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Dominica: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Dominica

In the context of the second review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility and request for a waiver of a performance criterion with Dominica, the following documents have been released and are included in this package:

- the staff report for the second review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criterion prepared by a staff team of the IMF, following discussions that ended on **May 14, 2004,** with the officials of Dominica on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 22, 2004**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **August 4, 2004** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its August 4, 2004 discussion** of the staff report that completed the review and request.

- a statement by the Executive Director for Dominica.

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

Letter of Intent sent to the IMF by the authorities of Dominica*
Supplement Memorandum of Economic Policies of the Government of Dominica*
Technical Memorandum of Understanding*

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

DOMINICA

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion

Prepared by Western Hemisphere Department

(In consultation with other departments)

Approved by José Fajgenbaum and Matthew Fisher

July 22, 2004

- **Arrangement.** A three-year Poverty Reduction and Growth Facility (PRGF) arrangement for SDR 7.7 million (94 percent of quota) was approved by the Executive Board on December 29, 2003. The objectives of the program are to restart growth, reduce unemployment-related poverty, deepen fiscal consolidation efforts, reduce the debt overhang and improve the investment climate. The first program and financing assurances reviews were completed by the Executive Board on March 24, 2004. On that occasion, Directors commended the authorities for the strong implementation of the program and encouraged them to stay the course. Completion of this review will make SDR 0.3 million immediately available to Dominica.
- **Developments.** There are encouraging signs of a broad-based economic recovery. Positive growth was recorded in the first quarter of 2004 in the banana sector, manufacturing and tourism, as well as public investment. The debt restructuring process is progressing but with delays due to creditors' initial reluctance to participate in the debt restructuring exercise. Performance under the PRGF-supported program remains strong, with all performance criteria and benchmarks consistently observed through end-March 2004, with the exception of the continuous performance criterion on external payments arrears which was not observed.
- **Issues.** There were broad understandings with the authorities on the main policy issues. The authorities reiterated their commitment on the full effect of fiscal measures equivalent to 2½ percent of GDP, some of which have already been implemented while others are incorporated in the 2004/05 budget, including a 5 percent reduction in the wage bill through labor retrenchment. With the prospect of payment difficulties on unrestructured claims, the authorities are expected to request continued Fund support using the lending into arrears policy if the difficulties materialize. The program for 2004/05 envisages a strengthening of the primary fiscal surplus target from the ½ percent of GDP originally envisaged to 2 percent, even after the elimination of the stabilization levy.
- **Discussions.** These took place in Roseau during April 29–May 14, 2004. The mission met with Prime Minister Skerrit, the Cabinet, Program Coordinator Lestrade, other senior officials and private sector representatives, including labor unions. Representatives from the ECCB and CDB participated in the discussions. The staff team consisted of A. Santos (Head), R. Randall, P. Dyczewski, (all WHD), S. Seshadri (PDR), G. Mitchell-Casselle (MFD), A. Ivanova and E. Baldacci (both FAD). Mr. Faircloth (OED) participated in the discussions.
- **Publication.** The authorities agree to publish this staff report and the letter of intent.

List of Acronyms

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

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Executive Summary

Performance under the program has been good. All but one performance criteria and benchmarks for end-March 2004 were observed with large margins. This was particularly the case for the fiscal target due to a combination of higher-than-expected tax revenues (including collections of tax arrears), higher grants, and improved expenditure control. However, the continuous performance criteria on external payments arrears was not observed. There is a high risk that additional external arrears will emerge due to delays in finalizing debt negotiations. The structural benchmark for end-March 2004—a study outlining the process by which the wage bill for 2004/05 will be reduced by 5 percent—was completed.

Signs of a nascent and broad-based economic recovery are emerging. After a long and pronounced contraction, the key banana sector appears to have recovered, and tourism and manufacturing have reported strong growth in the first quarter of 2004. While there are indications of a rebound, the authorities remain cautious and did not want to revise upward the 1 percent real GDP growth projection for 2004. The staff agreed to remain cautious, especially in an environment of high oil prices and increasing global interest rates.

The debt restructuring process is lagging behind. The authorities announced a debt exchange offer on April 6, which includes a menu of three bonds, with long maturities, low interest rates and (two of them) at a discount. There has been partial creditor participation in the debt exchange offer and its deadline was extended twice. The larger domestic creditors (the National Bank of Dominica and the Social Security) and one of the two large bond issues have agreed in principle to participate. Discussions with the other private external creditors are continuing. Discussions with bilateral creditors are at an advanced stage, some of them have expressed a preference for waiting until the private debt deal is completed. The Caribbean Development Bank has agreed "in principle" to a debt restructuring proposal consistent with inter-creditor equity.

The authorities are strengthening their fiscal policy for 2004/05. The authorities have raised the primary surplus for 2004/05 from ½ percent of GDP to 2 percent, despite the elimination of the stabilization levy. The budget for 2004/05 benefits from the full effect of measures equivalent to 2½ percent of GDP as originally envisaged, including the 5 percent reduction in the wage bill through labor retrenchment. The budget includes interest payments assuming full creditor participation in the debt deal. The budget was sent to Parliament on June 29 and approved on July 7.

Progress continues to be made in implementing the structural reform agenda. Work continues on each element of the reform agenda and a high level of coordination has been required to integrate these reforms in the 2004/05 budget, especially on civil service reform and pension reform.

I. Recent Developments

1. **Policy implementation and performance under the program continues to be strong.** The program remains on track as its implementation strengthened significantly following the modification to the Stand-By Arrangement (SBA) of July 2003; since then, all quantitative performance criteria and structural benchmarks have been observed through end-March 2004, with the exception of the continuous performance criterion on external payments arrears.[1] Progress continues to be made in all areas of structural reform.

2. **Performance in the fiscal area was strong, with the fiscal target achieved with large margins.** This reflected better-than-expected tax collections and improvements in expenditure controls:

- ***Tax collections remain buoyant***. While the program envisaged a significant increase in tax receipts (the sales tax and the custom service charge rates were raised by 50 percent in the 2003/04 budget), the higher-than-anticipated tax collections reflect improvements in tax administration (including collection of tax arrears and stricter controls on discretionary tax exemptions) and better macroeconomic conditions, which allowed the expansion of the tax base.

- ***Noninterest expenditures have been controlled more effectively***. The expenditure measures introduced with the 2003/04 budget created a culture of fiscal discipline. In particular, the wage cut made expenditure units more aware of the sacrifices made by other parts of society, and became more responsive to the requirements imposed by the cash management system (which still needs to be strengthened). Expenditures were severely restrained at the beginning of the program due to delays in external financing, which helped develop an awareness about the lack of resources. At the same time, the authorities were able to finance a higher level of capital expenditures by making more intensive use of grants. It is important to note that part of the current expenditure compression observed in the last few months is temporary, and could unwind in the last quarter of the fiscal year (April–June 2004).

[1] The March 2004 benchmark relates to a study outlining the process for the reduction in the wage bill for FY 2004/05 by 5 percent through retrenchment. The authorities met the benchmark by completing such a study. The financing of this reform is covered by an EU grant. The actual measure of reducing the wage bill by 5 percent on an annual basis was incorporated in the budget.

3. **Macroeconomic trends continue to improve, with output beginning to rise and inflation declining.** The early signs of an economic recovery identified during the previous review have strengthened during the first quarter of the year. In particular:

- ***There are increasing indications of stronger and more broad-based growth than earlier anticipated.*** Manufacturing growth rebounded in 2003 and accelerated further in the first quarter of 2004. The sharp decline in banana production appears to have ended in 2003, and an incipient recovery has begun in early-2004.

- ***Exports and tourism receipts are recovering***. Following a prolonged slump, exports rose considerably in the first quarter of 2004, supported by higher banana production and manufactured goods. There are also indications of growth in tourism, reflecting across-the-board increases in stay-over, excursionist, and cruise-ship visitors.

Dominica: Recent Developments
Annual Growth (%) 1/

	2003	Jan-Mar 2004
Production		
Manufactures	4.6	22.2
Bananas	-38.5	5.4
Inflation		
Consumer prices 2/	2.9	2.6
Public Finances		
Tax receipts	10.9	13.2
Balance of Payments		
Exports	-6.9	8.7
Tourism receipts	5.5	16.3
Imports	9.1	16.5

Source: Dominican authorities.
1/ With respect to same period the year before. Data not seasonally adjusted.
2/ 12-month growth rate e.o.p.

- ***Imports continue to expand rapidly***. Import growth accelerated in the first quarter of 2004, reflecting the higher level of public investment, stronger demand from the tourism sector, and FDI-related telecommunication equipment.

- ***The underlying rate of inflation is falling.*** The modest uptick in inflation during 2003, stemming from the electricity tariff adjustment and tax measures adopted in July 2003 is now abating. The underlying inflation rate is close to the program target of 1½ percent for 2004.

4. **The government established diplomatic relations with China and severed relations with Taiwan Province of China in March 2004**. This decision stopped financing from Taiwan Province of China but the Government of China pledged an aid package of US$110 million in grants over the next six years, as well as additional resources to finalize projects underway that were previously financed by Taiwan Province of China (altogether about 50 percent of annual GDP). The details of this aid package are not yet known although the net impact of this change on aid commitments is most likely to be positive, with the additional benefit that China's aid is in the form of grants as opposed to loans from Taiwan Province of China. However, this change in diplomatic relations may complicate the negotiations on the debt restructuring, as Taiwan Province of China is the largest bilateral creditor.

II. Policy Discussions

5. **The authorities reiterated their commitment to the program and agreed to preserve its design given the positive results.** Discussions focused on the already agreed fiscal measures that need to be implemented in the context of the 2004/05 budget, as well as on several structural issues that needed to be addressed in conjunction with the budget, especially those pertaining to the difficult civil service reform. In addition, the mission discussed different options on the budget presentation that would take into account the ongoing debt restructuring exercise.

Dominica: Macroeconomic Framework, 2002-2004

		SBA		PRGF	
		Prog 1/	Est	Prog 2/	Rev Proj
	2002	2003		2004	
	(In percent)				
GDP growth	-4.7	-1 to -3	0.0	1.0	1.0
Inflation	0.5	0.5	2.9	1.5	1.5
Current account / GDP	-15.0	-15.1	-16.9	-15.4	-15.5
	(In percent of GDP, fiscal year)				
Structural primary balance	-4.5	-2.0	-0.7	0.5	1.5
Overall fiscal balance	-7.1	-7.7	-4.2	-5.5	-4.1
Public debt (NFPS)	111.5	113.6	114.0	...	...

Sources: Dominican authorities; and Fund staff estimates.
1/ As modified in July 2003, IMF Country Report No. 03/293.
2/ As approved in December 2003, IMF Country Report No. 04/6.

A. Macroeconomic Framework

6. **While macroeconomic conditions have improved, the authorities want to maintain the same macro framework.** Recent developments are encouraging and signal the possibility of higher-than-programmed growth. However, the authorities argued—and the mission concurred—that it was too early to change the macroeconomic framework, and that it was better to frame the budget under relatively conservative assumptions, especially in an environment of high oil prices and increasing global interest rates. The 2004/05 budget was formulated under the assumption of a real GDP growth of 1 percent and an inflation rate of 1½ percent. Higher GDP growth will act as a safeguard to the program and mitigate unexpected adverse shocks or unintended slippages.

B. Fiscal Policy

7. **Parliament approved the 2004/05 budget in early-July, which includes the agreed measures, and a major strengthening of the fiscal target.** The 2004/05 budget incorporates new fiscal measures equivalent to 2 percent of GDP on an annual basis as previously agreed, as well as the full year effect of the measures adopted in December 2003 estimated at ½ percent of GDP.

- ***The measures adopted in December 2003.*** At that time the authorities significantly reduced discretionary tax exemptions. This measure was designed to generate ½ percent of GDP on an annualized basis. It is difficult to assess the full effect of this measure, but it is important to note that in addition to the estimated yield, available information (on indirect tax concessions) indicates that no new discretionary tax exemptions have been granted since December 2003 when the policy was adopted.[2] A comprehensive review of discretionary and statutory tax exemptions was prepared by the authorities—a benchmark for end-June 2004.

- ***The measures included in the 2004/05 budget*** are estimated to yield the equivalent of 2 percent of GDP on an annual basis, including cuts in noninterest budgetary expenditure, a 5 percent reduction in the wage bill, a gradual increase in the retirement age for public servants from 55 to 60 years, revisions to the vacation and study leave policies for public servants, a broadening of the tax base for professional license fees, and the elimination of the stabilization levy. Approval of the budget in line with the program was a prior action for completion of this review.

Dominica: Tax Exemptions
(Number of Cases) 1/

	Jul-Dec 2003	Jan-Mar 2004
Tax Concessions	17	9
Statutory 2/	6	9
Discretionary	11	0

Source: Dominican authorities.
1/ Indirect tax concessions.
2/ Fiscal Incentives and Hotel Aid Acts.

8. **While the estimated yield of the fiscal package is the same as agreed when the PRGF arrangement was approved in November 2003, its composition is somewhat different.** The package of fiscal measures still amounts to 2½ percent of GDP, but it now includes the elimination of the stabilization levy and offsetting measures. This reflects the authorities' concern that the retrenchment exercise—which would reduce public sector employment by about 5 percent (the government being the largest employer in the economy)—would add to the already high unemployment problem at a time the economy was still weak and recovering.[3] The authorities believe that the elimination of the stabilization levy would foster employment in the private sector. The mission agreed with that assessment and the proposed revision in the fiscal package. The revenue loss generated by the elimination of the stabilization levy is being offset by budgetary cuts on top of the originally agreed expenditure freeze.

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[2] There might still be negative effects on tax collections from previously approved exemptions.

[3] The stabilization levy was a temporary tax on workers which was introduced with the 2002/03 budget at a rate of 4 percent of wage earnings. It was reduced to 3 percent and extended for two years in the context of the 2003/04 budget. The tax was collected as a withholding on payrolls. It generated revenues of about 1 percent of GDP and was expected to expire in June 2005. The tax raises labor costs, reduces competitiveness and discourages employment, in circumstances in which the unemployment rate is estimated at about 25 percent.

9. **In an effort to demonstrate the seriousness of their fiscal efforts to achieve sustainability, the authorities have strengthened fiscal policy for 2004/05.** Rather than the envisaged gradual improvement of the primary fiscal balance, to a surplus of ½ percent of GDP in 2004/05 in the original program, the authorities have raised their target to 2 percent of GDP (Box 1). The new fiscal target—even with the same fiscal effort—is feasible due to permanent improvements in tax collections and expenditure control achieved during 2003/04, which the authorities want to preserve in the 2004/05 budget. This will help them attain their medium-term objective of a fiscal surplus of 3 percent of GDP earlier than anticipated, i.e., 2005/06 rather than by 2006/07.

Dominica: Fiscal Adjustment Package for 2004-05

	In percent of GDP
Total Fiscal Measures	**2.5**
Former Prior Action (December 2003)	**0.5**
1. Reduction in discretionary tax exemptions	0.5
Measures in the 2004/05 budget (July 2004)	**2.0**
2. Budgetary expenditure cuts 1/	1.5
3. Reduction of the wage bill by 5 percent	1.2
4. Increase in retirement age	0.1
5. Revision of vacation and study leave policy	0.1
6. Broadening tax base for professional license fees	0.1
7. Elimination of the stabilization levy	-1.0
Memorandum item:	
Revenue measures	-0.4
Expenditure measures	2.9

Sources: Ministry of Finance; and Fund staff estimates.
1/ Refers to non-interest current expenditurte

10. **Progress has been made toward preparing relevant fiscal legislation.** A law will be sent to Parliament shortly to gradually increase the retirement age of public employees from 55 to 60. On the fiscal responsibility law (FRL), the mission and FAD organized seminars to review the international experience as well as pros and cons of the law. While the authorities expressed concern about the failure of FRLs in other countries and the problems in designing appropriate exit clauses, they remain committed to adopt this kind of legislation. However, the authorities are of the view that it may take additional time to build enough consensus to support this legislation. They expect to have legislation similar to a FRL in time for the 2005/06 budget as originally envisaged. The mission agreed with the authorities' position.

C. Program Financing, Debt Restructuring and Fund Support

The strategy

11. **The program has been based on the expectation that Dominica will achieve a collaborative debt restructuring with its creditors that meets the residual near-term financing needs and ensures medium-term debt sustainability.** The authorities determined in December 2003 that the debt situation is unsustainable, an assessment supported by the staff (see IMF Country Report No. 04/6). In subsequent discussions with creditors, the authorities report that no creditor has challenged that assessment. The authorities hired debt advisors with considerable experience in other cases to design the debt restructuring strategy.

12. **The authorities and their advisors have designed a comprehensive debt restructuring proposal aligned with the fiscal effort envisaged under the program**. In

this, they balanced two overarching goals: (1) securing debt sustainability, and (2) achieving high participation through a cooperative approach emphasizing inter-creditor equity and intensive dialogue with creditors. The debt restructuring proposal was derived given the medium-term primary fiscal surplus target of 3 percent of GDP, and is designed to provide payments on the restructured instruments that are consistent with the country's payment capacity. The authorities' strategy envisages a pre-emptive restructuring of their claims, and it recognized that the limited resources available to the government called into question the ability to continue honoring the original contracts. At the same time, the authorities have not serviced fully the claims whose validity is in dispute (see box to the right). Arrears on these claims were not treated as program arrears under the SBA and the PRGF arrangement, in accordance with the Fund's standard policy on disputed claims. This category of debt was not explicitly described in previous program documents. Specifically, scheduled payments were not made, or made with delays, on two sizable bonds since the government initiated legal action in 2002. Though the authorities are challenging the validity of these claims, such claims have been included in the list of debt eligible for the debt exchange.

Dominica: Debts in Dispute and their Relation to the Program

- The bonds were arranged by Citibank of Trinidad and Tobago and RBTT Merchant Bank and have a combined face value of US$48 million, or about 15 percent of Dominica's public debt.
- The legal challenge to the validity of the claims is based on alleged deceptive actions taken by the holders of these bonds when the financing transaction was originally structured. Since the initiation of legal action in 2002, two payments have been made to each institution. The authorities explained to the staff that in the case of RBTT, the January 2003 and July 2003 payments were made on schedule because they were deducted (by RBTT, under a collateral arrangement) from a Debt Service Reserve Account; the scheduled January 2004 payment has not been made. In the case of Citibank, the January 2003 payment was made in March 2003 by the government "without prejudice", as the case was in the process of mediation; the July 2003 payment was made in March 2004, again "without prejudice", as a good-will action by the government in the context of the ongoing discussions on the exchange offer.
- For the purposes of the program, these claims have been excluded from the measurement of arrears under the PRGF arrangement (as they were under the previous SBA). This treatment is consistent with the Fund's policy on disputed claims, although these claims were not explicitly described in the previous program documents.
- In summary, the July 2003 payment to Citibank (US$0.8 million) was overdue through March 2004; and January 2004 payments to both Citibank and RBTT (US$2.7 million) are now overdue.

Progress made

13. **While significant progress has been made in implementing the strategy, it has taken longer than expected and additional creditor participation is needed to conclude the process.** The authorities have followed best practices in implementing the debt restructuring exercise (i.e., transparency, creditor consultations, and inter-creditor equity). They approached creditors at an early stage, while continuing to service fully their obligations under the program (except those in dispute, as noted above). The strategy identifies three main classes of creditors: (1) the Caribbean Development Bank (CDB); (2) bilateral official creditors; and (3) private creditors (including domestic creditors). While negotiations are proceeding on parallel tracks with all classes of creditors, to date mostly domestic creditors, holders of the Citibank bond, and a handful of external private creditors have formally announced their participation in the debt exchange.

14. **The CDB—the largest creditor—agreed to restructure the bulk of their claims to Dominica at its Board meeting of July 15.** CDB developed a restructuring proposal in late-January 2004 involving the bulk of its claims at favorable terms, extending maturities significantly, introducing long grace periods, reducing interest rates—*de facto* forgiving debt service payments in the first few years while continuing its lending activities. The staff estimates that CDB's proposal has a considerable element of NPV debt reduction, consistent with the needed reduction in the debt burden and inter-creditor equity.

15. **The authorities remain in close contact with official bilateral creditors—including those in the region—to reschedule their debts.** These debts are being restructured outside the Paris Club framework.[4] Bilateral creditors have been invited to participate in the debt exchange offer (see below) or to reschedule their loans with a debt reduction that is consistent with inter-creditor equity. The objective is to obtain a reduction of about 50 percent in NPV terms. Discussions with Barbados, the U.K., and Venezuela are at an advanced stage. Negotiations with other bilateral creditors continue, although some of them have expressed their preference to wait until the completion of the debt exchange with private creditors to evaluate their position.

Dominica: Public Debt for Restructuring Purposes 1/
(As of end-2003)

	Millions of US dollars	Percent of GDP	Share of Total	Terms of restructuring
Public Debt	**334.3**	**131.0**	**100.0**	
Non-reschedulable debt	67.4	26.4	20.2	
Preferred (IMF/WB)	30.9	12.1	9.2	No restructuring
T-bills	17.5	6.9	5.2	No restructuring
Operating overdraft	19.0	7.4	5.7	No restructuring
Reschedulable debt	266.9	104.6	79.8	
CDB	71.3	27.9	21.3	CDB proposal
Bilateral	51.4	20.1	15.4	50 percent debt reduction NPV
Citibank/RBTT bonds	47.4	18.6	14.2	Intermediate and Long bonds
Other commercial	96.8	37.9	29.0	
Short-term	36.0	14.1	10.8	Short, Intermediate, Long bonds
Medium-term	60.8	23.8	18.2	Intermediate and Long bonds
Memorandum items:				
Domestic debt	112.7	44.2	33.7	
External debt	221.6	86.8	66.3	

Source: Dominican authorities and Fund staff estimates.
1/ Public debt including obligations to the social security.

16. **Private creditors were presented in April 2004 with an exchange offer that involves NPV debt reduction through a menu of bonds with longer maturities and below-market coupons.** The authorities are offering three bonds aimed at (but not restricted to) private creditors, denominated in local currency, and bearing an interest rate of 3½ percent (Box 2).[5]

- ***A short bond*** with a bullet maturity of 10 years, exchanged at a 30-percent discount of principal;

[4] The Paris Club decided in the fall of 2003 to deal with Dominica's bilateral debt outside the framework of the Paris Club as France and the United Kingdom are the only bilateral creditors that are members of the Paris Club.

[5] Official bilateral creditors are eligible for the exchange offer as well as other nonprivate institutions.

- ***An intermediate bond*** with a bullet maturity of 20 years, exchanged at a 20-percent discount of principal; and

- ***A long bond*** with a bullet maturity of 30 years, exchanged at par.

Dominica: Proposed Terms of New Bonds

	Short	Intermediate	Long
Exchange Ratio	0.70	0.80	1.00
Maturity (years)	10.0	20.0	30.0
Grace (years)	10.0	20.0	30.0
After Buyback	5.0	6.0	15.0
Interest Rate (%)	3.5	3.5	3.5

Source: Dominica's exchange offer.

The new bonds feature CACs and mandatory debt management clauses (i.e., required buybacks) that effectively reduce the grace period from the creditor's perspective by about one half. The short bond is available only to creditors with eligible claims falling due within the next two years. The staff estimates debt reduction implicit in the exchange offer at 50–55 percent in NPV terms.

17. **Creditor participation has been limited so far, but there have not been any spillover effects on financial markets.** Liquidity in the banking system remains ample, deposits are stable, and treasury bill rollover rates remain satisfactory. To date, mostly domestic creditors (Dominica Social Security and National Bank of Dominica, accounting for over half of the eligible debt under the exchange offer), holders of the Citibank bond, and a handful of other external private creditors have announced their intention to participate.[6] The formal deadline for participation was extended twice, to June 11, although the authorities intend to keep the offer open informally for the next few months. Creditors (including those holding disputed claims) that accepted the offer before June 11 will be paid interest arrears in cash, while those accepting the offer after that date will be paid interest arrears with the short bond (at par). After several failed attempts to organize meetings of strip holders, such a meeting of Citibank strip holders took place on July 9 and an agreement was finally reached at a follow-up meeting on July 15. Discussions on the RBTT bond are less advanced, although the authorities hope that, given the common investor base, agreement on the Citibank bond will help catalyze progress toward satisfactory conclusion of these negotiations. The staff will provide an update on the discussions, as well as on other developments in the debt restructuring for the Board discussion.

18. **The authorities' efforts at reconciling public debt have revealed a number of incidents of nonobservance of the continuous performance criterion on external**

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[6] Restructuring the private external claims has proven difficult in part due to the complex nature of the derivatives created with the original bond issues, in addition to the legal disputes noted above. The two bonds issued in the late 1990s were stripped "horizontally" by the trustees (Citibank and RBTT Merchant Bank) and sold to a wide range of regional investors, with each coupon payment sold as a separate instrument. As a result, each strip holder owns a zero-coupon bond of a different maturity. The bonds and the derivative contracts contain collective action clauses (CACs) which make it possible to achieve a full restructuring with the participation of a critical mass of creditors.

payments arrears, which caused three purchases under the previous SBA and the second disbursement under the PRGF arrangement to be noncomplying. The claim in question was to an external supplier and was previously incorrectly recorded as a domestic claim. The supplier's credit amounted to US$0.3 million and the scheduled monthly repayments had been in arrears since July 2001. In April 2004, the supplier irrevocably tendered these claims in the government's ongoing debt exchange offer, which results in the elimination of the arrears for the purposes of the program. Given the corrective actions taken by the authorities and the minor program deviation entailed in these arrears, the staff supports the authorities' request for a waiver of nonobservance of the continuous performance criterion on external payments arrears associated with the second review and in connection with the noncomplying purchases and disbursement. In addition, the provision of inaccurate information on external payments arrears gives rise to a breach of obligations under Article VIII, Section 5, (the noncomplying purchases and disbursement and breach of obligations under Article VIII, Section 5 are addressed in detail in the accompanying Report on Noncomplying Purchases and Disbursement and Breach of Obligations under Article VIII, Section 5).

19. **The PRGF arrangement was approved with some existing arrears to private creditors which have now been settled.** The authorities report that there are no outstanding program arrears to private creditors. Accordingly, a financing assurances review is not warranted. If Dominica were to incur external payments arrears to private creditors during the program period, financing assurances reviews would be reinstituted.

Next steps, and financing the 2004/05 budget

20. **The authorities remain committed to pursuing their cooperative debt reduction strategy, anchored by the debt exchange offered to private creditors.** They have indicated that they will make every possible effort to avoid accumulating arrears to creditors whose claims are not in dispute while negotiations are proceeding. However, given the delays encountered thus far, and the lack of resources to fully service their debt, the 2004/05 budget approved on July 8 provides for debt service payments consistent with full creditor participation in the debt restructuring exercise. In this context, the authorities anticipate that payments to creditors that have not participated in the debt restructuring would be deposited in escrow accounts at the ECCB, in the amounts consistent with their participation, so that they would be available for collection upon acceptance of the offer, though there is some ambiguity as to the timing of this move.

21. **The targeted fiscal adjustment and the debt restructuring will combine to close the financing gap for 2004/05.** The targeted primary surplus (2 percent of GDP) will leave a projected financing gap of about US$22 million, or over 8 percent of GDP. The gap is expected to be covered by the debt restructuring, assuming full creditor participation. The authorities noted that in the event of significantly less-than-full participation, they do not expect to have the resources to finance the resulting gap, and in these circumstances an accumulation of arrears would likely become unavoidable. If this situation were to arise, the authorities expect to request continued Fund support under the lending-into-arrears (LIA) policy.

Dominica: Fiscal Deficit and Financing Gap for 2004/05

	In millions of US$	As percent of GDP
Primary balance	5.5	2.0
Interest payments	-17.2	-6.3
Overall fiscal balance	-11.7	-4.3
Overall financing	11.7	4.3
Domestic financing	-1.6	-0.6
External financing	-8.9	-3.3
Financing gap	22.2	8.2
Restructuring	22.2	8.2
Arrears	0.0	0.0

Sources: Fund and staff estimates.

Program implications

22. **The staff welcomed the authorities' determination to find a cooperative solution with their creditors, while expressing concern over the delays in achieving such a solution and the consequent increased risks to the program.** In that context, the staff urged the authorities to remain in close contact with the staff to provide full information about progress on the restructuring exercise and the resulting policy and program implications. In response, the authorities:

- Committed to keep staff informed about developments on all aspects of the debt negotiations;
- Reiterated that their prime goal remained to achieve a cooperative debt restructuring, which they consider to be a realistic objective given creditors' increased interest in negotiations in recent weeks;
- Underscored, however, that if achievement of this objective were to be no longer a realistic prospect because of continued creditor reluctance to participate, they would have no option but to interrupt payments to nonparticipating creditors, and shift toward placing payments earmarked for such creditors into an escrow account, as foreseen in the budget;
- Stressed that given the delicate state of creditor negotiations and the still-fragile stabilization gains, uninterrupted Fund support was critical to the success of their adjustment and financing strategy.

23. **While the authorities have remained current on nondisputed obligations,[7] their resources are limited, and they may therefore soon start accumulating arrears if a debt restructuring does not materialize.** The precise timing of such a shift is difficult to foresee, and the authorities have remained somewhat ambiguous on this in their public announcements as well as in their dialogue with the staff. This ambiguity creates some risk, in principle, for the Fund as disbursements could be used to pay creditors even if there are no longer realistic prospects for a restructuring succeeding. However, this risk is addressed by the authorities' stated policy not to continue debt service incompatible with their resource constraints (embodied in the 2004/05 budget). Furthermore, the authorities agreed that by the time of the next review, financing assurances would be comprehensively re-evaluated, on the basis of either a successful debt restructuring, or implementation of the policy in the budget of making partial debt service payments into escrow accounts for nonparticipating creditors. On balance, therefore, it is recommended that the present review be completed on the basis of the authorities' intention to avoid arrears under the program (and hence, keeping the continuous PC against arrears accumulation), given the improved prospects for an agreement with their creditors on a restructuring. If and when the authorities decide to shift their strategy and arrears accumulate, continued Fund support for Dominica's adjustment program could be assessed under the LIA policy.

D. Financial Sector Issues

24. **Deposits continue growing and liquidity remains abundant.** Deposits are being attracted by a positive interest differential and banks find themselves with excess liquidity. Improvements in economic conditions have not translated yet into a pick up in private sector credit demand. This situation could change in the coming months, as the economy continues to rebound, or if liquidity becomes less abundant. Banks have not observed a discernible change in market conditions following the announcement of the debt restructuring exercise, although the debt restructuring is likely to affect their profitability.

25. **The situation in the treasury bill market continues to be stable, and roll-over rates remain high**. The authorities' decision to exclude treasury bills from the debt restructuring exercise has been well-received by market participants. The decision reflected the record of full rollovers of the treasury bills and the expectation of a continuation of this pattern. While the authorities continue to monitor developments in the market, there are no indications of any emergent rollover problems. Indeed, liquidity in the treasury bill market and rollover rates remain high.

26. **The authorities continue to be of the view that a "looser" monetary stance would be appropriate**. While the authorities recognize the limited role of monetary policy in the context of a currency board arrangement within a currency union, they believe there is scope

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[7] Except for a small amount for which a waiver is being sought under the misreporting procedures—see the separate report on noncomplying purchases and disbursement.

for a reduction in domestic interest rates by simply removing the minimum savings deposit rate established by the ECCB. Lower deposit rates would translate into lower lending rates, which would encourage private investment and support the ongoing recovery. The monetary council considered this proposal in April but decided not to change the minimum rates. The mission noted that the window of opportunity for conducting such a policy could close in the next few months, as global interest rates are projected to increase.

E. Structural Reform

27. **The authorities continue to make progress in implementing the structural reform agenda, which aims to address the root causes of the macro imbalances and remove impediments to growth**. The authorities managed different aspects of the reforms simultaneously to have them ready for the 2004/05 budget. The complex nature of the reforms and the compressed timetable for achieving them has required technical assistance and a high level of coordination:

- ***Civil service reform.*** The authorities identified enough positions to reduce the wage bill by about 5 percent on an annual basis in the 2004/05 budget as originally agreed. The expectation is that a similar exercise will be conducted for the 2005/06 budget. However, there could be small delays from the EU in providing the grant to cover the severance payments associated with the reform.

Dominica: Structural Reform Agenda for 2004

Reform Area	Conditionality (Date)	Objective	Status
1. Civil Service Reform	Benchmark (March)	Reduce wage bill 10% in two years	Done (study completed).
2. Tax Policy	Benchmark (June)	Rationalize tax exemptions	Done. IMF mission sent a policy note.
3. Pension Reform	Benchmark (June)	Increase retirement age for public servants to 60 years	In progress. Announced in the budget.
4. Tax System	Benchmark (September)	Introduce the VAT by FY 2005/06	In progress. CARTAC designed timetable.
5. Budgetary Procedures	Prior Action	Budget consistent with program; and 3-year budget	Done.
6. Fiscal Responsibility Law	Structural Measure	Guide fiscal policy over business cycle	In progress. IMF mission organized seminars
7. Institutional Strengthening	Benchmark (September)	Improve framework for electricity sector	In progress. WB has consultant working.

Sources: Dominican authorities and Fund staff.

- ***Tax policy.*** This reform comprises two elements: (i) reductions in tax exemptions; and (ii) introduction of the VAT. The authorities have prepared a comprehensive review—including on the basis of staff recommendations—of discretionary and statutory tax exemptions (a program benchmark). The work on the VAT introduction in mid-2005 is basically on track. A VAT seminar by CARTAC and FAD took place in April to provide basic training in VAT to the tax authority and review the introduction plan. There is a need to expedite the preparation of VAT legislation. The introduction of the VAT was announced in the 2004/05 budget address.

- ***Pension reform.*** The authorities will submit shortly legislation to Parliament increasing the retirement age of civil servants from 55 to 60 years in a gradual manner. It is expected that a full transition to the new system will be achieved within five years. To facilitate the authorities' decision, FAD prepared a policy note outlining the trade-offs involved. In addition, CARTAC organized a seminar in May on the subject to raise awareness about the delicate financial situation of the social security system and the need to expedite pension reform.

- ***Three-year rolling budgetary projections.*** The 2004/05 budget provides the usual detail on revenue and expenditures for 2004/05 and, for the first time, projections for broad fiscal components for 2005/06 and 2006/07, thereby improving transparency. Through these projections, the authorities are signaling their commitment to adhere to the medium-term target of a primary surplus of 3 percent of GDP in 2005/06.

- ***Fiscal Responsibility Law (FRL).*** As mentioned before, following the seminars organized by the mission on the subject, the authorities now believe it will require more time to build the necessary consensus for the reform. However, the authorities remain committed to having this reform in place for the 2005/06 budget as originally agreed.

F. Program-Related Issues

28. **The attached letter of intent (LOI) solidifies the authorities' commitment to the program and addresses a few technical issues.** Attachments to the LOI include a supplement memorandum of economic policies (SMEP) and an updated technical memorandum of understanding (TMU). These documents address the following issues:

- ***Performance criteria.*** These were established for end-September and end-December 2004. Indicative targets were set for end-March 2005 and end-June 2005, in line with the program. The TMU also includes monthly indicative targets for all variables for the second half of 2004.

- ***Prior action***. Approval of the 2004/05 budget in line with the program is the only prior action for completion of this review. The prior action was observed, the budget was approved by Parliament on July 8.

- ***Interest payments adjustor***. As mentioned, interest payments are calculated in the budget under the assumption of full creditor participation in the debt restructuring exercise. In the event interest payments turn out to be different than projected (because creditors choose a different mix of options), the performance criterion on net banking system credit to the central government will be correspondingly adjusted for the full amount of such deviations.

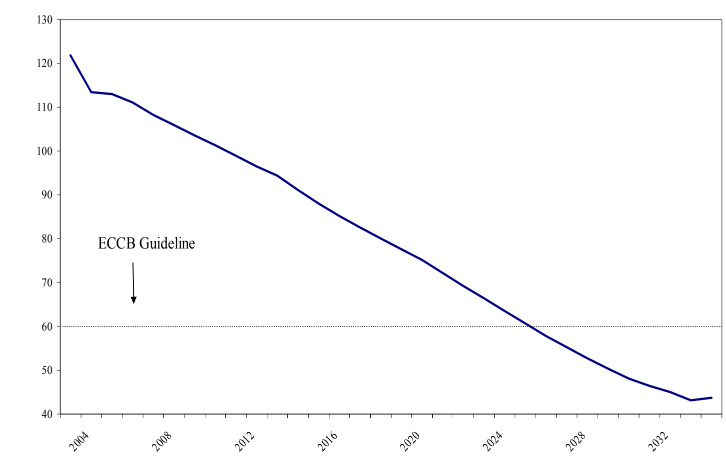
- ***Redefine net bank credit to the government***. This is a technical change. The central bank (ECCB) classifies IMF disbursements/purchases as an increase in gross reserves and government's deposits at the ECCB (i.e., a net credit contraction). The mission agreed with the authorities to change the definition to a more standard procedure, classifying the counter-entry to gross international reserves as a reserve liability so that IMF disbursements/purchases (or repayments/repurchases) do not have an impact on net international reserves or on net credit to the government.

29. **Only marginal progress has been made towards a full-fledged Poverty Reduction Strategy Paper (PRSP).** The demanding budget, the complex debt restructuring process, and the intense structural reform agenda took a toll on the progress on the PRSP given Dominica's capacity constraints. However, the authorities are confident that the PRSP would be completed by end-2004, as originally envisaged.

III. Medium-Term Scenario, Risks, and Capacity to Repay the Fund

30. **The medium-term outlook for public solvency improves significantly once the debt strategy is fully and successfully implemented**. Under a scenario where: (i) the debt restructuring is completed successfully with full creditor participation; and (ii) a sustainable primary fiscal target of 3 percent of GDP is achieved in 2005/06, the public debt-to-GDP ratio falls significantly, ultimately converging to the ECCB guideline of a 60 percent ratio by 2025. The combination of debt restructuring and fiscal adjustment will significantly alleviate the debt overhang problem, which could otherwise hamstring economic growth. Similarly, this combination will eliminate the previously envisaged large and persistent residual financing gaps—of over 8 percent of GDP—even if continued lending by bilateral creditors, donors, and multilateral organizations were to have occurred. Simultaneously, the authorities are trying to finance a higher portion of public investment with grants, keeping indebtedness within prudent levels while further underpinning growth.

Dominica: Public Debt After Restructuring
(% of GDP)



31. **The medium-term framework is robust to most exogenous shocks, but underscores the need for strong vigilance in policy decisions**. Both the public and the external debt sustainability analyses under a scenario of full completion of the debt restructuring illustrate that the amelioration in debt ratios is quite resilient to exogenous shocks, such as large adverse movement in global interest rates. However, they also indicate that a return to previous looser fiscal policies—mirrored by higher current account deficits

and increased external borrowing—can once again cause the debt situation to become unviable.

32. **Despite the promise of a significantly improved medium-term outlook, considerable risks remain.** The program is at a critical juncture, and implementation must remain strong, otherwise the nascent economic stabilization and recovery currently underway could falter. As mentioned on previous occasions, this operation poses significant risks to the Fund, but they will be reduced considerably after the successful completion of the debt restructuring and the approval of the 2004/05 budget which strengthens significantly the fiscal target. The list of specific risks include:

- ***Debt restructuring***. The primary risk is that the debt restructuring process might not be completed shortly, and the ensuing process of rapid accumulation of arrears could have a negative impact on economic activity.

- ***Policy slippages.*** As highlighted above, policy slippages can shift an otherwise sustainable debt situation back toward the path of unviable dynamics over the medium term.

- ***Technical capacity constraints.*** These constraints remain a source of long-term challenge for the authorities, and could give rise to program implementation difficulties. Weaknesses in the statistical infrastructure also remain a potential source of misreporting risk.

- ***Elections***. Unanticipated pressures on spending can occur against the backdrop of parliamentary elections, which are due by June 2005.

IV. Staff Appraisal

33. **The fruits of the authorities' commendable implementation of the program are beginning to emerge**. The improvements in policy implementation since mid-2003 and the strict adherence to the program since then have started to pay off. After experiencing the most pronounced and prolonged economic decline since independence, there are clear signs of an across-the-board economic recovery led by tourism, manufacturing and public investment. Banana production, which had declined by about 50 percent in the last three years appears to be recovering. The budgetary situation has improved markedly; the authorities implemented the difficult budget of 2003/04, achieving the program targets with large margins, as tax collections rebounded beyond expectations, and expenditures were tightly controlled.

34. **There have been clear achievements over the last year, but there is still much to be done.** The considerable progress made so far in itself is not enough to ensure a sustainable situation. There is a need to continue with a strong policy stance in order to consolidate the hard won achievements. While the authorities should be commended for their efforts, they should also be encouraged to stay the course and address steadfastly the country's complex economic problems. For the first time, a solution to this difficult situation is on the horizon.

35. **The staff welcomes the authorities' efforts to achieve a cooperative debt restructuring, although it regrets that progress has been much slower than envisaged under the program.** The authorities' debt strategy has followed international best practice and balances the requirements of medium-term debt sustainability, appropriate fiscal consolidation, and feasibility of achieving broad acceptance by creditors. To some extent, the difficulties in reaching an early pre-emptive restructuring reflect the diverse creditor base—creditor coordination has been weak due to the absence of a leading creditor group (i.e., no bondholder committee or Paris Club).

36. **For the authorities' strategy to succeed, early agreement on an appropriate restructuring is needed given the resource constraint.** The authorities remain committed to reaching an early agreement and, thereby, to avoid accumulation of arrears under the program. They have also indicated in the 2004/05 budget, that in the absence of such an agreement, debt service payments to nonparticipating creditors would be made into an escrow account. The staff recommends completion of the present review on the basis of the authorities' current strategy, including the avoidance of arrears under the program to date. Financing assurances will be comprehensively re-evaluated at the next review, at which time it is expected that a restructuring agreement has been reached or, alternatively, the authorities' financing strategy has shifted to the stance embodied in the 2004/05 budget.

37. **The authorities are doing their part to regain sustainability through yet another tough budget**. In addition to fiscal measures equivalent to 2½ percent of GDP, the 2004/05 budget contains difficult steps such as the retrenchment exercise to reduce the wage bill by 5 percent, and further expenditure cuts. At the same time, the budget eliminates the unpopular stabilization levy, which is likely to solidify support for the program and create incentives for private employment. The authorities have reacted to the difficulties in the debt negotiations by strengthening their fiscal position in order to demonstrate their seriousness and commitment to reform. This is a commendable decision, particularly as the additional effort is being undertaken in an election year.

38. **Significant progress has been made in implementing the structural reform agenda, and considerable further steps are being taken**. With the 2004/05 budget, many necessary structural measures are being implemented, including the first phase of the civil service and pension reforms. However, other important reforms still need to be implemented, including the design of a fiscal responsibility law which will serve as a guidance in the formulation of the budget and will act as an insurance policy—to both creditors and civil society—against future policy slippages which could lead to unsustainable debt situations. Looking ahead, the structural reform agenda needs also to focus on growth-enhancing issues, including fostering the investment climate and improving competitiveness.

39. **While the situation has improved, this arrangement continues to be a risky operation for the Fund.** At some level, the good performance reduces the high risks, as the capacity of the country to repay the Fund has been enhanced. However, at another level, there are significant risks stemming from the unsustainable debt situation and the possibility of a failure to achieve an orderly restructuring, with the resulting economic dislocations.

40. **In summary, the staff supports completion of the second program review.** The strong performance and commitment to the program warrant continued Fund support. The authorities are doing their best to achieve an early comprehensive restructuring of the debt, to ensure a seamless transition to a debt level and profile consistent with the near-term financing constraint and medium-term debt sustainability. Nonetheless, possible further delays in reaching a debt restructuring agreement in the next few weeks could lead to a period of arrears accumulation under the program. In that event, consideration will need to be given as to whether the Fund should continue to support the authorities' program under the LIA policy. Given the authorities' efforts at improving the debt statistics and comprehensively reconcile the public debt, the staff supports the completion of the second review under the PRGF arrangement and the authorities' request for a waiver of the nonobservance of the performance criterion on external arrears.

Box 1. Dominica: Assessing the Fiscal Adjustment Effort

The fiscal accounts are distorted by large swings in grants and capital expenditures. In order to have a more accurate picture of the "underlying" fiscal position, the staff estimates a "structural" primary fiscal balance for a constant but sustainable level of capital expenditure and related grants (in percent of GDP).[1] Based on historical experience, a level of capital expenditure of 7 percent of GDP is deemed to be adequate. Historically, about half of capital expenditure is financed with grants.

The headline fiscal figures underestimate the underlying weaknesses in the fiscal situation as well as the underlying improvement.

- ***The level***. The headline primary deficit for 2002/03 (1.6 percent of GDP) is masked by anemic capital expenditure and relatively high use of grants; the structural deficit is higher (4.5 percent of GDP). Similarly, the primary surplus for 2003/04 and 2004/05 (1.7 and 2.0 percent of GDP respectively) are overestimated by the high use of grants, notwithstanding the high public investment.
- ***The change***. The improvement in the headline primary fiscal balance between 2002/03 and 2004/05 (3.6 percent of GDP) is much lower than the improvement in the structural primary fiscal balance in the same period (6.0 percent of GDP) as the fiscal improvement was accompanied by a significant increase in (nongrant financed) capital expenditures.

Dominica: Structural Fiscal Accounts
(In percent of GDP)

		SBA		PRGF	
		Prog.	Rev. Proj.	Prog.	Rev. Proj.
	2002/03	2003/04		2004/05	
Primary Balance	-1.6	0.2	1.7	0.5	2.0
Capital expenditure shortfall	-1.9	0.0	1.5	0.0	4.8
Actual/Programmed	5.1	7.0	8.5	7.0	11.8
Structural	7.0	7.0	7.0	7.0	7.0
Grants adjustment excesses	-1.0	-2.2	-3.9	0.0	-5.3
Actual/Programmed	4.5	5.7	7.4	3.5	8.8
Structural	3.5	3.5	3.5	3.5	3.5
Structural Primary Balance	**-4.5**	**-2.0**	**-0.7**	**0.5**	**1.5**
Memorandum item:					
Primary savings (before grants)	-1.0	1.5	2.8	4.0	5.0
Cumulative fiscal effort	...	2.5	3.8	5.0	6.0

Source: Fund staff estimates.

The improvements in the underlying fiscal situation are mostly due to the measures included in the budget. For 2003/04, the improvement in the underlying fiscal situation of 3.8 percent of GDP can be explained by the fiscal measures adopted in the budget (2.5 percent of GDP) as well as the collection of tax arrears (0.3 percent of GDP), the measure limiting the issuance of discretionary tax exemptions adopted in December 2003 (0.1 percent of GDP in the period January–June 2004) and other factors related to improved macroeconomic conditions and additional expenditure cuts (0.9 percent of GDP). For 2004/05, the improvement in the underlying fiscal situation is also related to the additional budgetary measures (2.5 percent of GDP), adjusted for the collection of tax arrears that will not be replicated (0.3 percent of GDP), and the savings from the reduction of on discretionary tax exemptions, that were collected in the previous fiscal year (0.1 percent of GDP).

Dominica: Improvement in Structural Primary Balance
(In percent of GDP)

	Est. 2003/04	Proj. 2004/05	Proj. 2003-05
Change in Structural Primary Balance	3.8	2.2	6.0
Fiscal measures in the budget	2.5	2.5	5.0
Tax arrears collections	0.3	-0.3	0.0
Advance in discretionary tax exemptions	0.1	-0.1	0.0
Better macro conditions / other measures	0.9	0.1	1.0

Source: Fund staff estimates.

[1] The structural primary fiscal balance calculated here behaves in the same manner as the primary savings (before grants).

Box 2. Dominica: The Exchange Offer

Features of the new bonds. On April 6, 2004, the Dominican authorities launched an exchange offer aimed primarily at private sector creditors, but not exclusively limited to them. The proposed restructuring offers debt in the form of three new bonds to creditors in exchange for claims that were issued prior to December 17, 2003. The three new bonds have maturities of 10 (short), 20 (intermediate), and 30 (long) years respectively; are all denominated in local currency; and carry a coupon rate of 3.5 percent, and principal reductions of 30, 20, and 0 percent, respectively.

Mandatory debt management provisions. These are included in all three new bonds, requiring the authorities to buyback a certain minimum amount of the outstanding amount of the bonds at market prices, as the bond moves towards half the period of maturity. For example, at least 20 percent of the short bond would have to be purchased by the authorities starting in the sixth year since issuance. If the authorities fail to make the purchase in any given year, they are required to make up the shortfall in the following year. Holders of claims maturing before March 31, 2006, are eligible to receive all three bonds in the proportion they wish, while creditors with claims maturing thereafter are only eligible for the intermediate and long bonds. The structure of the offer is intended to provide investors with a menu of options, whereby they can trade off NPV losses against term risk, while simultaneously reducing principal risk in the new issues by use of the mandatory debt management feature. On average, private sector creditors are envisaged to take a 50 percent "haircut" in NPV terms off the face value of their claims (external commercial creditor claims were US$67.5 million as of end-2003)

Sinking funds under the old bonds. The largest proportion of private sector creditors being targeted are the holders of the bonds issued to Citibank and RBTT Merchant Bank. Both of these bonds were issued in 1999 (with face amounts of US$16.9 and US$30.5 million respectively). Both of these bonds have a highly complex structure, with a "sinking fund" provision, requiring the issuer to make partial principal payments through the life of the bond, and both of these bonds were subsequently stripped and sold as derivative zero coupon bonds to a wide variety of regional investors. The structure is further complicated by the fact that public sector agencies in Dominica purchased strips, creating in effect an obligation for the authorities to pay themselves. Besides the principal reductions specified in the new bonds, these bonds are also subject to an "up-front" principal reduction equivalent to the principal amount that had accreted to the "sinking fund".

Derivative structures. The complicated structure of these two bonds creates differing interests among the strip holders, as their term risk widely differs, and this creates a difficulty in creating the necessary formal quorum required to make a decision on accepting or rejecting the terms offered by the authorities in the exchange. In no small part due to this, response to the offer has thus far been slow, and the authorities postponed the closing of the exchange offer twice from its original April 30 date, first to May 7, and subsequently to June 11.

Table 1. Dominica: Quantitative Performance Criteria (PC) and Indicative Targets (IT) Under SBA and PRGF for 2003-2004

	SBA									PRGF			
	July 31, 2003 1/			September 30, 2003 1/			December 31, 2003 1/			March 31, 2004 2/			June 30, 2004 2/
	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Adjusted PC	Actual	Margin (+)/ Excess (-)	Performance Criteria
I. Performance Criteria													
(In millions of Eastern Caribbean dollars)													
Central government primary balance 3/	...	...	...	...	...	...	...	...	...	-4.1	28.0	32.0	0.8
Central government wage bill	37.5	36.9	0.6	55.8	54.8	1.0	84.0	81.3	2.7	83.2	77.9	5.3	108.6
Banking system net credit to central government 4/	15.0	8.6	6.4	10.4	5.5	4.9	11.1	-15.7	26.8	3.0	-31.0	34.0	3.0
Net changes in central government arrears to private domestic parties 5/	15.0	-2.5	17.5	15.0	-4.7	19.7	15.0	-5.6	20.6	15.0	-3.4	18.4	15.0
(In millions of U.S. dollars)													
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year 3/ 6/	19.5	1.6	17.9	22.0	5.9	16.1	28.9	19.3	9.6	31.5	23.9	7.6	33.0
Net changes in the oustanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 5/ 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net changes in external payments arrears of the central government 5/ 7/	0.0	0.0	0.0	0.0	-0.5	0.5	0.0	-0.4	0.4	0.0	-0.7	0.7	0.0
II. Indicative Targets													
(In millions of Eastern Caribbean dollars)													
Central government overall balance 3/	-30.4	-15.2	15.2	-36.3	-19.7	16.6	-54.3	-11.9	42.4	-37.6	-6.3	31.3	-39.2
Central government revenues	58.9	69.0	10.1	89.3	103.5	14.2	140.5	156.9	16.4	148.5	157.7	9.2	197.4
Central government primary savings	-11.8	3.9	15.7	-11.9	13.8	25.7	-9.5	23.1	32.6	0.0	27.0	27.0	10.6

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

1/ Cumulative amounts from March 31, 2003, PC (Performance Criteria), IT (Indicative Target).

2/ Cumulative amounts from June 30, 2003, PC (Performance Criteria), IT (Indicative Target).

3/ Up to June 2004, limits will be adjusted downward (upwards) to the extent that project financing falls short of (exceeds) programmed amounts. Upward adjustments will not exceed US$7.7 million by end-June 2004. The central government overall balance was a performance criterion up to December 31, 2003, and then became and indicative target.

4/ Up to June 2004, limits on banking system net credit to the central government will be adjusted upward to the extent that there are shortfalls in external nonproject financing that are outside the control of the authorities. These upward adjustments will not exceed US$7.7 million by end-June 2004. Limits on banking system net credit to the central government will be adjusted downward to the extent that external nonproject financing exceeds programmed amounts. Beginning in September 2004, limits on banking system net credit to the central government will be adjusted upward (downward) to the extent that cash interest payments of the central government are higher (lower) than in the baseline projection.

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

6/ For the definition of external debt, see paragraph 21of the Technical Memorandum of Understanding.

7/ External arrears accumulated prior to the Executive Board discussion on July 25, 2003, were waived.

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

	Completion Date	Category	Status
Tax policy Significant reduction of discretionary tax exemptions.	Mid-December 2003	Prior Action	Done
Civil service reform Study outlining the process for redcution in the wage bill for FY2004/05 by 5 percent through retrenchment	End-March 2004	Benchmark	Done
Tax policy and administration Conduct a review of all statutory tax exemptions with a view to assessing their effectiveness and justification, and to prevent abuses.	End-June, 2004	Benchmark	Done
Pension reform Submit legislation to Parliament proposing a phased increase in the retirement age for public employees to 60 years.	End-June, 2004	Benchmark	In progress. It was announced in the budget address and Cabinet took the decision to submit the legislation to Parliament.
Budget approval Approval of FY2004/05 budget, consistent with the program.	Early-July 2004	Prior Action	Done
Tax policy Announcement in the budget for FY2004/05 the adoption of the VAT by mid-2005. Cabinet approval of key parameters such as the base, the rate, registration threshold, filing frequency, and refund system.	End-September 2004	Benchmark	In progress
Institutional strengthening Improve the regulatory framework for electricity supply, following the recommendations of technical assistance mission.	End-September 2004	Benchmark	In progress

Sources: Dominican authorities and Fund staff.

Table 3. Dominica: Selected Economic and Financial Indicators

	2000	2001	2002	Est. 2003	Prog. 1/ 2004	Proj. 2004
(Annual percent change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	1.4	-4.2	-4.7	0.0	1.0	1.0
GDP deflator (factor cost)	0.6	1.2	-0.4	1.5	1.5	1.5
Nominal GDP (at factor cost)	2.0	-3.0	-5.1	1.5	2.6	2.6
Nominal GDP at market prices	1.3	-2.7	-6.2	1.3	3.1	3.2
Consumer prices (end of period)	1.1	1.9	0.5	2.9	1.5	1.5
Money and credit						
Net foreign assets of the banking system 2/	-12.8	6.6	19.9	16.7	1.3	-2.5
Net domestic assets of the banking system 2/	13.4	0.9	-11.3	-15.8	1.8	5.7
Of which						
Net credit to the nonfinancial public sector 2/	5.7	5.6	-7.0	-5.9	0.0	4.7
Credit to the private sector 2/	7.3	-3.1	-1.3	-2.3	2.4	2.4
Liabilities to the private sector (M2)	0.6	7.4	8.5	1.0	3.1	3.2
Balance of payments						
Merchandise exports, f.o.b.	-2.3	-18.9	-3.7	-7.2	3.0	5.1
Merchandise imports, f.o.b.	7.3	-11.6	-12.1	10.0	0.0	4.3
Terms of trade	-5.3	1.5	0.1	…	…	…
Real effective exchange rate						
(end-of-period; depreciation -)	4.8	3.7	-6.4	-6.7	…	…
(In millions of U.S. dollars)						
Merchandise exports, f.o.b.	54.7	44.4	42.8	39.7	41.1	41.7
Merchandise imports, f.o.b.	130.4	115.3	101.4	111.5	106.4	116.3
Current account balance	-52.5	-47.6	-37.0	-41.8	-40.3	-41.4
Capital account balance 3/	50.3	49.5	48.5	43.3	15.9	20.8
Overall balance	-2.2	1.9	11.4	1.5	-24.4	-20.6
(In percent of GDP, unless otherwise specified)						
Savings and investment						
Gross domestic investment	24.8	21.2	10.6	14.7	14.9	19.1
Public	16.7	15.3	6.6	7.7	8.4	11.6
Private	8.1	5.9	4.0	7.0	6.5	7.5
Gross national saving	5.3	3.0	-4.3	-2.2	-0.5	3.5
Public	-0.6	-2.4	-3.0	-2.2	-1.4	-0.6
Private	5.8	5.4	-1.4	-0.7	0.9	4.1
Central government 4/						
Savings	5.3	-3.0	-0.6	4.0	1.2	7.0
Of which						
Primary	10.7	2.4	5.1	10.1	7.5	13.8
Grants	9.4	1.7	4.5	7.4	3.5	8.8
Capital expenditure and net lending	16.6	5.7	5.1	8.5	7.0	11.8
Primary balance	-5.9	-3.3	-1.6	1.7	0.5	2.0
Overall balance	-10.9	-8.6	-7.1	-4.2	-5.5	-4.3
Nonfinancial public sector debt (gross) 4/	87.4	95.4	121.9	122.0	117.8	...
External 5/	59.1	71.0	82.4	87.4	92.2	...
Domestic	28.2	24.4	39.4	34.6	25.7	...
External sector						
Current account balance	-19.5	-18.2	-15.0	-16.9	-15.4	-15.5
External public debt service 6/	7.4	10.8	12.3	20.9	14.5	14.5
Amortization	3.1	4.5	4.9	12.3	7.1	7.1
Interest	4.3	6.4	7.5	8.6	7.5	7.5
Memorandum items:						
Nominal GDP at market prices (EC$ millions)						
Calendar year	726.4	706.8	680.5	689.1	704.1	719.4
Net international reserves						
(U.S.dollars millions; end-of-period) 7/	29.0	30.4	43.6	45.1	46.7	47.7

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

1/ IMF Country Report No. 03/293.
2/ Change relative to the stock of M2 at the beginning of the period.
3/ Including errors and omissions.
4/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.
5/ Including external financing gap.
6/ In percent of exports of goods and nonfactor services.
7/ Imputed reserves at the ECCB.

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

				Prog. 2/	Proj.	Prog. 2/	Proj.	Projection	
	2000/01	2001/02	2002/03	2003/2004		2004/2005		2005/2006	2006/2007
	(In millions of Eastern Caribbean dollars)								
Total revenue and grants	**271.5**	**209.7**	**224.1**	**237.2**	**262.0**	**233.8**	**278.7**	**278.4**	**288.5**
Current revenue	200.5	197.1	191.9	196.3	207.5	207.3	211.1	217.6	225.4
Capital revenue	3.0	0.9	1.3	1.5	2.3	1.6	3.0	2.6	2.7
Grants	68.0	11.8	30.9	39.3	52.2	24.9	64.6	58.2	60.5
Total expenditure 3/	**350.3**	**269.3**	**261.3**	**276.3**	**291.9**	**273.2**	**310.3**	**303.8**	**309.6**
Current expenditure	230.1	229.7	226.6	227.7	231.6	223.4	224.1	224.4	227.1
Wages and salaries	116.2	116.5	116.1	108.6	108.6	103.2	102.7	99.7	103.2
Interest	36.0	36.9	37.6	40.5	41.7	43.1	46.4	48.2	44.7
Domestic	20.2	19.3	17.8	18.1	18.8	15.9	21.2	21.2	21.2
External	15.7	17.5	19.8	22.4	22.9	27.2	25.1	27.0	23.4
Others	77.9	76.3	72.8	78.6	81.3	77.2	75.1	76.5	79.2
Capital expenditure and net lending	120.2	39.6	34.7	48.6	60.2	49.8	86.2	79.4	82.5
Overall balance	**-78.8**	**-59.5**	**-37.2**	**-39.2**	**-29.9**	**-39.5**	**-31.6**	**-25.4**	**-21.1**
Statistical discrepancy 4/	18.7	8.2	-11.5	0.0	0.0	0.0	0.0	0.0	0.0
Financing	**60.1**	**51.3**	**48.7**	**18.4**	**29.9**	**-26.1**	**31.6**	**25.4**	**21.1**
Net foreign financing	42.7	25.6	44.9	28.8	40.6	-26.1	23.5	24.0	15.9
Disbursements	...	31.9	47.7	65.6	75.9	19.9	20.6	21.2	22.0
Amortization	...	6.3	6.5	39.7	37.2	46.0	44.7	18.2	19.4
Other including rescheduling	...	0.0	3.8	2.9	1.9	0.0	47.5	21.0	13.3
Net domestic financing	17.4	25.7	3.8	-10.4	-10.7	0.0	8.1	1.4	5.1
Bank	11.2	16.3	-6.9	-10.5	-8.0	0.0	-4.9	-11.5	-6.5
Nonbank	6.2	9.5	10.7	0.1	-2.0	0.0	0.6	0.6	0.5
Other including rescheduling	0.0	0.0	0.0	0.0	-0.7	0.0	12.4	12.3	11.2
Gap	**0.0**	**0.0**	**0.0**	**20.8**	**0.0**	**65.5**	**0.0**	**0.0**	**0.0**
	(In percent of GDP)								
Total revenue and grants	**37.6**	**30.2**	**32.7**	**34.2**	**36.9**	**32.6**	**38.0**	**36.7**	**36.7**
Current revenue	27.8	28.4	28.0	28.3	29.2	28.9	28.8	28.7	28.7
Capital revenue	0.4	0.1	0.2	0.2	0.3	0.2	0.4	0.3	0.3
Grants	9.4	1.7	4.5	5.7	7.4	3.5	8.8	7.7	7.7
Total expenditure 3/	**48.5**	**38.8**	**38.2**	**39.8**	**41.1**	**38.1**	**42.3**	**40.0**	**39.4**
Current expenditure	31.9	33.1	33.1	32.8	32.6	31.2	30.6	29.6	28.9
Wages and salaries	16.1	16.8	17.0	15.7	15.3	14.4	14.0	13.1	13.1
Interest	5.0	5.3	5.5	5.8	5.9	6.0	6.3	6.4	5.7
Domestic	2.8	2.8	2.6	2.6	2.6	2.2	2.9	2.8	2.7
External	2.2	2.5	2.9	3.2	3.2	3.8	3.4	3.6	3.0
Others	10.8	11.0	10.6	11.3	11.5	10.8	10.2	10.1	10.1
Capital expenditure and net lending	16.6	5.7	5.1	7.0	8.5	7.0	11.8	10.5	10.5
Overall balance	**-10.9**	**-8.6**	**-5.4**	**-5.6**	**-4.2**	**-5.5**	**-4.3**	**-3.4**	**-2.7**
Statistical discrepancy 4/	2.6	1.2	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Financing	**8.3**	**7.4**	**7.1**	**2.7**	**4.2**	**-3.6**	**4.3**	**3.4**	**2.7**
Net foreign financing	5.9	3.7	6.6	4.2	5.7	-3.6	3.2	3.2	2.0
Disbursements	...	4.6	7.0	9.5	10.7	2.8	2.8	2.8	2.8
Amortization	...	0.9	1.0	5.7	5.2	6.4	6.1	2.4	2.5
Other including rescheduling	...	0.0	0.6	0.4	0.3	0.0	6.5	2.8	1.7
Net domestic financing	2.4	3.7	0.6	-1.5	-1.5	0.0	1.1	0.2	0.7
Bank	1.5	2.3	-1.0	-1.5	-1.1	0.0	-0.7	-1.5	-0.8
Nonbank	0.9	1.4	1.6	0.0	-0.3	0.0	0.1	0.1	0.1
Other including rescheduling	0.0	0.0	0.0	0.0	-0.1	0.0	1.7	1.6	1.4
Gap	**0.0**	**0.0**	**0.0**	**3.0**	**0.0**	**9.1**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Savings (incl. grants)	5.3	-3.0	-0.6	1.1	4.0	1.2	7.0	6.8	7.5
Primary savings (before grants)	1.3	0.7	0.6	1.5	2.8	4.0	5.0	5.8	5.8
Primary balance (incl. grants) 5/	-5.9	-3.3	-1.6	0.2	1.7	0.5	2.0	3.0	3.0
Total debt service to government revenue	...	24.7	23.7	36.2	39.1	42.9	0.0	0.0	0.0
Nominal GDP at market prices (EC$ millions)	722.4	693.7	684.8	693.5	709.9	716.3	733.4	758.7	785.6

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

1/ Fiscal years beginning July 1.
2/ IMF Country Report No. 04/6.
3/ On a due basis.
4/ Difference between identified financing below-the-line and overall balance above-the-line.
5/ Starting from FY 2002/2003 the primary balance is computed using overall deficit measured from below-the-line.

Table 5. Dominica: Summary Accounts of the Banking System

	2000	2001	2002	2003	Prog. 1/ 2004	Proj. 2004
(In millions of Eastern Caribbean dollars, end of period)						
I. Consolidated Banking System						
Net foreign assets	**65.2**	**96.1**	**196.7**	**288.7**	**225.8**	**274.6**
Net domestic assets	**405.8**	**409.8**	**352.5**	**265.8**	**357.5**	**297.6**
Net credit to the nonfinancial public sector	75.8	102.3	66.8	34.6	67.3	60.9
Of which						
Central government	70.3	92.3	56.2	38.4	59.8	53.3
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-49.5	-84.4
Credit to the private sector	454.1	439.6	433.2	420.6	442.2	434.1
Other items (net) 2/	-88.3	-94.4	-101.0	-107.6	-102.6	-112.9
Broad money 3/	**471.0**	**506.0**	**549.2**	**554.5**	**583.3**	**572.2**
II. Operations of the Eastern Caribbean Central Bank						
Imputed net international reserves	**78.2**	**82.1**	**117.8**	**121.7**	**126.0**	**128.8**
Net domestic assets	**10.9**	**10.2**	**13.4**	**4.9**	**16.3**	**4.9**
Monetary base	**89.1**	**92.3**	**131.2**	**126.6**	**142.3**	**133.7**
Currency in circulation	35.4	34.6	35.5	34.2	37.7	35.3
Commercial bank reserves	53.6	57.7	95.7	92.4	104.5	98.4
III. Commercial Banks						
Net foreign assets	**-12.9**	**14.0**	**79.0**	**167.0**	**99.8**	**145.8**
Net claims on ECCB	**51.2**	**58.5**	**98.2**	**81.6**	**104.2**	**84.2**
Net domestic assets	**397.3**	**398.9**	**336.6**	**271.7**	**341.5**	**306.9**
Net credit to the nonfinancial public sector	65.0	92.1	53.4	29.7	52.1	56.0
Net credit to nonbank financial institutions	-35.8	-37.7	-46.6	-81.8	-49.5	-84.4
Credit to the private sector	454.1	439.6	433.2	420.6	442.2	434.1
Other (net)	-86.0	-95.2	-103.5	-96.7	-103.3	-98.7
Private sector deposits 3/	**435.6**	**477.4**	**513.7**	**520.3**	**545.5**	**536.9**
IV. Consolidated Banking System						
(Annual percentage change)						
Credit to the private sector	8.2	-3.2	-1.4	-2.9	3.1	3.2
Private sector deposits	0.3	9.6	7.6	1.3	3.1	3.2
Broad money	0.6	7.4	8.5	1.0	3.1	3.2
(Contributions to liquidity growth) 4/						
Net foreign assets	**-12.8**	**6.6**	**19.9**	**16.7**	**1.3**	**-2.5**
Net domestic assets	**13.4**	**0.9**	**-11.3**	**-15.8**	**1.8**	**5.7**
Net credit to the nonfinancial public sector	5.7	5.6	-7.0	-5.9	0.0	4.7
Credit to the private sector	7.3	-3.1	-1.3	-2.3	2.4	2.4
Memorandum items:						
Interest rates 5/						
Deposits (3-month time—maximum rate) 6/	6.0	6.0	6.0	6.0	…	4.0
Lending: Minimum rate 6/	9.5	9.5	8.5	8.0	…	8.5
Maximum rate 6/	20.8	20.8	20.8	18.2	…	18.2

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

1/ IMF Country Report No. 03/293.
2/ Includes interbank float.
3/ Including deposits denominated in U.S. dollars.
4/ Change relative to broad money at the beginning of the period.
5/ Commercial banks; end-of-period rates, percent per annum.
6/ For 2004, rates shown are as of end-May.

Table 6. Dominica: Balance of Payments

	2000	2001	2002	Est. 2003	Prog. 1/ 2004	Proj. 2004
	(In millions of U.S. dollars)					
Current account balance	**-52.5**	**-47.6**	**-37.0**	**-41.8**	**-40.3**	**-41.4**
Trade balance	-75.6	-70.9	-58.6	-71.8	-65.4	-74.6
Exports (f.o.b.) 2/	54.7	44.4	42.8	39.7	41.1	41.7
Imports (f.o.b.)	130.4	115.3	101.4	111.5	106.4	116.3
Services balance	37.1	25.0	25.2	31.0	32.3	37.0
Exports of services	89.7	76.7	74.7	87.1	81.7	91.5
Travel	48.2	46.3	44.2	52.1	48.7	54.7
Other	41.6	30.4	30.5	35.0	33.0	36.8
Imports of services	52.7	51.7	49.4	56.1	49.3	54.5
Net income	-32.0	-19.2	-20.1	-17.2	-20.1	-18.2
Interest payments (public sector)	-6.2	-7.7	-8.8	-8.0	-11.1	-10.3
Other income	-25.8	-11.5	-11.3	-9.3	-9.0	-7.9
Net current transfers	18.1	17.5	16.4	16.2	12.9	14.4
Private	10.6	11.5	12.0	13.0	12.9	14.4
Public	7.4	5.9	4.4	3.2	0.0	0.0
Capital and financial account	**53.2**	**41.2**	**27.3**	**22.8**	**15.9**	**20.8**
Capital account	10.9	18.0	13.3	11.3	15.3	24.4
Public capital transfers	9.6	15.3	10.5	8.3	12.3	21.4
Private capital transfers	2.7	2.7	2.7	2.9	3.0	3.0
Financial account	42.3	23.2	14.1	11.5	0.6	-3.6
Public sector	21.2	23.0	25.2	8.9	-10.3	-4.5
Budgetary flows (net)	23.9	24.6	24.4	8.9	-10.3	-4.5
Disbursements	28.4	30.0	30.1	24.0	10.4	15.6
Repayments	4.5	5.4	5.7	15.1	20.7	20.0
Nonbudgetary flows (net)	-2.7	-1.6	0.8	0.0	0.0	0.0
Private sector	22.7	0.2	-11.1	2.7	11.0	0.9
Direct investment	10.8	11.9	13.2	24.4	13.2	21.1
Commercial banks	19.7	-10.0	-24.0	-32.6	-1.2	7.8
Other private flows	-7.8	-1.7	-0.3	10.9	-1.1	-28.1
Errors and omissions	**-2.9**	**8.3**	**21.2**	**20.5**	**0.0**	**0.0**
Overall balance	**-2.2**	**1.9**	**11.4**	**1.5**	**-24.4**	**-20.6**
Overall financing	**2.2**	**-1.9**	**-11.4**	**-1.4**	**24.4**	**20.6**
Net international reserves	2.2	-1.9	-13.2	-1.4	-1.6	-2.6
Gross reserves	2.2	-1.9	-16.0	-2.7	-1.6	-2.6
Reserve liabilities (IMF)	0.0	0.0	2.8	1.3	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	26.0	23.3
Arrears	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling	0.0	0.0	0.0	0.0	0.0	23.3
Financing gap	0.0	0.0	0.0	0.0	26.0	0.0
	(In percent of GDP)					
Memorandum items:						
Current account balance	-19.5	-18.2	-15.0	-16.9	-15.4	-15.5
External public debt 3/	53.7	64.6	77.4	87.4	91.5	...

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

1/ IMF Country Report 04/6.

2/ Includes stores and bunkers.

3/ Includes external financing gap.

Table 7. Dominica: Financial and External Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	Prel. 2003	Proj. 2004
Financial indicators						
Broad money (percent change, 12-month basis)	10.4	0.6	7.4	8.5	1.0	3.2
Private sector credit (percent change, 12-month basis)	2.4	8.2	-3.2	-1.4	-2.9	3.2
Unsatisfactory assets/total loans	17.9	17.4	22.6	19.2	21.1	21.1
General and specific provisions for loan losses/unsatisfactory assets	37.3	40.0	30.2	36.7	35.4	35.4
Specific provisions for loan losses/unsatisfactory assets	33.5	33.3	26.2	32.6	30.1	30.1
Total capital/risk weighted assets (locally incorporated banks)	38.2	30.8	35.4	34.1	29.1	29.1
Tier 1 capital/risk weighted assets (locally incorporated banks)	35.2	27.4	34.1	32.9	29.3	29.3
Three-month treasury bill rate (end of period)	6.4	6.4	6.4	6.0	6.3	6.3
Three-month treasury bill rate (real) 2/	6.4	5.3	4.5	5.5	3.4	4.8
External indicators						
Exports of goods and services (percent change, 12-month basis in U.S. dlrs.)	3.4	-7.9	-16.2	-3.0	-7.2	5.1
Imports of goods and services (percent change, 12-month basis in U.S. dlrs.)	4.9	1.4	-8.8	-9.7	10.0	4.3
Current account balance	-12.9	-19.5	-18.2	-15.0	-16.9	-15.5
Capital and financial account balance 3/	14.2	18.7	18.9	19.2	17.0	7.8
Net official reserves (in millions of U.S. dollars, end of period) 4/	31.5	29.0	30.4	43.6	45.1	47.7
Net reserves to broad money (percent, end of period) 4/	18.2	16.6	16.2	21.4	21.9	22.5
Public sector external debt	48.4	53.7	64.6	77.4	87.4	...
External debt (end of period) to exports of goods and services (percent) 5/	82.7	100.8	140.8	163.2	175.6	...
External interest payments to exports of goods and services (percent) 5/	1.7	4.3	6.4	7.5	6.3	...
External amortization payments to exports of goods and services (percent) 5/	3.3	3.1	4.5	4.9	11.9	...
Exchange rate (per U.S. dlrs, end of period)	2.7	2.7	2.7	2.7	2.7	...
REER appreciation (end of period; depreciation -)	0.8	4.8	3.7	-6.4	-6.7	...

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

1/ As of March 2004.
2/ Treasury bill rate adjusted by end-of-period inflation.
3/ Includes errors and omissions.
4/ Imputed reserves at the ECCB.
5/ Refers to public sector debt.

Table 8. Dominica: Medium-Term Projections

			Est.	Projections		
	2001	2002	2003	2004	2005	2006
			(Annual percentage change)			
National income and prices						
GDP at constant (1990) prices	-4.2	-4.7	0.0	1.0	2.0	2.0
Implicit GDP deflator (factor cost)	1.2	-0.4	1.5	1.5	1.5	1.5
			(In percent of GDP, unless otherwise stated)			
Saving and investment						
Gross domestic investment	21.2	10.6	14.7	19.1	21.0	21.5
Public	15.3	6.6	7.7	11.6	12.0	12.5
Private	5.9	4.0	7.0	7.5	9.0	9.0
Gross national saving	3.0	-4.3	-2.2	3.5	8.1	11.2
Public	-2.4	-3.0	-2.2	-0.6	0.7	1.4
Private	5.4	-1.4	-0.7	4.1	7.4	9.8
Central government finances 1/						
Central government saving (excluding grants)	-4.7	-5.1	-3.4	-1.8	-0.9	-0.2
Current revenue	28.4	28.0	29.2	28.8	28.7	28.7
Current expenditure	33.1	33.1	32.6	30.6	29.6	28.9
Overall balance (after grants)	-8.6	-5.4	-4.2	-4.3	-3.4	-2.7
Grants	1.7	4.5	7.4	8.8	7.7	7.7
Capital spending	5.7	5.1	8.5	11.8	10.5	10.5
Primary balance	-3.3	-1.6	1.7	2.0	3.0	3.0
Balance of payments						
External current account	-18.2	-15.0	-16.9	-15.5	-13.0	-10.3
Of which						
Exports of goods and services	46.3	46.6	49.7	50.0	51.0	51.8
Imports of goods and services	63.8	59.8	65.7	64.1	62.6	61.6
Capital and financial account 2/	18.9	19.2	17.0	7.8	8.4	7.3
Overall balance	0.7	4.3	0.1	-7.7	-4.5	-3.0
Identified financing	-0.7	-4.5	-0.6	7.7	4.5	3.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0
Public sector debt and debt service						
Public sector debt 1/	95.4	121.9	122.0	...	...	...
External	71.0	82.4	87.4	...	...	...
Domestic	24.4	39.4	34.6	...	...	...
External debt/exports 3/	153.5	176.9	176.0	...	...	...
External debt service/exports 3/	10.8	12.3	20.9	...	...	...

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

1/ These data are presented on a fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.

2/ Including errors and omissions.

3/ Exports of goods and services.

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

	Debt Stocks			
	In millions of EC$	In millions of US$	In percent of GDP	Share of Total Debt
Domestic debt	**182.4**	**67.6**	**26.5**	**22.9**
Commercial banks	109.3	40.5	15.9	13.7
NCB	74.6	27.6	10.8	9.4
Others	34.7	12.9	5.0	4.4
ECCB	16.2	6.0	2.4	2.0
Private	43.3	16.1	6.3	5.4
Arrears	13.5	5.0	2.0	1.7
External debt	**614.7**	**224.9**	**88.1**	**77.1**
Multilateral	309.4	114.6	44.9	38.8
CDB	192.5	71.3	27.9	24.2
World Bank	71.8	26.6	10.4	9.0
IMF	20.0	7.4	2.9	2.5
Others 1/	25.1	9.3	3.6	3.2
Bilateral	106.7	51.4	20.1	13.4
Taiwan Province of China	32.1	11.9	4.7	4.0
France	31.1	11.5	4.5	3.9
United Kingdom 2/	27.6	10.2	4.0	3.5
Others 3/	48.1	17.8	7.0	6.0
Commercial	182.4	52.8	20.7	22.9
RBTT (Royal Merchant Bank)	82.6	30.6	12.0	10.4
Citicorp	45.5	16.9	6.6	5.7
Intercommercial Bank	5.4	2.0	0.8	0.7
Others	9.2	3.4	1.3	1.2
Arrears	16.2	6.0	2.4	2.0
Total	**797.1**	**292.4**	**114.6**	**100.0**
Memorandum item:				
Total debt of the NFPS 5/	906.4	335.7	131.5	115.4
Of which				
Domestic debt 6/	299.3	110.9	43.4	38.5

Sources: Dominican authorities; and Fund staff estimates.

1/ Includes EIB, IFAD and OPEC.

2/ Loan provided by Societe Generale and guaranteed by the U.K. government. The guarantee has been exercised.

3/ Includes Bahamas, Barbados, Belize, Grenada, Kuwait, St. Vincent and the Grenadines, Trinidad and Tobago and Venezuela.

4/ This definition of the debt adds Dominica Social Security's claims on the central government to the nonfinancial public sector debt.

5/ Due to updated stock of debt information, the data has been revised.

Table 10: Dominica : External Arrears 1/

	September	December	March
	2003		2004
	(In millions of US dollars)		
Total External Arrears	**3.8**	**4.6**	**4.3**
Under Litigation 2/	**3.6**	**4.0**	**4.0**
Citibank	0.8	0.8	0.8
RBTT	1.4	1.4	1.4
Intercommercial Bank	1.4	1.8	1.8
Not under litigation	**0.5**	**0.6**	**0.3**
U.K (Societe Generale/ECGD)3/	0.2	0.3	0.0
Other 4/	0.3	0.3	0.3

Source: Dominican Authorities

1/ Does not include penalties, and interest on arrears

2/ Arrears under Litigation are excluded from the measurement of the external arrears performance criterion, for the purpose of the program.

3/ Does not include arrears of $1.4 million as of March 31 2003, incurred under original arrangement with Societe Generale/ECGD which are to have been rescheduled under a new set of payment streams beginning April 2003, pending the clearance of interest arrears incurred under the original agreement.

4/ This includes IBM arrears (0.3 million US dollars)

Table 11. Dominica: Schedule of Purchases Under the Stand-By Arrangement and the Poverty Reduction and Growth Facility

Date	Purchases (in millions) US$ 1/	SDR	As Percent of Quota	Conditions
2002	**2.973**	**2.050**	**25.0**	
August 28	2.973	2.050	25.0	Board approval of SBA (first credit tranche)
2003	**4.757**	**3.281**	**40.0**	
July 28	0.446	0.308	3.8	First review under the SBA; and adoption of prior actions
September 15	0.446	0.308	3.8	End-July 2003 performance criteria
Decemeber 29	0.446	0.308	3.8	Second review under the SBA; and end September 2003 performance criteria
Decemeber 29	3.419	2.358	28.8	Board approval of PRGF; and adoption of prior actions
2004	**1.786**	**1.232**	**15.0**	
March 24	0.447	0.308	3.8	First review under the PRGF; end-December 2003 performance criteria; and adoption of prior action.
August 6	0.447	0.308	3.8	Second review under the PRGF; and end-March 2004 performance criteria
September 15	0.447	0.308	3.8	Third review under the PRGF; and end-June 2004 performance criteria
December 15	0.447	0.308	3.8	End-September 2004 performance criteria
2005	**3.567**	**2.460**	**30.0**	
March 15	0.892	0.615	7.5	Fourth review under the PRGF; and end-December 2004 performance criteria
June 15	0.892	0.615	7.5	End-March 2005 performance criteria
September 15	0.892	0.615	7.5	Fifth review under the PRGF; and end-June 2005 performance criteria
December 15	0.892	0.615	7.5	End-September 2005 performance criteria
2006	**2.378**	**1.640**	**20.0**	
April 30	1.189	0.820	10.0	Sixth review under the PRGF; and end-December 2005 performance criteria
October 31	1.189	0.820	10.0	Seventh review under the PRGF; and end-June 2006 performance criteria
Total	**15.46**	**10.66**	**130.0**	
SBA	4.31	2.97	36.3	
PRGF	11.15	7.69	93.8	
Memorandum item:				
Quota (in millions)	11.89	8.20	100.0	

Source: Fund staff estimates.

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

Table 12. Dominica: Indicators of Capacity to Repay the Fund, 2003–08

		Projections				
	2003	2004	2005	2006	2007	2008
Fund repurchases and charges 1/						
In millions of SDRs	0.1	0.1	0.4	1.2	1.3	0.4
In millions of U.S. dollars	0.1	0.1	0.6	1.8	1.9	0.6
In percent of exports of goods and services	0.1	0.1	0.4	1.2	1.3	0.4
In percent of debt service	0.6	0.5	2.6	8.8	9.2	2.8
In percent of quota	1.2	1.2	4.9	14.6	15.9	4.9
In percent of imputed net official reserves	0.3	0.3	1.2	3.5	3.6	1.1
Fund credit outstanding 1/						
In millions of SDRs	5.3	6.6	8.7	9.3	8.1	7.7
In millions of U.S. dollars	7.5	9.7	12.9	13.7	12.0	11.4
In percent of exports of goods and services	5.9	7.3	9.2	9.3	7.8	7.2
In percent of debt service	32.4	31.9	57.5	67.8	56.8	54.4
In percent of quota	65.0	80.0	106.4	113.0	98.3	93.4
In percent of imputed net official reserves	16.5	20.3	26.1	26.8	22.5	20.7
Memorandum items:						
Exports of goods and services (millions of U.S. dollars)	126.8	133.2	140.5	147.8	153.3	159.0
Debt service (millions of U.S. dollars) 1/	23.0	30.3	22.4	20.2	21.1	20.9
Quota (millions of SDRs)	8.2	8.2	8.2	8.2	8.2	8.2
Quota (millions of U.S. dollars)	11.5	12.1	12.1	12.1	12.2	12.2
Imputed net official reserves (millions of U.S. dollars)	45.1	47.7	49.4	51.2	53.1	55.0
GDP (millions of U.S. dollars)	255.2	266.4	275.7	285.5	295.6	306.0
SDRs per U.S. dollar 2/	0.715	0.679	0.677	0.675	0.674	0.673

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

1/ Including hypothetical purchases under the PRGF, not shown in the BoP projections.

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

Table 13. Dominica: Public Sector Debt Sustainability Framework, 1998–2015

(In percent of GDP, unless otherwise indicated)

						Projections											
	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
											I. Baseline Projections						
Public sector debt 1/	71.0	76.8	87.4	95.4	121.9	122.0	115.0	113.8	111.4	108.7	106.3	103.9	101.5	99.1	96.8	94.0	90.8
Of which : foreign-currency denominated	52.6	52.6	61.7	68.5	65.9	80.6	73.2	73.2	72.0	70.5	69.3	68.1	66.8	65.5	64.2	62.5	60.4
Change in public sector debt	10.1	5.8	10.6	8.0	26.4	26.6	-6.8	-1.2	-2.4	-2.7	-2.4	-2.4	-2.4	-2.4	-2.3	-2.8	-3.2
Identified debt-creating flows	4.0	10.3	13.3	13.3	6.1	-0.8	-2.6	-2.8	-2.8	-2.6	-2.6	-2.6	-2.6	-2.5	-2.5	-2.5	-2.4
Primary deficit	4.3	8.1	7.6	5.1	-0.1	-1.7	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Revenue and grants	39.1	37.2	45.0	35.3	32.5	37.2	38.1	36.7	36.8	36.8	36.8	36.9	36.9	36.9	36.9	36.9	36.9
Primary expenditure	43.4	45.3	52.6	40.4	32.5	35.5	36.1	33.7	33.8	33.8	33.8	33.9	33.9	33.9	33.9	33.9	33.8
Automatic debt dynamics 2/	-0.2	2.2	5.7	8.2	6.1	0.9	-0.6	0.2	0.2	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.6
Contribution from interest rate/growth differential 3/	-0.2	2.2	5.7	8.2	6.1	0.9	-0.6	0.2	0.2	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.6
Of which: Contribution from real interest rate	1.1	3.3	4.6	4.2	3.8	1.4	1.2	2.4	2.4	2.6	2.5	2.5	2.5	2.4	2.4	2.4	2.4
Contribution from real GDP growth	-1.3	-1.0	1.1	4.0	2.3	-0.5	-1.8	-2.2	-2.2	-2.2	-2.1	-2.1	-2.0	-2.0	-1.9	-1.9	-1.8
Residual, including asset changes	6.0	-4.5	-2.7	-5.2	20.3	27.4	-4.3	1.6	0.3	-0.1	0.2	0.2	0.2	0.1	0.2	-0.3	-0.8
Public sector debt-to-revenue ratio 1/	181.4	206.7	194.3	270.5	374.5	328.1	302.1	309.7	302.8	295.3	288.5	281.8	275.1	268.5	262.2	254.7	246.5
Gross financing need 4/	6.8	12.0	12.6	10.4	5.4	7.4	8.1	3.5	3.6	3.6	3.9	3.8	3.6	3.4	3.3	3.2	3.1
In millions of U.S. dollars	17.7	32.0	33.5	26.7	13.8	19.4	22.1	9.7	10.4	10.8	12.1	12.1	12.0	11.9	11.9	11.8	11.8
Key Macroeconomic and Fiscal Assumptions	10-Year Historical Average	10-Year Standard Deviation															
Real GDP growth (in percent)	0.8	2.6	-1.4	-4.4	-2.4	0.5	1.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Average nominal interest rate on public debt (in percent) 5/	5.0	0.9	6.5	5.9	5.7	3.2	3.4	3.7	3.7	3.9	4.0	4.0	4.0	4.0	4.1	4.1	4.2
Average real interest rate	3.2	1.5	5.9	4.6	4.0	1.5	1.1	2.2	2.2	2.4	2.5	2.5	2.5	2.5	2.6	2.6	2.7
Nominal appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	1.8	0.7	0.6	1.3	1.7	1.7	2.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Growth of real primary spending	0.9	14.9	14.5	-26.6	-21.5	9.9	3.0	-4.6	2.1	2.1	2.1	2.1	2.1	2.0	2.0	2.0	1.8
Primary deficit	2.5	3.6	7.6	5.1	-0.1	-1.7	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
											II. Stress Tests						
A. Alternative Scenarios																	
A1. Key variables are at their historical averages in 2005-09 6/						148.3	142.1	141.0	138.7	136.0	133.5	131.0	128.6	126.1	123.7	120.8	117.4
A2. No policy change (constant primary balance) in 2005-09						122.0	115.0	113.8	111.4	108.7	106.3	103.9	101.5	99.1	96.8	94.0	90.8
A3. Selected variables are consistent with market forecast in 2005-09						144.5	138.3	137.1	134.7	132.1	129.9	127.6	125.3	123.0	120.8	118.2	115.2
B. Bound Tests																	
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						148.7	141.8	146.2	149.6	147.1	144.8	142.6	140.4	138.1	136.0	133.5	130.5
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						147.5	139.9	149.5	161.0	162.3	164.0	165.7	167.4	169.1	171.0	172.4	173.5
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						147.5	140.6	161.9	181.5	182.8	184.6	186.4	188.1	190.0	192.0	193.5	194.6
B4. Combination of B1, B2 and B3 using one standard deviation shocks						147.5	156.1	173.9	180.2	179.8	179.6	179.4	179.3	179.2	179.3	179.0	177.7
B5. One time 30 percent real depreciation in 2005 8/						147.5	140.6	138.6	135.5	132.2	129.2	126.2	123.1	120.1	117.1	113.8	110.0
B6. 10 percent of GDP increase in other debt-creating flows in 2005						147.5	140.6	148.6	145.5	142.2	139.3	136.3	133.3	130.3	127.4	124.1	120.4

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

5/ Derived as nominal interest expenditure divided by previous period debt stock.

6/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

7/ The implied change in other key variables under this scenario is discussed in the text.

8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 14. Dominica: External Debt Sustainability Framework, 2000-15

(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
					Projections											
					I. Baseline Projections											
External debt	53.7	64.6	77.4	86.6	76.1	69.2	69.0	68.6	68.1	67.7	67.2	66.7	66.3	66.0	64.3	62.9
Change in external debt	5.3	10.9	12.8	9.2	-10.5	-6.8	-0.2	-0.4	-0.4	-0.5	-0.5	-0.5	-0.4	-0.4	-1.7	-1.3
Identified external debt-creating flows	14.8	15.5	12.2	8.2	6.1	2.8	0.6	-0.3	-0.8	-1.1	-1.5	-1.9	-2.4	-2.8	-3.2	-3.1
Current account deficit, excluding interest payments	17.1	15.1	11.4	13.3	12.9	11.0	8.3	6.7	6.0	5.3	4.7	4.0	3.3	2.6	2.1	2.0
Deficit in balance of goods and services	14.2	17.4	13.5	16.0	14.4	11.9	10.1	9.1	8.1	7.3	6.5	5.7	5.0	4.2	3.4	3.3
Exports	53.3	45.9	47.4	49.7	51.2	52.1	53.0	53.1	53.1	53.2	53.3	53.4	53.5	53.6	53.7	51.9
Imports	67.5	63.3	60.9	65.7	65.6	64.1	63.1	62.1	61.3	60.6	59.9	59.2	58.5	57.8	57.1	55.2
Net nondebt creating capital inflows (negative)	-4.0	-4.5	-5.3	-9.6	-8.1	-7.8	-7.6	-7.3	-7.1	-6.8	-6.6	-6.4	-6.2	-5.9	-5.7	-5.5
Automatic debt dynamics 1/	1.7	4.8	6.2	4.5	1.4	-0.3	-0.1	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.4
Contribution from nominal interest rate	2.3	2.9	3.5	3.3	3.1	2.3	2.3	2.7	2.7	2.7	2.7	2.7	2.7	2.8	2.7	2.6
Contribution from real GDP growth	-0.3	2.5	2.4	1.6	-0.4	-1.5	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.2
Contribution from real exchange rate changes 2/	-0.3	-0.6	0.3	-0.4	-1.3	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9
Residual, incl. change in gross foreign assets (2-3)	-9.5	-4.6	0.5	1.1	-16.6	-9.7	-0.8	-0.2	0.3	0.7	1.0	1.5	2.0	2.4	1.5	1.8
External debt-to-exports ratio (in percent)	100.8	140.8	163.2	174.3	148.7	132.8	130.2	129.2	128.2	127.1	126.0	124.9	123.9	123.0	119.7	121.3
Gross external financing need (in millions of US dollars) 3/	57.0	53.0	42.8	56.1	49.7	37.8	32.8	30.5	29.2	28.3	27.5	26.8	25.6	24.0	26.7	30.3
In percent of GDP	21.0	20.1	17.3	22.0	19.1	14.0	11.8	10.6	9.8	9.1	8.6	8.1	7.5	6.7	7.3	8.0
Key Macroeconomic Assumptions	10-Year Historical Average	10-Year Standard Deviation														
Real GDP growth (in percent)	0.4	2.8	-3.6	-2.0	0.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Exchange rate appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP deflator in US dollars (change in percent)	2.0	1.7	-0.4	0.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Nominal external interest rate (in percent)	3.6	1.1	5.1	4.2	3.6	3.1	3.4	4.0	4.0	4.1	4.1	4.2	4.3	4.3	4.3	4.2
Growth of exports (US dollar terms, in percent)	5.6	26.5	-3.0	8.0	5.0	5.5	5.2	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	0.0
Growth of imports (US dollar terms, in percent)	3.6	9.0	-9.7	11.2	1.9	1.1	1.8	2.0	2.2	2.3	2.3	2.3	2.3	2.3	2.3	0.0
Current account balance, excluding interest payments	-16.7	6.0	-11.4	-13.3	-12.9	-11.0	-8.3	-6.7	-6.0	-5.3	-4.7	-4.0	-3.3	-2.6	-2.1	-2.0
Net nondebt creating capital inflows	8.4	6.3	5.3	9.6	8.1	7.8	7.6	7.3	7.1	6.8	6.6	6.4	6.2	5.9	5.7	5.5
					II. Stress Tests											
A. Alternative Scenarios																
A1. Key variables are at their historical averages in 2005-09 4/					76.1	75.4	83.7	92.8	102.5	112.6	123.3	134.6	146.6	159.3	171.1	183.4
A2. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 5/					76.1	69.2	69.0	68.6	68.1	67.7	70.1	70.5	72.6	73.1	73.8	74.7
A3. Selected variables are consistent with market forecast in 2005-09					76.1	69.2	69.0	68.6	68.1	67.7	67.2	66.7	66.3	66.0	64.3	62.9
B. Bound Tests																
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006					76.1	71.3	72.7	72.3	71.9	71.5	71.0	70.5	70.2	69.9	68.2	66.9
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006					76.1	73.6	77.6	76.0	74.6	73.2	71.9	70.7	69.6	68.8	66.4	64.5
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006					76.1	70.6	71.7	70.8	70.0	69.1	68.3	67.6	66.9	66.4	64.4	62.8
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006					76.1	86.9	107.1	106.8	106.5	106.3	106.0	105.8	105.7	105.6	104.2	103.1
B5. Combination of 2-5 using one standard deviation shocks					76.1	85.5	104.8	104.4	104.0	103.7	103.3	102.9	102.7	102.5	100.8	99.5
B6. One time 30 percent nominal depreciation in 2005					76.1	89.4	85.5	81.9	78.7	75.6	72.8	70.3	68.1	66.3	62.8	59.8

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ The implied change in other key variables under this scenario is discussed in the text.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 15. Dominica – Millenium Development Goals

	1990	1995	2001	2002
Eradicate extreme poverty and hunger: 2015 target = halve 1990 $1 a day poverty and malnutrition rates 1/				
Population below $1 a day (%)	...	...	...	...
Prevalence of child malnutrition (% of children under 5)	...	...	...	...
Population below minimum level of dietary energy consumption (%)	...	...	...	...
Achieve universal primary education: 2015 target = net enrollment to 100 2/				
Net primary enrollment ratio (% of relevant age group)	...	...	91.4	...
Percentage of cohort reaching grade 5 (%)	...	...	85.4	...
Promote gender equality: 2005 target = education ratio to 100 3/				
Ratio of girls to boys in primary and secondary education (%)	...	...	102.5	...
Proportion of seats held by women in national parliament (%)	...	9.0	...	...
Reduce child mortality: 2015 target = reduce 1990 under 5 mortality by two-thirds 4/				
Under 5 mortality rate (per 1,000)	23.0	20.0	16.0	15.0
Infant mortality rate (per 1,000 live births)	19.0	17.0	14.0	13.0
Immunization, measles (% of children under 12 months)	91.0	96.0	99.0	98.0
Improve maternal health: 2015 target = reduce 1990 maternal mortality by three-fourths 5/				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	...
Births attended by skilled health staff (% of total)	...	...	99.9	...
Combat HIV/AIDS, malaria and other diseases: 2015 target = halt, and begin to reverse, AIDS, etc. 6/				
Prevalence of HIV, female (% ages 15-24)	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	...	...	15.0	15.5
Tuberculosis cases detected under DOTS (%)	...	91.0	...	36.5
Ensure environmental sustainability: 2015 target = various 7/				
Forest area (% of total land area)	66.7	...	61.3	...
Nationally protected areas (% of total land area)	...	...	10.0	22.8
CO2 emissions (metric tons per capita)	0.8	1.1	1.4	...
Access to an improved water source (% of population)	...	...	97.0	...
Access to improved sanitation (% of population)	...	...	83.0	...
Develop a Global Partnership for Development: 2015 target = various 8/				
Youth unemployment rate (% of total labor force ages 15-24)	...	40.6	...	...
Fixed line and mobile telephones (per 1,000 people)	163.8	241.3	397.9	423.9
Personal computers (per 1,000 people)	...	...	77.1	89.7

Source: *World Development Indicators database, April 2004*

1/ Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

2/ Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary

3/ Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

4/ Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

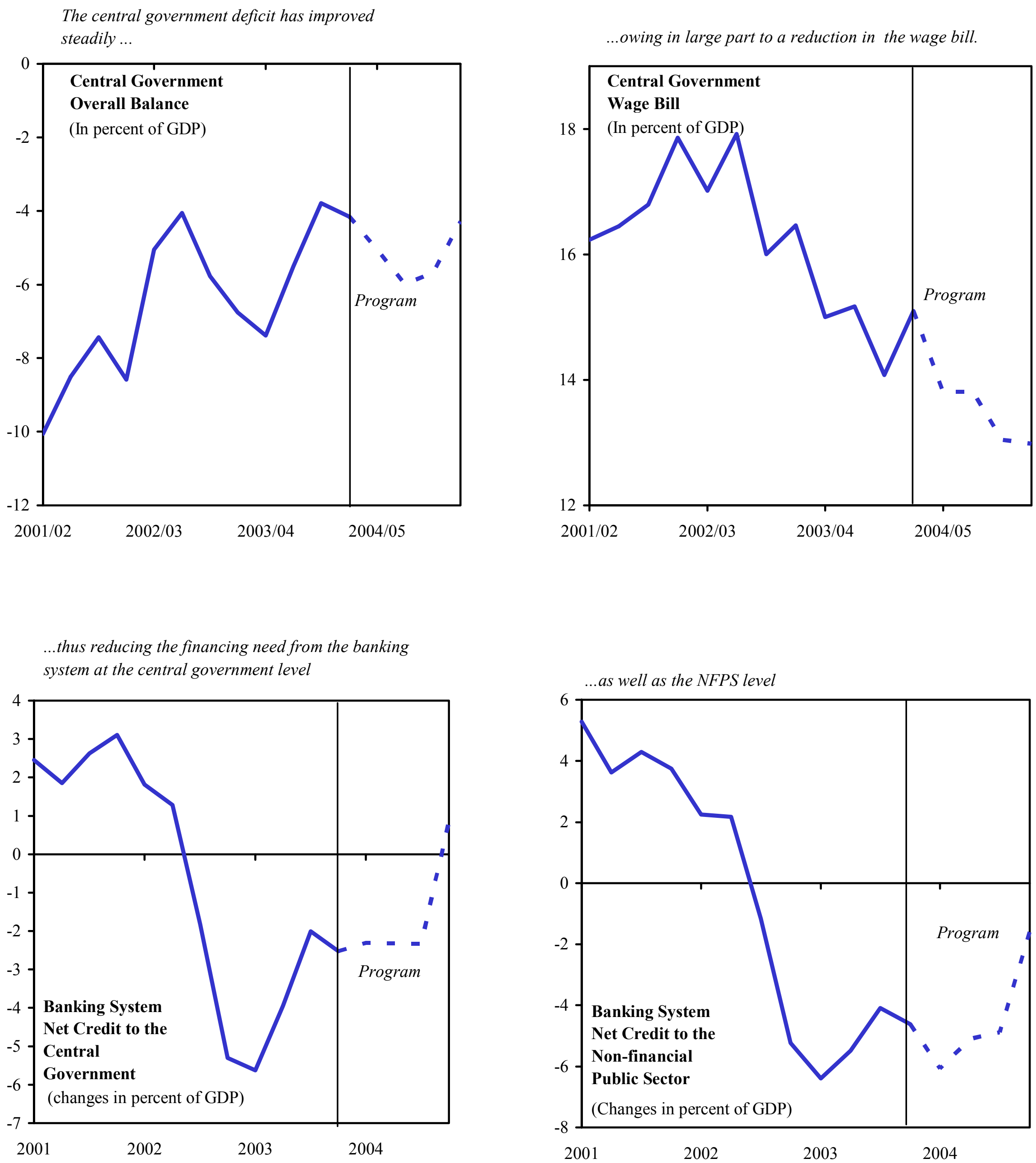
5/ Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

6/ Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

7/ Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

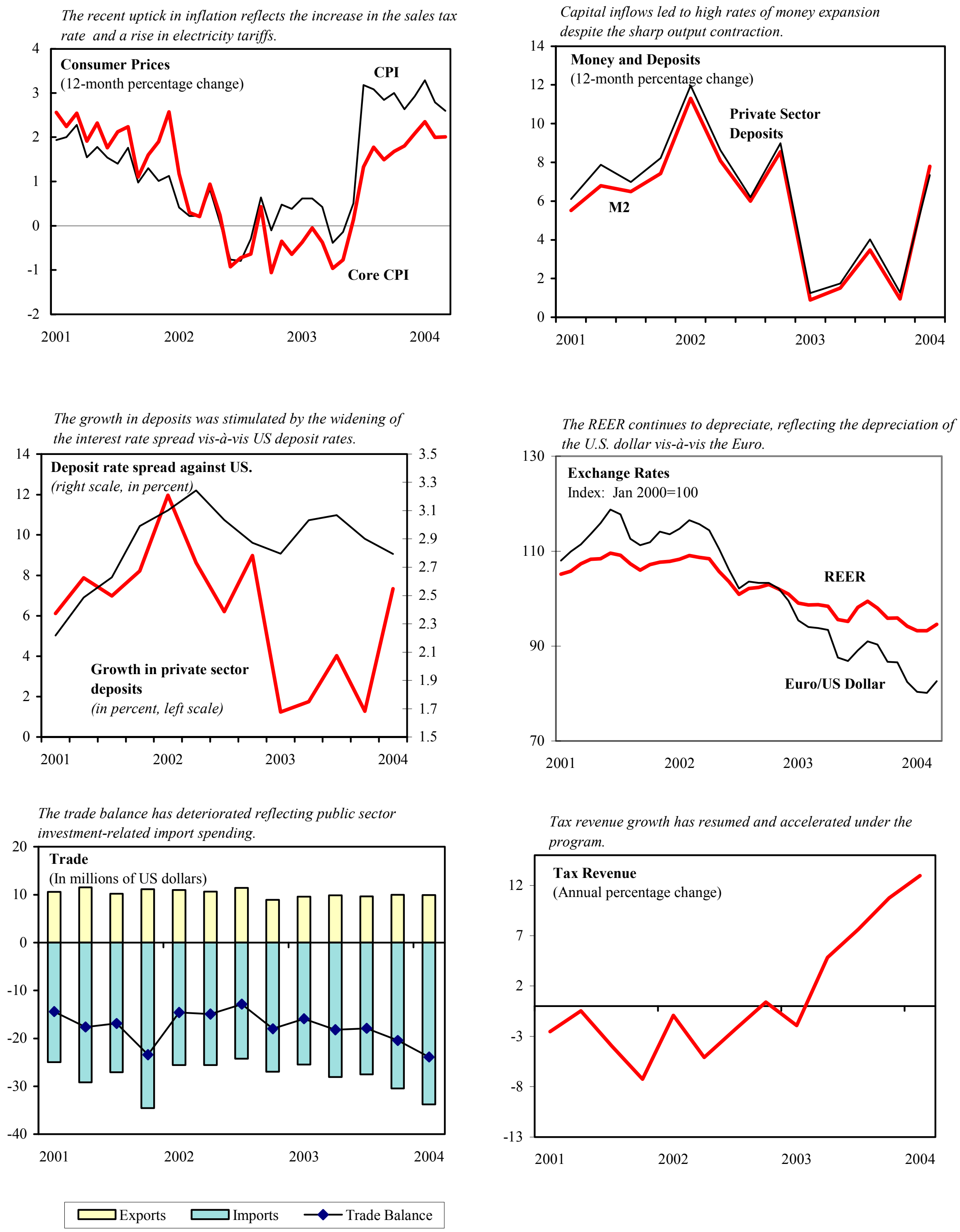
8/ Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Figure 1. Dominica: Performance Under the Program



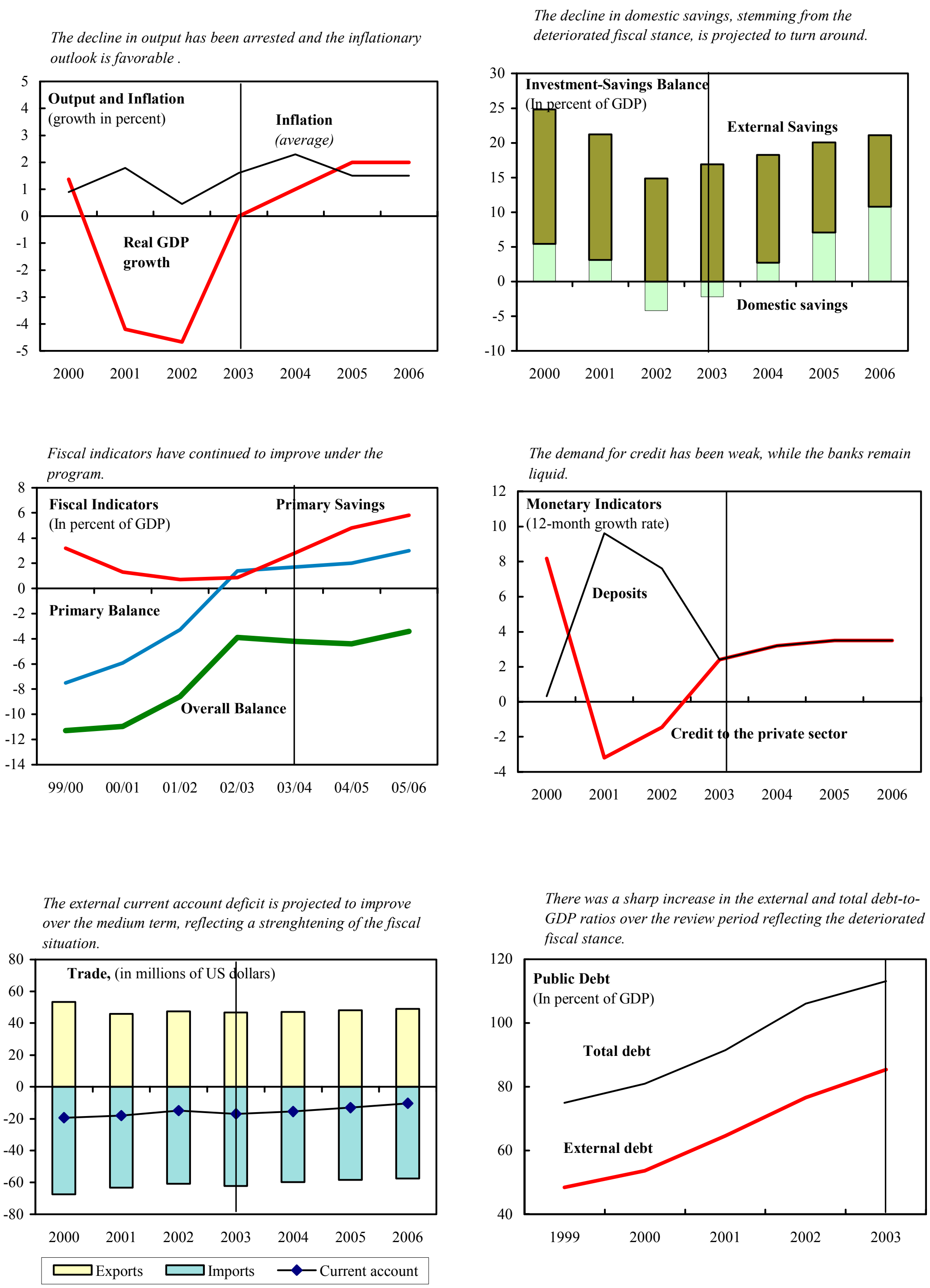
Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

Figure 2. Dominica: Macroeconomic Performance



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

Figure 3. Dominica: Recent Economic Developments and Outlook



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

Dominica: Fund Relations

(As of May 31, 2004)

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

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

III. SDR Department	**SDR Million**	**Allocation**
Net cumulative allocation	0.59	100.00
Holdings	0.00	7.25

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
PRGF Arrangements	2.67	32.51
Stand-by arrangements	2.97	36.25

V. Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	12/29/03	12/28/06	7.69	2.67
Stand-By	08/28/02	01/02/04	2.97	2.97
SAF	11/26/86	11/25/89	2.80	2.80
Stand-By	07/18/84	07/17/85	1.40	0.97
EFF	02/06/81	02/05/84	8.55	8.55

VI. Projected Obligations to the Fund[8]:

	Forthcoming				
	2004	**2005**	**2006**	**2007**	**2008**
Principal	0.00	0.26	1.10	1.23	0.38
Charges/Interest	0.06	0.10	0.09	0.06	0.03
Total	**0.06**	**0.36**	**1.19**	**1.29**	**0.41**

* Less than SDR 50,000.

[8] Obligation basis.

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

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

IX. **Article IV consultation**: The last Article IV consultation was concluded by the Executive Board on August 28, 2002 (EBM/02/89); the relevant documents are IMF Country Report No. 02/223 and IMF Country Report No. 02/224. Dominica is on a 24-month cycle.

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

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

Dominica: Relations with the Caribbean Development Bank (CDB)

(As of May 31, 2004)

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

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

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

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

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

Dominica: World Bank Relations[9]

(As of May 31, 2004)

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

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

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

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

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

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

[9] Source: World Bank.

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

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

Analytical and Advisory Services: During FY 2003, the Bank prepared a Dominica-specific Country Financial Accountability Assessment, Country Procurement Assessment Report and Social Protection Review. More recently, the Bank completed a review of public expenditures in Dominica. The Bank is also providing technical assistance to support public sector reforms and actions in the petroleum, electricity and financial sectors.

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

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

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

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

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

Gross Disbursements and Debt Service During Fiscal Year

	1997	1998	1999	2000	2001	2002	2003	2004*
Total disbursements	0.5	1.9	1.4	2.1	0.5	1.7	2.7	4.0
Repayments	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6
Net disbursements	0.5	1.8	1.3	1.9	0.4	1.6	2.3	3.4
Cancelled	0.0	0.0	0.0	0.0	0.0	1.0	2.3	0.0
Interest and fees	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.4

* Projections as of March 25, 2004.

Dominica: Statistical Issues

Dominica's statistical database is inadequate for meeting the authorities' needs and for Fund surveillance. There are weaknesses 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.

The authorities are aware of the deficiencies in their statistical database and started participation in the General Data Dissemination System (GDDS) in September 2000. 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. The ECCB compiles semi-annual GDP estimates, which are then available with a one-quarter lag. Estimated annual 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

There are statistical capacity problems that affect the timely production of quality government finance statistics—in particular, the data are subject to frequent revisions stemming in part from data omissions and misclassifications. Data on central government operations are incomplete and must be supplemented with additional information from external sources. For instance, some investment project spending is undertaken outside the consolidated fund as are some loan and grant receipts as well as related on-lending and transfers to public enterprises. As a result the authorities' capital expenditure data, recorded by the Treasury, must be supplemented with additional donor financing information, particularly since the Public Sector Investment Program (PSIP) data are not timely. The delays in the reporting of the Public Sector Investment Program data reportedly stem from reporting delays from the line ministries.

The authorities do not provide consolidated nonfinancial public sector data, and data for the rest of the public sector—Dominica Social Security and the public enterprises—must be obtained directly from each entity during Fund Article IV consultation missions.

In addition, only limited financing data are available. Although much progress has been made in improving the measurement of the government's debt, there are concerns that there is still some under recording of government commitments. However, there are several ongoing initiatives to strengthen expenditure management, which should help minimize the extent of this problem. In particular, there is an ongoing effort to automate the expenditure execution process. The new automation technology will be fully installed in all line ministries in 2004, at which point all local purchase orders (LPOs) will be entered and tracked electronically. Automatic commitments will be charged against a specific budget allocation once LPOs are generated electronically. All ministries and suppliers of goods and services will be compelled to use the new system following the completion of the automation program.

No government finance data are reported to STA for publication in the *International Financial Statistics* (*IFS)* or the *Government Finance Statistics* (*GFS) Yearbook*.

The authorities have been receiving technical assistance from DIFID on the cash management system and from CARTAC on monitoring implementation of the stabilization programme and treasury accounting.

Monetary statistics

Monetary statistics are compiled by the ECCB on a monthly basis and reported to the Fund regularly, although the coverage merits improvements. For instance, the banking statistics do not explicitly capture loans from ECCB's fiscal reserve tranche to the government of Dominica. 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 timeliness of the data has improved recently but the data still suffers from exceptionally high and volatile errors and omissions, at times reaching levels of 12 percent of GDP.

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. The Treasury maintains the data on bonds placed abroad. Unfortunately, the two government agencies do not consolidate their databases to provide a comprehensive external debt picture. The external debt data is deficient not only in its ability to measure the debt stock, but also in the ability to provide comprehensive monthly information on payments by creditor (actual and scheduled), which makes the compilation of up-to-date information on arrears, and the NFPS debt stock very difficult.

Dominica: Core Statistical Indicators
(As of June 4, 2004)

	Exchange Rates	Interna-tional Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	4-30-04	4-30-04	4-30-04	4-30-04	4-30-04	4-30-04	4-30-04	4-30-04	12-31-03	3-31-04	12-31-03	4-30-04
Date Received	5-25-04	5-25-04	5-21-04	5-21-04	5-21-04	5-28-04	5-19-04	4-4-04	2-1-04	4-22-04	1-30-04	5-25-04
Frequency of Data	M	M	M	M	M	M	M	M	A	M	A	M
Frequency of Reporting	M	M	M	M	M	M	M	M	A	M	A	M
Source of Update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	E	E	E	E	E	E	E	E	E	E	E	E
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication	Q	Q	Q	Q	Q	Q	Q	Q	A	Q	A	A

Roseau, Dominica
July 21, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. The letter of intent and memorandum of economic policies (MEP) of December 10, 2003 outlines the government's strategy to address the fiscal and public debt difficulties facing the country while setting the basis for sustained growth and reducing poverty.

2. Performance under the program supported under the Poverty Reduction and Growth Facility (PRGF) has been quite strong despite difficult conditions. All but one of the performance criteria and benchmarks through end-March 2004 have been observed. In the course of the debt reconciliation exercise we have undertaken following the announcement of the debt exchange offer in April 2004, we found out that an external supplier's credit extended by IBM was in arrears from July 2001 to April 2004. This was due to a misclassification in our reporting system which resulted in these claims being treated as domestic arrears and were not identified as external payments which were due. As a result, the continuous performance criterion on non-accumulation of external payments arrears as defined in the TMU was not met. Accordingly, we request completion of the second review under the PRGF arrangement and a waiver of nonobservance of the performance criterion on external payments arrears. We continue to make best efforts to remain current on our debt obligations under the program.

3. Regarding the external financing outlook and debt management, the Government of Dominica wishes to reiterate its commitment to the satisfactory completion of the ongoing debt restructuring exercise. In this regard, it has sought to remain current in servicing its debt obligations to all creditors, except in the case of debts that are in dispute, including two sizable bonds issued in 1999. The government has challenged the validity of all claims from the issue of these bonds since May 2002, and wishes to explain that our legal challenge is based on apparent deceptive actions taken by the holders of these bonds when the financing transaction was originally structured.

4. We continue negotiation in good faith with our creditors, and hope to be able to secure agreement on a pre-emptive deal with our creditors. In the last week significant progress has been made with two of our major creditors, the Caribbean Development Bank

(which accounts for 23 percent of Dominica's total debt) and Citigroup (the second largest commercial creditor) joining the list of those who have participated in the debt restructuring so far. We believe that this achievement will serve to encourage those creditors who have not yet participated in the offer.

5. We reiterate our commitment to the program, including the adoption of additional fiscal measures equivalent to 2 percent of GDP in the context of the 2004/05 budget, as described in the attached supplement memorandum of economic policies (SMEP) and continuation of existing policies. The 2004/05 budget in line with the program was approved by Parliament on July 8. Accordingly, the SMEP establishes performance criteria for the second half of 2004.

6. The government will continue the usual close and productive dialogue with the Fund and stands ready to adopt the necessary measures to achieve the objectives of the program. During the second year of the arrangement, the fourth and fifth reviews are expected to be completed no later than mid-March 2005 and mid-September 2005. We have authorized the Fund to publish this letter to enhance transparency, facilitate a wider access to our policies, and to continue signaling the seriousness of our commitment to the program to civil society and the international community.

Sincerely yours,

/s/

Honorable Roosevelt Skerrit
Prime Minister and Minister of Finance And Planning

Attachment

SUPPLEMENT MEMORANDUM OF ECONOMIC POLICIES OF THE GOVERNMENT OF DOMINICA

I. BACKGROUND

1. **The government confronted one of the most difficult economic situations of its recent economic history**. Over the last few years, our economy was subject to a series of significant shocks to the banana sector—the traditional economic mainstay—and offshore banking and tourism sectors. Unfortunately, the policy response, which favored financing rather than adjustment, fell short of what was required, in part because the shocks turned out to be more permanent than transitory, and their economic impact larger than anticipated. As a result, the economy contracted by almost 10 percent in 2001–03, the public debt doubled to 115 percent of GDP in the period 1998–2003, private investment collapsed to an estimated 7 percent of GDP in 2003 (almost one third of its level in 1997) and the budgetary situation was on an unsustainable path. Against this background and uncertain economic prospects, we recognized that, even with ambitious fiscal adjustment policies, the debt situation had become unsustainable.

2. **The government adopted a bold two-stage strategy in mid-2003 to stabilize the situation and address the deep-rooted problems in the economy**. The idea was to address short-term financing and budgetary problems in the first stage and longer-term growth and sustainability issues in the second stage.

- ***The first stage*** involved an economic program under a tight budget for 2003/04 to stabilize the fiscal situation. Our program was supported by a modified and extended Stand-By Arrangement (SBA) in July 2003 which gave us time to develop a comprehensive program and a structural reform agenda. By and large, this first stage was successful and a budgetary crisis was averted.

- ***The second stage*** involves the implementation of a medium-term program with a strong structural component to restore growth and reduce unemployment related poverty. Our program was supported with a three-year poverty reduction and growth facility (PRGF) in December 2003.

II. PROGRAM PERFORMANCE

3. **Following the sharpest and most prolonged contraction since independence, the economy appears to be growing for the first time since 2000**. The economic decline was stopped in 2003 and there are indications of a modest but broad-based economic recovery in the first quarter of 2004. Similarly, exports are beginning to rebound for the first time since 1998 and import growth has accelerated. We expect real GDP to grow by 1 percent in 2004. Inflation remains under control as we expect prices to grow by merely 1½ percent in 2004.

4. **The PRGF-supported program has had a good start.** The strong performance observed under our revised program since the modification of the SBA in July 2003, continued under the successor PRGF arrangement. The first PRGF review was completed in March 24, 2004 and all performance criteria and structural benchmarks for end-March 2004 were observed.

5. **A debt exchange offer was announced on April 6, and we are negotiating in good faith with our creditors, in line with international best practices**. We offered to exchange eligible creditor's claims for a menu of three bonds involving longer maturities and principal haircuts for two of them at an interest rate of 3½ percent. The deadline for participation was extended to June 11. Thus far, the take up has fallen short of initial expectations. However, in the last week significant progress has been made with two of our major creditors coming on board and participating in the restructuring. We continue negotiating with our other creditors. We intend to leave the exchange offer open for a few months. However, in the interest of inter-creditor equity, the terms of the offer are not expected to be better than those given to creditors that participated in a timely manner in the initial exchange offer.

III. Macroeconomic Policies for the rest of 2004

6. **In order to signal to our creditors the seriousness of our policies, we have strengthened the primary surplus objective for 2004/05 from ½ percent to 2 percent of GDP.** While we retain our long-term objective of achieving a primary fiscal surplus of 3 percent of GDP in 2006/07, we are prepared to further front-load our efforts. This reflects the strong implementation of our policies which allows us to run the program ahead of schedule.

7. **The budget for 2004/05 will require fiscal measures equivalent to 2½ percent of GDP to achieve the more ambitious fiscal objective**. One of these measures, equivalent to ½ percent of GDP, was taken in December 2003 at the time of the PRGF arrangement approval. It consists of a significant reduction in the number of discretionary tax exemptions. We will remain vigilant in this area to ensure that the original objective is achieved. We have conducted a comprehensive overview of tax exemptions (a benchmark for end-June under the program). As regards other fiscal measures, initiatives equivalent to 2 percent of GDP (mostly on the expenditure area, as described below) are included in the budget for 2004/05 that was approved by Parliament. In addition to the policies agreed in the MEP of December 2003, we are announcing further expenditure cuts to facilitate the elimination of the stabilization levy.

On the expenditure side:

- ***Wage bill reduction***. The government will reduce the wage bill by 5 percent in nominal terms by reducing employment in the 2004/05 budget. The European Union has given a commitment to provide grant financing to meet the cost of severance payments. This measure will generate savings of 1.2 percent of GDP on an annual basis.

- ***Expenditure cuts***. The government will reduce nominal noninterest expenditures by 10 percent. These expenditure cuts have been designed with the objective of minimizing its impact on direct social spending. This measure includes a continuation of the hiring and wage freezes. This measure will accrue savings of about 1.5 percent of GDP on an annual basis.

- ***Retirement age increase***. The statutory retirement age in the public service will increase from 55 to 60 years to be implemented over a period of five years. The resulting savings in pension payments and postponement of gratuities amount to 0.1 percent of GDP in 2004/05.

- ***Benefits policy modification.*** Measures are being adopted to reduce cost of vacation and study leave for public employees by 20 percent, resulting in savings of 0.1 percent of GDP in 2004/05 on an annual basis.

On the revenue side:

- ***Tax base broadening.*** The government will strengthen the enforcement of the professional license fees charged, and will also broaden the coverage of these fees to other professional activities not currently covered. We estimate that additional revenues for 0.1 percent of GDP can be obtained.

- ***Elimination of the stabilization levy***. In view of the negative impact of the public sector retrenchment exercise on employment, we are prepared to abolish the stabilization levy in order to create adequate incentives for employment in the private sector. This step is also consistent with the significant progress made toward achieving our medium-term fiscal primary surplus target. This measure will reduce tax collection by 1.0 percent of GDP on an annual basis but is more than offset by reduced expenditures reflecting tighter expenditure controls and a better use of our scarce budgetary resources.

8. **The aid program agreed with China will allow us to further expand the public sector investment program (PSIP) without creating an additional debt burden.** We reached agreement with the Government of China to provide grants for US$110 million over the course of the next six years to finance development projects as well as budgetary support for US$10 million to cover the costs of ongoing projects for which financing was interrupted. We estimate that the country can absorb high quality public investment for about 12 percent of GDP in 2004/05. However, we will try to overshoot our target by using additional grants from China. Our PSIP consists of high-value projects and its implementation is generally on track. The ministry of finance will continue to centralize borrowing decisions for externally-financed projects.

9. **The financing of the program will be covered by the debt restructuring exercise**. We continue negotiating with our creditors in good faith and remain confident that we will reach full participation in the next few months. For the purpose of the 2004/05 budget, we have assumed that all creditors participate according to the terms expressed in the exchange offer. We will maintain the terms of the exchange offer open to creditors after the deadline of June 11. Creditors that decide to participate after the June 11 deadline will be considered "late participants." The government has budgeted enough resources to cover those interest payments, signaling the sustainability of the operation. For those claims not tendered, the government intends to deposit in an escrow account the proceeds according to the new bonds to which they are entitled. The program will include a new adjustor to the credit to the government target to take into account potential deviations in interest payments from the programmed levels due to a differences in the composition of bonds selected by creditors.

IV. Structural Reforms for the rest of 2004

10. **The structural reform agenda aims to remove impediments to growth, and ensure medium-term sustainability**. We reiterate our commitments included in the MEP of December 2003. While the reform agenda covers several areas, it focuses on fiscal issues in the short term, especially on public sector reform, tax policy, pension reform, and budgetary procedures.

11. **The wage bill will be reduced by 5 percent through reduction in employment.** We remain committed to reduce the wage bill by 10 percent over the next two years. The 2004/05 budget includes the retrenchment of enough positions to generate savings of 5 percent of the wage bill. Severance payments are being covered by a EU grant.

12. **The value added tax will be introduced in 2005/06.** The 2004/05 budget has announced the introduction of the value added tax (VAT) in the upcoming budget and the consequent elimination of the consumption tax, the sales tax, the hotel occupancy tax and other minor levies. The 2004/05 budget includes the preparatory regulations for the VAT to be introduced in July 2005. In addition, we are conducting a review of all tax exemptions to improve our collections.

13. **The retirement age of public employees will be increased from 55 to 60 years.** We are sending legislation to Parliament shortly to increase the retirement age for public employees in a phased manner.

14. **The 2004/05 budget includes three-year projections.** In an attempt to enhance transparency, standardize practice with the PSIP, and further strengthen the burgeoning culture of fiscal discipline, the 2004/05 budget will include for the first time three-year rolling budgetary projections based on our medium-term macroeconomic framework.

15. **In keeping with fiscal sustainability principles, we will introduce legislation or amend an existing one with a view to providing guidelines on how to design and**

implement the budget in the future. This legislation will include numerical targets and procedures to follow in the design of the budget with the aim of preventing an episode of rapid accumulation of debt in the future. We will embrace other transparency initiatives in the budget, including publishing of statutory tax concessions and the level of public employment. We expect that this modified legislation will guide the budget for 2005/06.

16. **The regulatory framework for electricity supply will be strengthened**. We expect to introduce this framework in September 2004 following the recommendations of the World Bank.

V. Contingencies and Modifications

17. **We remain fully committed to the program, and will take any additional action that is necessary to ensure that the objectives of the program are achieved.** We will remain in contact with the IMF to identify potential problems. We are proposing some technical modifications and the introduction of an adjustor to the target on credit to the government to improve on the program design. These changes are reflected in the revised technical memorandum of understanding.

Table 1. Dominica: Quantitative Performance Criteria (PC) and Indicative Targets (IT), for 2004-2005 Under the Poverty Reduction and Growth Facility Arrangement

	2004			2005	
	Jun. 30 1/ (PC)	Sept. 30 2/ (PC)	Dec. 31 2/ (PC)	Mar. 31 2/ (IT)	Jun. 30 2/ (IT)
I. Performance Criteria					
(In millions of Eastern Caribbean dollars)					
Central government primary balance 3/	0.8	-3.0	3.0	11.0	14.7
Central government wage bill	108.6	27.0	54.0	78.5	102.7
Banking system net credit to central government 4/	3.0	3.0	3.0	0.0	0.0
Net changes in central government arrears to private domestic parties 5/	15.0	15.0	15.0	15.0	15.0
(In millions of U.S. dollars)					
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year 6/	33.0	4.0	6.0	8.0	10.0
Net changes in the oustanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 6/	0.0	0.0	0.0	0.0	0.0
Net changes in external payments arrears of the central government 6/ 7/	0.0	0.0	0.0	0.0	0.0
II. Indicative Targets					
(In millions of Eastern Caribbean dollars)					
Central government overall balance 3/	-39.2	-16.7	-19.6	-25.6	-31.6
Central government revenues 8/	197.4	48.8	103.2	160.2	210.6
Central government primary savings	10.6	4.1	15.2	29.6	36.3

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

1/ Cumulative amounts from June 30, 2003, PC (Performance Criteria), IT (Indicative Target).

2/ Cumulative from June 30, 2004 , PC (Performance Criteria), IT (Indicative Target).

3/ Up to June 2004, limits will be adjusted downward (upwards) to the extent that project financing falls short of (exceeds) programmed amounts. Upward adjustments will not exceed US$6.35 million and US$7.7 million by end-June 2004.

4/ Up to June 2004, limits on banking system net credit to the central government will be adjusted upward to the extent that there are shortfalls in external nonproject financing that are outside the control of the authorities. These upward adjustments will not exceed US$6.35 million and US$7.7 million by end-June 2004. Limits on banking system net credit to the central government will be adjusted downward to the extent that external nonproject financing exceeds programmed amounts. Beginning in September 2004, limits on banking system net credit to the central government will be adjusted upward (downward) to the extent that cash interest payments of the central government are higher (lower) than in the baseline projection.

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

6/ For the definition of external debt, see paragraph 21of the Technical Memorandum of Understanding.

7/ External arrears accumulated prior to the Executive Board discussion on July 25, 2003, were waived; no arrears have been accumulated since then.

8/ Excludes revenues from the Economic Citizenship Program, foreign and domestic grant receipts, loan repayments, wage refunds, and privatization receipts; and includes income tax refunds.

DOMINICA—TECHNICAL MEMORANDUM OF UNDERSTANDING

1. Dominica's performance under the Stand-By Arrangement and Poverty Reduction and Growth Facility (PRGF), described in the letter of the Government of Dominica dated June 22, 2004, will be assessed by the IMF on the basis of the observance of quantitative performance criteria as well as compliance with structural performance criteria and benchmarks. This Technical Memorandum of Understanding (TMU) sets out and defines the performance criteria (and adjustors), indicative targets, and benchmarks specified in Tables 1 and 2 of the Supplement of Memorandum of Economic Policies, as well as the monitoring and reporting requirements.

2. The authorities of Dominica are committed to transmit to the Fund staff the best data available. All revisions or expectations thereof shall be promptly reported to the Fund staff.

3. The variables mentioned herein for the purpose of monitoring the performance criteria, which are not explicitly defined, are consistent with the Government Financial Statistics (GFS). For variables omitted from the TMU which are relevant for the program targets, the authorities of Dominica shall consult with the staff on their appropriate treatment, based on GFS principles and Fund program practices.

I. FISCAL TARGETS

1. Indicative Target on the Overall Balance of the Central Government

	Floor (In millions of Eastern Caribbean dollars)
Cumulative balance (from June 30, 2003)	
End-June 2004 (indicative target)	-39.2
Cumulative balance (from June 30, 2004)	
End-July 2004 (indicative target)	-8.0
End-August 2004 (indicative target)	-12.0
End-September 2004 (performance criterion)	-16.7
End-October 2004 (indicative target)	-19.0
End-November 2004 (indicative target)	-21.0
End-December 2004 (performance criterion)	-19.6
End-March 2005 (indicative target)	-25.6
End-June 2005 (indicative target)	-31.6

4. **The central government overall balance** will be measured from the financing side as the sum of the net domestic borrowing plus net external borrowing. The floor on the overall balance is cumulative from the specified dates.

5. **Net domestic financing** by the central government is the sum of: (i) net domestic bank financing as reported by the consolidated balance sheet of the banking system adjusted for double signature accounts[10] and for the proceeds of borrowing from the International Monetary Fund, (ii) net nonbank financing measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions (including special tranches from the ECCB); (iii) the change in the stock of domestic arrears of the central government defined as net changes in unpaid checks issued, unprocessed claims, invoices pending, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid; (iv) gross receipts from divestment; and (v) any other exceptional financing, including related to debt restructuring of interest or arrears.

6. **Net external financing** of the central government is defined as the sum of (i) disbursements of project and nonproject loans, including securitization, but excluding the proceeds of borrowing from the International Monetary Fund; (ii) proceeds from bond issues abroad; (iii) exceptional financing (rescheduled principle plus interest), net changes in cash deposits held outside the domestic banking system, (iv) net changes in short-term external debt; (v) any change in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid; (vi) any other exceptional financing, including related to debt restructuring of interest or arrears, minus (vii) payments of principal on current maturities for bonds and loans on a due basis and any prepayment of external debt.

The following adjusters will apply:

7. The floor on the **overall balance of the central government** will be adjusted upward[11] (downward) to the extent that project loans fall short of (exceed) programmed

[10] Net domestic bank financing is defined as the changes in the net credit extended by the domestic banking system to the central government, excluding net changes in "double signature accounts" in which grant receipts are deposited. The double signature accounts include the accounts 115002797, 115002976,115002220, 115001912, 115003051, 115001911, 115003025, 115001471, 115001523, 115003053, 115001710, and 100038724 held in the National Bank of Dominica (NBD), and any new account in which grant receipts are deposited and which requires a signature of an external party for the release of its funds. Cash grants from China that are not used immediately will be treated as a double signature account. Treasury bills will be recorded at face value, except for those held by the banking system which will be recorded on a purchase price basis.

[11] Upward adjustment means lower deficit.

amounts. This adjustor applies up to June 2004 and will be discontinued thereafter. **Project loans** are defined as the receipt of loan proceeds to finance the central government's portion of the Public Sector Investment Program. For the purpose of this adjustor, the project loans amount to: cumulative from June, 30, 2003, US$5 million by end-March 2004 and US$6.6 million by end-June 2004; upward adjustments will not exceed US$6.35 million by end-March 2004 and US$7.7 million by end-June 2004. This adjustor does not apply after end-June 2004.

8. **Budgetary grants** are defined as grant receipts that are not earmarked for capital outlays. Budgetary grants will be programmed as part of revenue if the funds are to be used to cover the cost of any specific reform, otherwise the floor on the **overall balance of the central government** will be adjusted upward to the extent that budgetary grants exceed programmed amounts.

9. The floor on the overall balance of the central government will be adjusted downward by the amount of severance payments or administrative expenditures linked to the debt strategy. It is expected that these costs will be mostly covered by grants, which would also be excluded from the measurement of the overall balance of the central government. In the event of bridge loan financing for this purpose, it will not count toward the measurement of the overall balance of the central government.

2. Performance Criterion on the Central Government Primary Balance

	Floor (In millions of Eastern Caribbean dollars)
Cumulative balance (from June 30, 2003)	
End-June 2004 (performance criterion)	0.8
Cumulative balance (from June 30, 2004)	
End-July 2004 (indicative target)	0.0
End-August 2004 (indicative target)	0.0
End-September 2004 (performance criterion)	3.0
End-October 2004 (indicative target)	-1.0
End-November 2004 (indicative target)	0.0
End-December 2004 (performance criterion)	3.0
End-March 2005 (indicative target)	11.0
End-June 2005 (indicative target)	14.7

10. **The central government primary balance** will be defined as the central government overall balance (from the financing side as defined in paragraph 4) plus scheduled domestic

and external interest payments. Interest payments do not include either domestic or external interest payment made by the central government on behalf of other parties.

The following adjusters will apply:

11. The same adjustors described in paragraph 7, 8 and 9 apply to the primary balance.

3. Performance Criterion on the Central Government Wage Bill

	Ceiling (In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (performance criterion)	108.6
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	9.0
End-August 2004 (indicative target)	18.0
End-September 2004 (performance criterion)	27.0
End-October 2004 (indicative target)	36.0
End-November 2004 (indicative target)	45.0
End-December 2004 (performance criterion)	54.0
End-March 2005 (indicative target)	78.5
End-June 2005 (indicative target)	102.7

12. The **central government wage bill** will be measured as the total expenditure of the central government on wages and salaries of central government employees net of wage refunds, including acting allowances, special duty allowances, responsibility allowances, subsistence allowances, the employer contribution to Dominica Social Security, and any wage payment made to units transferred outside the Treasury in the context of the 2004/05 budget, but not including retirement benefits, severance payments or other related one-off payments (i.e., accumulated leave). As such, the ceiling does not include wage-related transfers to schools, the National Development Corporation, and local governments.

4. Performance Criterion on the Central Government Arrears Accumulation to Domestic Private Parties

	Ceiling (In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (performance criterion)	15.0
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	15.0
End-August 2004 (indicative target)	15.0
End-September 2004 (performance criterion)	15.0
End-October 2004 (indicative target)	15.0
End-November 2004 (indicative target)	15.0
End-December 2004 (performance criterion)	15.0
End-March 2005 (indicative target)	15.0
End-June 2005 (indicative target)	15.0

13. **Net changes in central government arrears to domestic private parties** is defined as changes in the sum of all pending payments by government for goods and services already purchased from these parties, as well as pending interest and amortization obligations on domestic debt, which has already been restructured according to the debt exchange offer. Private domestic parties exclude DOWASCO, Dominica Social Security, National Development Corporation, Dominica Broadcasting Corporation, DEXIA, and the Ports Authority. The measure used will be unpaid checks issued and pending invoices for which payment is overdue. This ceiling will be monitored on a continuous basis.

13. **Net changes in central government arrears to domestic private parties** is defined as changes in the sum of all pending payments by government for goods and services already purchased from these parties, as well as pending interest and amortization obligations on domestic debt, which has already been restructured according to the debt exchange offer. Private domestic parties exclude DOWASCO, Dominica Social Security, National Development Corporation, Dominica Broadcasting Corporation, DEXIA, and the Ports Authority. The measure used will be unpaid checks issued and pending invoices for which payment is overdue. This ceiling will be monitored on a continuous basis.

5. Indicative Targets on Revenues of the Central Government

	Floor (In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (indicative target)	197.4
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	16.7
End-August 2004 (indicative target)	32.6
End-September 2004 (indicative target)	48.7
End-October 2004 (indicative target)	66.8
End-November 2004 (indicative target)	82.9
End-December 2004 (indicative target)	103.6
End-March 2005 (indicative target)	160.3
End-June 2005 (indicative target)	210.6

14. The floor on the overall balance of the **central government revenue** is defined as the minimum of tax collections and nontax revenues reported in the treasury accounts (economic classification), excluding: (i) revenues from the economic citizenship program, (ii) foreign and domestic grant receipts, (iii) loan repayments, (iv) wage refunds, and (v) privatization receipts, and includes income tax refunds.

6. Indicative Targets on the Primary Savings of the Central Government

	Floor (In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (indicative target)	10.6
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	3.0
End-August 2004 (indicative target)	3.2
End-September 2004 (indicative target)	4.1
End-October 2004 (indicative target)	6.5
End-November 2004 (indicative target)	8.7
End-December 2004 (indicative target)	15.2
End-March 2005 (indicative target)	29.6
End-June 2005 (indicative target)	36.3

15. **Central government primary savings** is measured on an accrual basis (including unpaid checks issued and unprocessed invoices) and is defined as the central government revenue before grants (i.e., excluding grants) minus current noninterest expenditure. The adjustors described in paragraph 8 and 9 apply to the central government primary savings.

Monitoring discretionary tax exemptions

16. **Discretionary tax exemptions** are defined as tax exemptions granted under sections 6(2) and 31[12] of the Consumption Order Act, Section 26 of the Sales Tax Act, Section 60 of the Customs (Control and Management) Act, Section 25(2) of the Income Tax Act, or remissions of tax under section 109 of the Income Tax Act (except in cases where the Comptroller certifies that the tax to be remitted is uncollectible).

The number of discretionary tax exemptions will be monitored on a continuous basis.

[12] As a transitional rule the government might allow exemptions described in Section 31(b) relating to agreements entered into before the date of announcement. The Cabinet's decision should include a decision not to enter into such agreements after the date of announcement.

II. MONETARY TARGETS

7. Performance Criterion on the Net Credit of the Banking System to the Central Government

	Ceiling (In millions of Eastern Caribbean dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (performance criterion)	3.0
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	3.0
End-August 2004 (indicative target)	3.0
End-September 2004 (performance criterion)	3.0
End-October 2004 (indicative target)	3.0
End-November 2004 (indicative target)	3.0
End-December 2004 (performance criterion)	3.0
End-March 2005 (indicative target)	0.0
End-June 2005 (indicative target)	0.0

17. **Net credit of the banking system** is defined as in paragraph 5. The **banking system** is defined as the consolidation of the Eastern Caribbean Central Bank operations in Dominica (including credit extended under the fiscal tranche window), with the accounts of all banks licensed by the ECCB to do business in Dominica as commercial banks, but excluding the proceeds of borrowing from the International Monetary Fund.

The following adjusters will apply:

18. The limits on the **banking system net credit to the central government** will be adjusted downward to the extent that budgetary lending has been obtained and not used for the intended reform, or upwards to bridge financing for agreed reforms.

19. The limits on **banking system net credit to the central government** will be adjusted to the extent that actual interest payments deviate from the programmed schedule of interest payments. If actual payments are higher (lower) than programmed, then the limits on **banking system net credit to the central government** will be adjusted upward (downward) by the full amount of the discrepancy. The program assumes cash interest payments according to the following schedule:

8. Baseline Projection on Public Sector Interest Payments

	Scheduled interest payments	Cash interest payments
Cumulative flows (from June 30, 2004)		
End-July 2004	8.7	1.6
End-August 2004	11.3	3.6
End-September 2004	13.7	5.3
End-October 2004	17.6	6.8
End-November 2004	20.3	8.6
End-December 2004	22.6	15.5
End-March 2005	36.6	20.3
End-June 2005	46.4	29.7

III. External Sector Targets

9. Performance Criterion on Disbursements of Nonconcessional External Central Government or Central Government Guaranteed Debt with Maturity of at Least One Year

	Ceiling (In millions of U.S. dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (performance criterion)	33.0
Cumulative flows (from June 30, 2004)	
End-July 2004 (indicative target)	1.0
End-August 2004 (indicative target)	2.0
End-September 2004 (performance criterion)	4.0
End-October 2004 (indicative target)	4.0
End-November 2004 (indicative target)	5.0
End-December 2004 (performance criterion)	6.0
End-March 2005 (indicative target)	8.0
End-June 2005 (indicative target)	10.0

20. **Disbursements of nonconcessional external central government and central government guaranteed debt with maturity of at least one year** will be monitored by the Accountant General's Office on a monthly basis. **Central government and central government guaranteed external debt** is defined to include debt contracted or guaranteed by the central government.

21. The term **debt** is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000):

"(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

> (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is

required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 21(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

22. **Nonconcessional** is defined as debt having a grant element (in net present value relative to face value) **of less than 35 percent**, based on the currency- and maturity-specific Commercial Reference Rates (CIRR), published monthly by the OECD.[13] The limit excludes the disbursements of short-term import-related debts, the use of Fund resources, refinancing operations, and disbursements of external loans for clearance of payment arrears to DOWASCO.

The following adjusters will apply:

23. The limits on the **disbursement of nonconcessional external loans** will be adjusted downward (upward) to the extent that external project loans fall short of (exceed) programmed amounts. **External project loans** are defined as the receipt of loan proceeds to finance the central government's portion of the PSIP. The cumulative programmed amounts are as follows: cumulative from June, 30, 2003, US$6.6 by end-June 2004. Upward

[13] For loans with a maturity of at least 15 years, the 10-year average commercial interest reference rates and for loans with shorter maturities, the 6-month average CIRRs, as of November 15, 2003 published by the OECD will be used as the discount rates. To both the 10-year and 6-month averages, the following margins for differing repayment periods will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 years or more.

adjustments will not exceed US$7.7 by end-June 2004. This adjustor does not apply after end-June 2004.

10. Performance Criterion on the Net Changes in the Outstanding Stock of Short-Term External Debt with Original Maturity of Less than One Year Contracted or Guaranteed by the Central Government

	Ceiling (In millions of U.S. dollars)
Cumulative flows (from June 30, 2003)	
End-June 2004 (performance criterion)	0.0
Cumulative flows (from June 30, 2004)	0.0
End-July 2004 (indicative target)	
End-August 2004 (indicative target)	0.0
End-September 2004 (performance criterion)	0.0
End-October 2004 (indicative target)	0.0
End-November 2004 (indicative target)	0.0
End-December 2004 (performance criterion)	0.0
End-March 2005 (indicative target)	0.0
End-June 2005 (indicative target)	0.0

24. **Stock of short-term external debt outstanding** is defined as debt with original maturity of less than one year contracted or guaranteed by the central government. The term debt is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000) (see paragraph 16), but excludes normal import-related credits. This ceiling will be monitored on a continuous basis. The ceiling must not be exceeded at any time. For the period beginning January 1, 2004, the ceiling is cumulative from June 30, 2003.

11. Performance Criterion on Nonaccumulation of Central Government and Central Government Guaranteed External Payment Arrears

25. **Central government and central government guaranteed external payment arrears** are defined as overdue payments on debt contracted or guaranteed by the central government. The definition of arrears under the program excludes the Citibank and RBTT bond claims whose validity is in dispute, the IBM claims and other debt claims which have been irrevocably tendered in the debt exchange offer launched by the authorities on April 6, 2004, and claims of official bilateral debts which are under rescheduling or refinancing negotiation. It also does not include outstanding subscription payments to regional and international organizations for which understandings will be reached to ease payment obligations consistent with the program. The ceiling on the nonaccumulation of central

government and central government guaranteed external payment arrears is cumulative from July 25, 2003, when a waiver was granted. This ceiling will be monitored on a continuous basis.

IV. Prior actions, Structural performance criteria, and Structural Benchmarks

Prior actions

26. Approval of the 2004/05 budget, consistent with the program, will be a prior action for completion of the Second Review under the Poverty Reduction and Growth Facility.

Structural benchmarks

27. **Tax policy and administration.**

- Conduct a review of all statutory tax exemptions with a view to assessing their effectiveness and justification and to prevent abuses (end-June 2004).

- Announce in the budget for 2004/05 the adoption of the VAT by mid-2005. Cabinet approval of key parameters such as the base, rate, registration threshold, filing frequency, and refund system (end-September 2004).

28. **Pension reform.** Submit legislation to Parliament proposing a phased increase in the retirement age for public employees to 60 years (end-June 2004).

29. **Institutional strengthening.** Improve the regulatory framework for electricity supply, following the recommendations of technical assistance mission (end-September 2004).

V. Periodic Reporting

30. Regular **reporting on a monthly basis** (and when possible weekly) will include the following:

- Data for monitoring the program's performance criteria and monthly indicative targets, including

  - Fiscal sector

    (i) Central government budgetary accounts.

    (ii) Dominica Social Security Balance Sheet, showing amounts receivable from central government for contributions and interest.

    (iii) Central government domestic debt data.

    (iv) Current grant inflows.

    (v) Stock of unpaid checks issued and stock of unprocessed claims due and invoices pending.

    (vi) Capital expenditure (project by project) and composition of financing, including revised projections for the remainder of the fiscal year.

    (vii) Balances in the debt servicing account linked to the Royal Merchant Bank Bond Issue.

    (viii) Total number of exemptions issued (by type of exemption).

  - Financial sector

    (ix) Monetary survey for Dominica as prepared by the Eastern Caribbean Central Bank, including balances in central government double signature accounts.

  - External and real sectors

    (x) Imports and exports data by product.
    (xi) Detailed (creditor by creditor) external debt report from the Debt Unit in the Ministry of Finance and Planning, showing fiscal year-to-date disbursements, amortization, interest payments, and outstanding stocks, for the central government, public enterprises and AID-Bank.

(xii) Total disbursements/grant receipts, monthly, disaggregated into: (a) budgetary support (by type—either loans or external “bonds” and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.

(xiii) Stock of external payment arrears of the NFPS, including amortization and interest payment arrears, and supplier arrears for the central government, public enterprises, and AID-Bank.

(xiv) Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.

(xv) Consumer price index.

(xvi) Real sector indicators

All information will be reported to Fund staff within three weeks of the end of each month.

32. Reporting **on an annual basis** will include the following:

- External and real sectors

(xvii) GDP and its components.

(xviii) Balance of payments accounts.

33. Other reporting will include:

- Reports of legislative changes pertaining to economic matters.

Statement by the IMF Staff Representative
August 4, 2004

This statement provides additional information on developments since the issuance of the staff report for the second PRGF review for Dominica. This information does not materially change the staff appraisal.

1. Recent Developments and Performance under the Program

Macroeconomic conditions continued to improve with output growth accelerating rapidly and inflation under tight control in the first half of 2004. Data through May indicate that output recovery is more broad-based and stronger than previously anticipated. The growth in the banana sector observed at the beginning of the year has firmed up, and the strong growth in manufacturing and tourism has persisted. In all likelihood, real GDP growth for 2004 will surpass program projections. The uptick in inflation observed in the second half of 2003 continues to unwind with the price level flat in the first six months of the year.

Social and political conditions continue to be calm. The budget address was well-received by the public. The budget in line with the program was approved by Parliament on July 8, this was a prior action for this review. There were concerns about the population's reaction to the fiscal measures, especially the retrenchment exercise. However, as in last year's budget, the authorities showed a high level of ownership and diffused potential problems by coherently explaining the rationale of their policies.

Performance under the program for end-June continues to be strong. While this review is not associated with performance for end-June, preliminary indications are that, with the exception of the external arrears target (for which a waiver is requested), all performance criteria for end-June were observed. The large margins observed in the fiscal accounts through end-March were not reversed by end-June as anticipated. Strong revenue collections and tight expenditure controls, in anticipation of further expenditure cuts for 2004/05, were responsible for these margins.

2. Debt Strategy Update

There has been significant progress towards restructuring the public debt.

- ***Considerable progress has been made in restructuring the claims of bilateral creditors***. The UK, one of the largest bilateral creditors, agreed in principle in early July to provide a debt restructuring with a NPV debt reduction of 50 percent. Other bilateral creditors have also expressed their willingness to participate in the restructuring exercise, including Bahamas, Barbados, Belize, Grenada, and Venezuela. Agreement was reached yesterday on a debt deal with France.

- ***The CDB agreed to restructure its exposure***. The Caribbean Development Bank (CDB), the largest creditor, agreed in mid-July to restructure the bulk of their exposure to Dominica, involving longer maturities and lower interest rates as well as providing a grant to finance the debt service to CDB in the next three years. The staff estimates that this proposal entails NPV debt reduction of at least 50 percent.

- ***One of the two large private bonds has already been restructured***. The holders of participating rights on the bond originally purchased and stripped by Citibank, agreed in mid-July to participate in the debt exchange offer. Participating rights holders have tendered their exposure and the bond exchange will take place shortly.

- ***The bulk of domestic creditors have already agreed to the exchange offer***. The largest creditors include Dominica's Social Security and the National Bank of Dominica. However, some further reconciliation is still needed before the debt exchange takes place.

All in all, the staff estimates that over 60 percent of the eligible debt has already been restructured or have been agreed in principle to be restructured. The authorities continue to negotiate with other creditors, especially the holders of the other large external bond (i.e., the RBTT bond). The authorities are in the process of drafting legislation to stop the earmarking of a special tax account that services this particular bond.

The authorities have instructed the ECCB to open a special escrow account for debt payments. While the authorities continue to work constructively and in good faith with the remaining creditors, the purpose of the new ECCB account is to deposit interest earnings on claims held by creditors that have not yet participated in the restructuring exercise (on the assumption that they will eventually participate). This is done in accordance with the 2004/05 budget and in anticipation of a possible change in debt service payments strategy on creditors that have not yet participated.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under Dominica's PRGF Arrangement and Reviews Noncomplying Purchases and Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the second review of the Dominica's performance under its three-year Poverty Reduction and Growth Facility (PRGF) arrangement. In doing so, the Executive Board approved Dominica's request for a waiver on the nonobservance of the continuous performance criterion on nonaccumulation of external payment arrears.[1]

This decision enables Dominica to draw an amount equivalent to SDR 0.31 million (about US$450,000) under the arrangement, and would bring total disbursements to SDR 2.97 million (about US$4.3 million). The IMF's Executive Board approved Dominica's three-year PRGF arrangement on December 29, 2003 (see Press Release No. 03/228) for an amount equivalent to SDR 7.7 million (about US$11.2 million).

Following the Executive Board's discussion of Dominica, on August 4, 2004, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair said:

"The Dominican authorities' consistently strong implementation of the economic program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement has contributed to a rebound of economic growth, with continued low inflation. The prospects for sustained economic recovery will depend on the authorities' successful execution of the 2004/05 budget,

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[1] The Board also reviewed four noncomplying purchases/disbursement during 2002-04 and a breach of obligations under Article VIII, Section 5 of the Fund's Articles of Agreement, which arose as a result of misreporting on the observance of the continuous performance criterion on nonaccumulation of external payments arrears due to a misclassification of a small external claim. The Board was satisfied with the authorities' swift actions to correct this problem and granted waivers for the noncomplying purchases and disbursement and decided not to take action for the breach of obligations under Article VIII, Section 5.

the timely implementation of comprehensive structural reforms, and completion of the ongoing debt restructuring needed for Dominica's medium-term sustainability.

"The authorities have strengthened their fiscal consolidation efforts, as seen in the 2004/05 budget. They are aiming for a larger primary surplus for this fiscal year, and are advancing the timetable for reaching the medium-term primary surplus target to FY 2005/06. However, a large financing gap remains, which is expected to be covered by the debt restructuring.

"It was noted that the authorities were observing the best international practices regarding transparency, creditor consultations, and the safeguarding of inter-creditor equity in their debt restructuring efforts. While the initial slow pace of engagement on the part of some of Dominica's creditors was regrettable, the recent progress in advancing the debt restructuring process is encouraging. Over the last few weeks, the authorities reached agreement with creditors including the Caribbean Development Bank, several bilateral creditors, private investors with participatory rights in one of the two large external bonds, and the bulk of domestic creditors. The banking system and treasury bill market have remained stable in the wake of the ongoing debt restructuring.

"Timely implementation of comprehensive structural reforms will improve the investment climate, enhance competitiveness, and strengthen the financial sector. These reforms include: downsizing the civil service; raising civil servants' retirement age; rationalizing tax exemptions; introducing a VAT; implementing the Fiscal Responsibility Law; and improving the budgetary framework," Mr. Carstens said.

Statement by Ian E. Bennett, Executive Director for Dominica
August 4, 2004

Dominica is in the midst of a complex economic transformation that aims to resolve destabilizing macro trends and strengthen the basis for sustained robust growth. The three-year PRGF arrangement and preceding SBA have proven important in underpinning an orderly economic transition. The overall strategy is bearing fruit. The severe economic contraction of recent years has given way to a nascent and broad-based economic recovery led by tourism, a rebound in manufacturing, and a recovery in the traditionally important banana sector. Destabilizing fiscal trends have also been reversed – the primary and structural fiscal balance has shifted solidly into surplus, reflecting improved revenue collection, better expenditure controls, and corrective fiscal measures. The recently approved 2004/05 budget looks to build on these gains through the implementation of key structural fiscal reforms that will generate permanent fiscal savings, sending a signal of Dominica's shift towards prudent fiscal management

These favorable economic outcomes reflect the proactive and forward-looking two-staged approach that the Fund adopted in Dominica's case to stave off a major fiscal crisis and restore the basis for sustained growth. Ultimately, however, the bulk of the credit rests with the Dominica authorities and their firm commitment to implement an ambitious set of corrective fiscal and structural reforms. Indeed, policy implementation has been very strong since mid-2003. As a result, program risks have been reduced markedly, particularly relative to the last review. Nevertheless, the economic situation in Dominica remains fragile, and the government has committed to broadening and deepening the process of economic stabilization and growth embedded in the PRGF arrangement.

The Debt Restructuring Process

The immediate priority is to quickly reach a collaborative debt restructuring agreement with creditors that puts debt dynamics on a sustainable track and addresses the problem of debt overhang. While debt negotiations have unfortunately taken longer-than-envisaged to complete, discussions have proceeded on the basis of good faith and in line with international best practices. In fact, Dominica's handling of the debt negotiations could be held up as a model in many respects.

Once a determination was made in late 2003 that the debt burden was unsustainable, the authorities sought and received donor support to engage an internationally respected team of debt advisors. Full information sessions were held with all creditors and the constructive dialogue culminated in the launching of a formal debt exchange offer in April 2004. The offer included a menu of bond options that the government and its advisors believed would garner widespread support among creditors while accommodating debt sustainability objectives. At the same time, my Dominican authorities have complied fully with the Fund in terms of implementing an ambitious set of corrective fiscal and structural reforms as required under the Fund-sponsored arrangement. Indeed, having careful regard to performance to date as well as projections for the future, and conscious of the calls from members of the IMF Board, the government has advanced the pace of fiscal adjustment as a signal to creditors and the international community of their seriousness in tackling their fiscal problem. Finally, the authorities have shown flexibility in extending the expiration date on the exchange offer to provide creditors with time to reflect on the proposal and/or devise reasonable counter offers.

In the interim, and in line with program conditionality, the authorities have remained current on external debt obligations throughout the negotiation period with few exceptions. Consistent with the Fund's policy on claims in dispute, payments to Citibank and RBTT have not been serviced fully. In addition, a clerical error in the classification of a claim to an external supplier unfortunately resulted in the accumulation of external program arrears which, in turn, has given rise to several instances of non-complying purchases under the predecessor SBA and one non-complying purchase during the PRGF. Fortunately, this unintentional breach in program conditionality was both isolated and minor, and has now been fully resolved as the supplier has tendered these claims in the government's debt exchange offer.

While remaining current on external claims is difficult to justify when debt is clearly unsustainable, it is a concrete sign of Dominica's good faith efforts to reach a cooperative and equitable resolution of the debt problem with its creditors. Of course, this situation cannot continue indefinitely and, at which point, the authorities will seek the Fund's continued support under its lending into arrears policy. This possibility is reflected in the 2004/05 budget which is based on debt service payments consistent with full creditor participation. The principles of good faith, however, will not be abandoned in this instance – payments to non-participating creditors will be made on restructured terms and held in an escrow account until such time as an agreement is reached.

While we should not shy away from lending into arrears given Dominica's proven track record, the authorities are hopeful this option will not prove necessary. As reported, debt negotiations continue and are gaining momentum. On July 15th, the Board of Directors at the CDB –the largest single creditor– endorsed a debt restructuring proposal that approximates a 50 percent debt reduction in net present value terms. Discussions with commercial creditors have also picked up steam; the July agreement by Citibank stripholders to participate in the process marks an important milestone and will hopefully catalyze a similar agreement with RBTT. Finally, negotiations with bilateral creditors have advanced significantly in recent weeks. Regional partners, including Barbados, Venezuela, Grenada, and Belize have proposed rollover options consistent with Dominica's exchange proposal, and Trinidad and Tobago is considering a similar proposal. The United Kingdom has agreed, in principle, to accept a 50 percent NPV debt reduction and the actual repayment schedule is being worked out. With the participation of these bilateral partners, creditor participation in the debt strategy will account for over 60 percent of eligible debt, giving confidence that a full collaborative resolution to the debt restructuring will materialize. However, the government is aware that debt dynamics will remain fragile even after the successful implementation of the debt strategy. Fiscal consolidation and prudent fiscal management, therefore, remains a program centerpiece and major priority for the government going forward.

Fiscal Adjustment

Performance in the fiscal area continues to be strong; benchmarks were achieved with large margins. The strong performance reflects improved tax collection, better expenditure control, and an overall strengthened culture of fiscal discipline. Indeed, as mentioned above, the 2004/05 budget frontloads the fiscal adjustment effort – it will deliver a 2 percent of GDP primary surplus and the medium-term 3 percent primary surplus target is expected to be reached one year earlier than forecast. Finally, core elements of the agreed fiscal adjustment package remain intact – notably the commitment to reduce public sector employment by 5 percent in 2004/05 and to gradually increase the retirement age of public servants. On the basis of this package, the primary structural balance is projected at 1.5 percent of GDP in 2004/05 as compared to a deficit of 4.5 percent in 2002/03. This swing in the fiscal accounts marks a truly impressive turnaround, particularly as these gains were achieved during years of contracting or flat real GDP growth.

Financial Sector and Monetary Policy Issues

Financial sector developments are generally positive and should help support the economic recovery now underway. The authorities' decision to exclude treasury bills from the debt restructuring exercise has been well-received by market participants – the T-bill market is stable and there are no indications of impending rollover problems. In addition, banking deposits are on the rise and liquidity is abundant. This is expected to feed through into increased private sector credit as the recovery picks up steam. However, the authorities continue to believe that monetary conditions could be more supportive. While there is limited policy scope to pursue this objective within the context of the monetary union, removing the minimum savings deposit rate imposed by the ECCB is one option that would help lower lending rates in support of private sector-led growth.

Structural Reforms

The structural reform agenda aims to address the root cause of macro imbalances and impediments to growth. Given the excessive debt burden and the related problem of debt overhang, the agenda largely consists of structural measures that entrench fiscal sustainability into public accounts. Key among these is civil service retrenchment – which is included in the current budget and expected to be carried forward in 2005/06 – and the pension reform legislation that will shortly be submitted to parliament. In addition, the introduction of three-year rolling budgetary projections in the 2004/05 budget is expected to increase fiscal transparency and, thus, discipline. Finally, the authorities are examining the possibility of introducing fiscal responsibility legislation (possibly through appropriate amendments to its Finance Administration Laws) and is actively exploring options to strengthen tax policy, including through the introduction of a VAT and the further reduction in discretionary tax exemptions (which have already been reduced significantly).

Conclusion

The authorities are committed to the program and its underlying objectives to restore fiscal sustainability, broaden the basis for strong sustained growth, and accelerate the delivery of poverty reduction. In line with these objectives, the authorities hope to complete a full-fledged PRSP by end-2004. Against this backdrop and given Dominica's strong track record of policy performance to date, I am hopeful that the Board will look favourably on the decision to complete the second review under the PRGF as well as the authorities' request for a waiver on the nonobservance of the performance criterion on external arrears.