¼ percent in 1999, mainly due to an increase in retail trade and consumer-based loans.

With respect to the Fund's offshore financial sector program, Dominica is participating in the Module I self-assessment exercise.

The external current account deficit, which averaged 12 percent of GDP in 1996–97, increased to an average of 19 percent of GDP in 1999–2000, owing to a decline in banana exports, stagnating tourism receipts, and a large increase in imports. An increased surplus in the capital and financial account, reflecting heavy government borrowing and a substantial increase in foreign direct investment, financed the large current account deficit in these latter two years.

Little progress was made on structural reforms during 1999–2000. The authorities postponed the planned privatization of a development bank and deferred scheduled reductions in the common external tariff under the CARICOM agreement of 1992 due to concerns about the possible impact on industry and on government revenue, as well as administrative difficulties.

Executive Board Assessment

Directors noted that Dominica has experienced several years of slow growth resulting from the retrenchment of the banana industry and sluggish activity in other sectors. Further diversification and improvements in competitiveness were seen as needed to raise long-term growth and to reduce the external vulnerability of the economy. In this regard, Directors called on the authorities to persevere with structural reforms to raise national savings and investment.

Directors expressed particular concern about the continued weakness of public finances, as the overall deficit of the consolidated nonfinancial public sector more than doubled last year. Mainly responsible for this outcome was the central government, which had to borrow heavily from domestic banks and commercial external creditors and build up arrears, especially to the social security system. Directors emphasized the need for strong fiscal consolidation, and noted that generating higher public saving is the key for supporting the investment needed to improve Dominica's growth prospects.

Directors considered that immediate steps needed to be taken to increase tax revenue and tighten expenditure controls. On the revenue side, it was important to phase out the extensive array of tax concessions, and enforce the tax code to reduce the high level of tax arrears. Directors also encouraged the authorities to simplify indirect taxation and to initiate steps to introduce a VAT, possibly in the context of a region-wide agreement. Directors also advised the authorities on the need to adjust domestic fuel prices.

Directors noted that a cautious expenditure policy also would be crucial to support fiscal consolidation. They emphasized the importance of exercising utmost restraint on wage increases in the context of the ongoing three-year wage negotiations. Directors noted that reducing public employment through attrition and moving forward with civil service reform would help increase efficiency.

Directors considered that the authorities should monitor carefully the selection of projects for inclusion in the public investment program and to choose only those that can be financed on concessional terms and that are aimed at redressing the main impediments to growth. In this connection, Directors recommended that the authorities consider postponing or canceling the costly construction of a new sports stadium if concessional financing is not available.

Directors encouraged the authorities to begin lowering the government's indebtedness to the state-owned commercial bank to enable it to comply with prudential regulations. Directors also emphasized the importance of strengthening nonbank financial institutions, including through the transfer of supervisory responsibilities to the Eastern Caribbean Central Bank.

Directors welcomed the authorities' intention to strengthen the regulatory and supervisory framework of the offshore financial sector and commended them for the steps taken thus far. A few Directors questioned whether diversification into the offshore sector was appropriate, while others noted that a well-regulated offshore sector could provide economic benefits. Directors noted that recent amendments to offshore legislation as well as the pending establishment of a Financial Intelligence Unit to address money laundering issues are expected to ensure that the regulation and supervision of the sector will be consistent with international best practices.

Directors considered that the exchange rate regime and membership in a currency union has helped Dominica to maintain price stability. At the same time, the fixed exchange rate regime underscores the need for continued fiscal discipline, wage moderation, and structural reforms to strengthen competitiveness.

Directors stressed that completing the orderly restructuring of the banana sector, implementing the final phase of the common external tariff, undertaking further trade reform, and strengthening the financial position of the large state-owned bank are essential to diversify the economy and strengthen the basis for high growth.

Directors noted that Dominica's statistical database is inadequate for effective economic analysis and surveillance, particularly in the area of national accounts and government finances. Directors encouraged the authorities to provide adequate resources to the Central Statistical Office in order to establish a solid foundation for effectively absorbing technical assistance in statistics, which may be available from bilateral and multilateral sources, including through the Caribbean Regional Technical Assistance Center.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Dominica: Selected Economic Indicators

	1996	1997	1998	1999	Prel. 2000
Output and prices (change in percent)					
Real GDP at factor cost	3.1	2.0	2.4	0.9	0.5
Consumer prices (end of period)	2.0	2.2	1.5	0.0	1.1
Bananas (production for export)	20.4	-10.0	-17.6	-4.4	-2.7
Saving and investment (percent of GDP)					
Gross national saving	13.8	20.7	21.3	17.4	9.0
Gross domestic investment	27.5	31.2	27.0	28.5	29.3
Public finances (in percent of GDP) 1/					
Nonfinancial public sector saving	4.5	3.4	2.1	2.4	1.2
Nonfinancial public sector capital expenditure	13.0	9.5	8.8	12.3	14.8
Nonfinancial public sector overall balance (after grants)	-1.4	-0.8	-2.9	-4.9	-10.9
Money and credit (end of year, percent change) 2/					
Money and quasi-money	2.0	3.5	11.4	10.4	0.6
Credit to private sector	4.0	6.1	7.6	2.3	7.3
Interest rates (percent)					
Average deposit rate	4.4	4.9	4.2	4.0	4.0
Average lending rate	12.0	12.0	11.4	11.4	11.4
Balance of payments and external debt (percent of GDP)					
Current account balance	-13.7	-10.6	-5.7	-11.1	-20.3
External debt 3/	43.3	37.5	36.7	50.6	56.2
Debt-service ratio 4/	5.9	7.6	5.1	5.5	7.0
Exchange rate (change in percent)					
Real effective exchange rate (end of period), depreciation -)	1.3	11.4	-3.8	0.7	4.8
Terms of trade	0.1	2.5	2.6	-12.5	-16.3

Sources: Dominican authorities; ECCB; and IMF staff estimates and projections.

1/ Data are for fiscal years ending June 30.
2/ Changes in relation to liabilities to private sector at beginning of period.
3/ Total public and publicly guaranteed debt.
4/ In percent of exports of goods and services.

Statement by Thomas A. Bernes, Executive Director for Dominica
June 15, 2001

On behalf of my Dominican authorities, I would like to express sincere gratitude to the staff for their work in conducting the Article IV consultation. These discussions provide an invaluable opportunity for the authorities to take a critical look at their own—and alternative— macroeconomic policies in the context of an in-depth picture of the economy, the broad objectives of macroeconomic policy, and various policy constraints. Institutional and human capacity challenges make it difficult for the authorities to conduct such analyses themselves on a regular basis, and they benefit greatly from the staff's expertise and advice.

During this consultation, the staff conducted the final discussions with the full Cabinet of the Government, and the Permanent Secretaries. This was very useful in helping to engender a broader awareness across various Government Ministries of the challenges facing the government as a whole, and the policy coherence and interlinkages required to address those challenges.

Policy Challenges

As the staff report points out, the authorities agree on the major challenges that need to be addressed. The core issues are: (i) to arrest and reverse the deterioration in the budget deficit and put the fiscal accounts on a more solid medium-term footing; (ii) to implement structural reforms, including civil service and trade reform, that will lead to a diversification of economic activity, reduce the economy's susceptibility to external shocks, and help elevate the economy's longer-term growth potential; and (iii) to restructure the banana industry, to make it more efficient and competitive, and operate on a commercial basis.

In and of themselves, these are lofty policy objectives, and needless to say their attainment will not be an easy task. The authorities are committed to putting in place the required policies; however they want to design a package of measures that minimizes major economic and social dislocations to the greatest extent possible. Indeed, this is an important consideration that affects the authorities' decisions on the pace and prioritization of policy actions, particularly in light of Dominica's relatively low per capita income and higher incidence of poverty compared to other economies in the region.

With respect to fiscal policy, the authorities acknowledge the pressing need to reverse the deterioration in the current balance and to improve the productivity of capital investments. The lack of firm commitments made at the time of the Article IV discussions referred to in the staff report reflected to a large extent the fact that discussions had only just been initiated on the FY2001/02 budget, rather than a lack of willingness to address the situation.

Recent developments are encouraging. Budget negotiations are now at an advanced stage, and the budget should be finalized by end-June. On the expenditure side, the draft budget provides for a 2 percent nominal ceiling on the increase in overall current expenditures, and international travel allocations have been cut by 20 percent across all Ministries. Moreover, the government recently announced the elimination of two Cabinet positions and the amalgamation of the respective Ministries (the Ministry of Education, Science and Technology will be combined with Sports and Youth Affairs, and the Ministry of Communications and Works will be combined with Housing and Physical Planning). Budgetary savings are expected to arise as a result of the two government Ministers having been relieved of their duties, and a rationalization of staff and other operational expenditures.

To increase expenditure control, the authorities have put in place an electronic expenditure management system that tracks and manages most current expenditures, including the civil service payroll. Also, they have conducted an audit of the civil service and are considering measures that could cut the public sector wage bill, including through allowing the size of the civil service to shrink by way of attrition. A report, with recommendations, is being presented to Cabinet for a decision on the matter.

Negotiations on public-sector wages are progressing. The authorities' initial offer of a zero percent increase in the coming two years, followed by a one percent increase in the third year, was rejected by the public sector unions. A second offer, of zero percent in the first year, followed by 1 percent in each of the following two years has not been rejected, and negotiations are now focusing on non-wage benefits.

On the revenue side, the draft budget calls for a small yet symbolic increase in fuel prices. Also, a tax amnesty has recently been announced in an effort to reduce tax arrears. The amnesty will forgive interest and penalties due, provided that tax arrears are settled in full. The amnesty will be in force until August. To help improve enforcement of the provisions of the amnesty, and to improve the efficiency of tax compliance more broadly, a State Attorney has been assigned to the Inland Revenue Service, and the government has retained an independent lawyer on a short-term contractual basis.

The authorities recognize that tax concessions constitute an important weakness in the fiscal accounts. However they would also like to point out the regional aspect to this problem, whereby tax concessions are used in other regional economies to affect competitiveness and to attract foreign direct investment. Nonetheless, efforts are being made to rationalize these tax concessions in order to strengthen the fiscal accounts. As for introducing a VAT, as the staff notes, the authorities recognize the merits of a VAT, and they are open to exploring the potential for implementing a VAT at the regional level to take advantage of potential administrative efficiency gains.

With respect to public-sector investment, the authorities agree with the staff that such investments need to concentrate on productive areas, and at the same time contribute coherently to a structural reform agenda that aims at economic diversification and increasing the longer-run growth potential of economic activity. Indeed, in looking for evidence of the pressing need to diversify economic activity, particularly with respect to agricultural production and the banana sector, one need look no further than the continuing erosion of preferential access to the EU banana market, and the staggering 27 percent deterioration in the terms of trade that occurred during 1999-2000. Both factors have contributed importantly to the recent period of economic stagnation, the increasing incidence of poverty, and consequently fiscal pressures.

Given the existing debt burden of the country, public-sector investment (the PSIP) will focus heavily on grant funded projects and concessional refinancing. In this context, it should be noted that the EU has recently given approval for the release of STABEX grant resources for budgetary support.

The authorities are also in the process of formulating an Integrated Development Plan that will help define a decentralized holistic and sustainable process for achieving the country's broad structural and development objectives. Under this Plan, management and quality of the PSIP will be improved, and investment projects will focus on those that contribute to enhancing growth and development. In general terms, the authorities are looking to non-traditional agriculture, tourism, the offshore sector, and information technology as avenues for growth and diversification.

To facilitate growth in tourism and agriculture, the government is fully committed to improving air access to Dominica, either through upgrading the existing airports, or by building a new international airport. However, a final decision will be taken only after the results of an EU-financed feasibility study has been completed (now expected by early-August 2001). As noted in the staff report, financing for the airport project will need to involve private sector participants, and the authorities preference is for a BOT (build, operate and transfer) arrangement.

With respect to the offshore financial sector, the authorities recognize the potential that offshore financial service provision can play in diversifying economic activity, but they also recognize the importance of a strong regulatory and supervisory framework. In this context, as noted in the staff report, the authorities have delegated supervisory responsibility to the ECCB (the first ECCB-member country to do so). A new Money Laundering Prevention Act and International Business Corporation Act were introduced last year, an Offshore Financial Services Council was established as an advisory body to the government, and a Financial Intelligence Unit was established last month. On the latter, the authorities would like to express their gratitude to the government of the United States for providing physical equipment for the operation of the Unit.