 September 2007
IMF Country Report No. 07/322

Dominica: 2007 Article IV Consultation—Staff Report; Staff Supplement;and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with Dominica, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 8, 2007, 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 2, 2007. 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 supplement on the debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 16, 2007 discussion of the staff report that concluded the Article IV consultation.

The document listed below will be separately released.

Statistical Appendix

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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

DOMINICA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with Dominica

Approved by José Fajgenbaum and Matthew Fisher

July 2, 2007

Background. Dominica has recovered remarkably from an economic crisis in 2001–02 through fiscal adjustment and structural reform, supported by the Poverty Reduction and Growth Facility Arrangement.

Exchange system. The currency is the Eastern Caribbean dollar of the Eastern Caribbean Currency Union, which has been pegged to the U.S. dollar since 1976. Dominica has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Focus of discussion. The discussion focused on various challenges faced by Dominica in sustaining economic growth and reducing poverty and on the policies and measures to address them.

Discussions. The consultation took place during April 26–May 8, 2007. The team comprised G. Kwon (Head), M. Dehesa, I. de Carvalho Filho, N. Mwase (all WHD), and P. Rodriguez (PDR). The mission was joined by staff of the ECCB and the Caribbean Development Bank. Y. Alvarez (OED) participated in the final meeting. The team met with Prime Minister Skerrit, the Cabinet, and senior government officials, as well as representatives of the private sector and labor unions.

Fund relations. The last Article IV consultation was concluded in September 2005. The staff report and the summing up of Executive Directors' discussions and policy recommendations are available at:
http://www.imf.org/external/pubs/cat/longres.cfm?sk=18656.0

Contents Page

Executive Summary 3

I. Introduction 4

II. Recent Economic Developments 4

III. Macroeconomic Outlook and Risks 9

IV. Report on Policy Discussions 10
A. Ensuring Fiscal Sustainability 10
B. Strengthening Resilience of the Financial Sector 13
C. Fostering Growth and Reducing Poverty 14

V. Staff Appraisal 16

Boxes
1. Reform of Indirect Taxes 19
2. Managing an Aid Surge 20
3. External Competitiveness 21

Figures
1. Economic Developments in Perspective 5
2. Selected Economic Indicators 7
3. Fiscal Developments, 2002–06 8

Tables
1. Selected Economic and Social Indicators 22
2. Summary Accounts of the Central Government 23
3. Balance of Payments 24
4. Summary Accounts of the Banking System 25
5. Medium-Term Macroeconomic Framework 26
6. Financial and External Vulnerability Indicators 27
7. Millennium Development Goals 28

EXECUTIVE SUMMARY

Background

Dominica has recovered remarkably from the 2001–02 crisis and its near-term outlook is positive. The authorities undertook a bold economic reform program in late 2002, supported by the Fund, to restore debt sustainability and pave the way for sustained growth and poverty reduction. Performance under the program was exemplary. Public finances improved considerably and public debt declined sharply. Output growth exceeded the historical average, reaching a near two-decade high in 2006, and is expected to remain strong. Inflation has been subdued and is projected to remain low. Substantial progress has been made in indirect tax and social security reforms, as well as in other reform areas.

Key remaining challenges are: (i) maintaining sound fiscal policies to continue to reduce the public debt ratio, which is still high at about 100 percent of GDP and renders the economy vulnerable to external shocks, particularly natural disasters and abrupt declines in aid; (ii) strengthening the resilience of the financial sector, which has contributed to the strong post-crisis recovery and yet remains weakly regulated and supervised; and (iii) continuing to undertake structural reforms to help diversify the economy further away from the waning banana sector and find new growth drivers.

Policy discussions

To address these challenges, the authorities have recently embarked on a comprehensive reform program, embodied in the Growth and Social Protection Strategy (GSPS). Key elements of the strategy are undertaking structural reforms to foster private sector-led growth and reduce poverty while maintaining prudent fiscal policy, including attaining a primary surplus target of 3 percent of GDP.

The mission endorsed the authorities' reform agenda, while emphasizing some aspects of the GSPS including the need to:

- strengthen public finance management (especially aid and aid-related spending), maintain the integrity of the value-added tax (VAT), and explore alternatives to the current tax incentive regime;
- enhance financial sector regulation and supervision, including intensifying on-site inspection of banks and creating a fully-functioning regulatory and supervisory body over nonbank financial institutions (in particular credit unions and insurance companies); and
- prioritize structural reforms, in particular, streamline public sector entities along their core mandates; improve contract enforcement and foreclosure arrangements; and reform the utilities and customs administration.

I. INTRODUCTION

1. **Dominica has fully recovered from the 2001–02 crisis.** Expansionary fiscal policy in the 1990s led to an acute economic crisis. In response, the authorities adopted a bold reform strategy in late 2002, supported by the Fund. Performance under the program was exemplary. The fiscal primary surplus in 2005/06 was some 10 percentage points of GDP higher than in 2000/01, and public debt declined by 30 percentage points of GDP (Figure 1). As a result, economic activity rebounded markedly, inflation remained subdued and international reserves rose considerably.

2. **Dominica is now in a strong position to address remaining challenges.** Key remaining challenges are: (i) reducing further the public debt ratio, which is still high at about 100 percent of GDP and renders the economy vulnerable to external shocks, in particular natural disasters and abrupt declines in aid; (ii) ensuring that the financial sector is well regulated and supervised; and (iii) diversifying the economy further away from the waning banana sector and find new growth drivers.

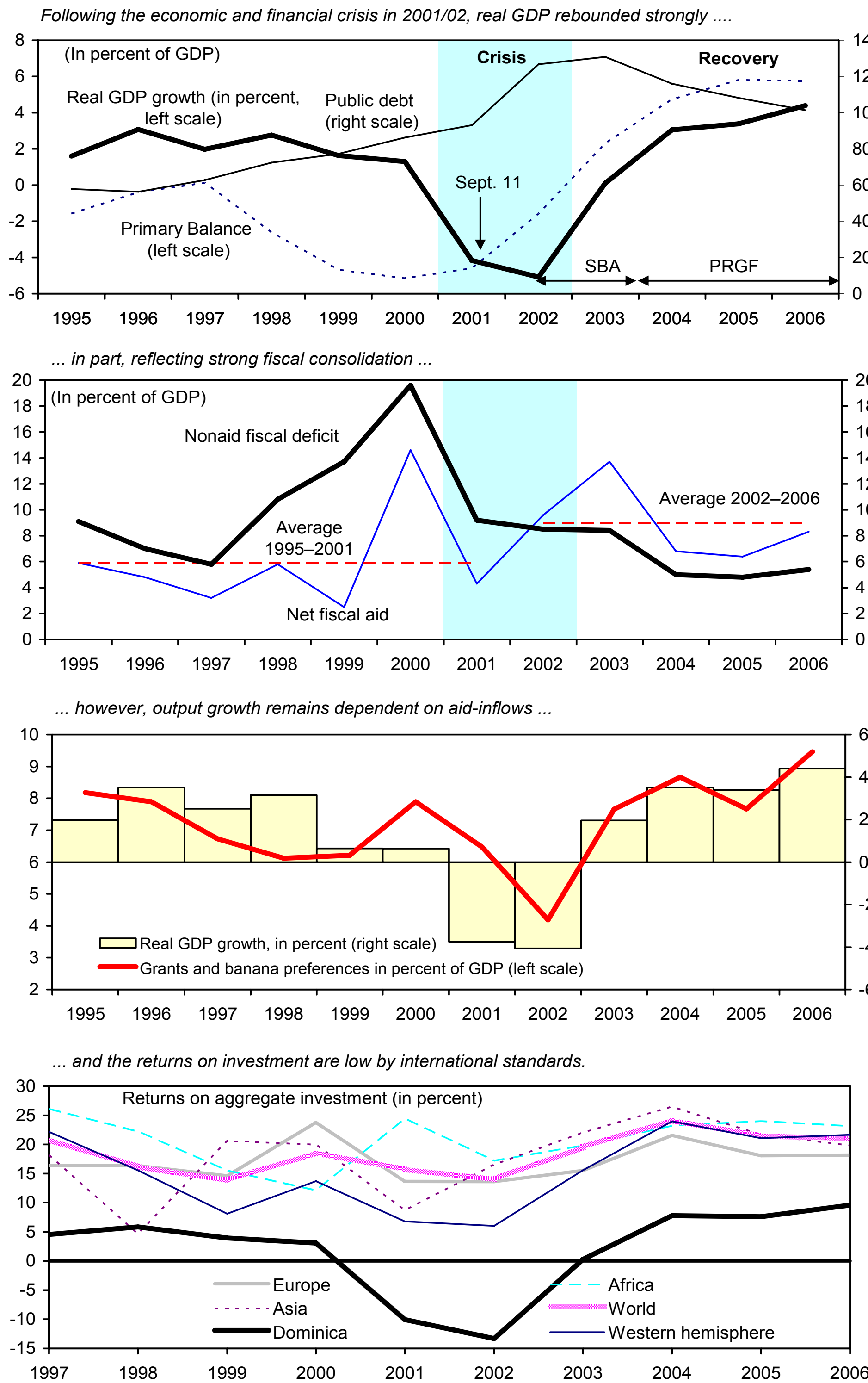
3. **Political support for structural reforms remains unabated.** The current government, in power since early 2000, increased its majority in the 2005 elections with a reform platform. The government has successfully implemented often unpopular yet critical reforms, such as nominal wage cuts and imposition of stabilization levies. Following the end of the PRGF-supported program last December, the authorities publicly launched the Growth and Social Protection Strategy (GSPS), a home-grown reform strategy that had been formulated in close consultation with donors. The authorities are currently conducting wide-ranging public consultations regarding the possibility of a successor Fund program to support the GSPS.

4. **Dominica has generally been receptive to the Fund's policy advice.** The authorities have demonstrated strong program ownership both in fiscal consolidation and structural reforms. Some structural reforms have been slow, mainly reflecting limited implementation capacity. Technical assistance from the Fund has been active, mostly through CARTAC, particularly in tax policy and administration, public finance management, and social security reform.

II. RECENT ECONOMIC DEVELOPMENTS

5. **Dominica's economic performance has strengthened remarkably.** The economy grew by an estimated 4 percent last year, the strongest in nearly two decades, driven by a pickup in tourism and buoyant construction (Figure 2, first panel). A recovery in banana production as well as a boost in offshore school activity also played a role. Annual inflation was limited to 1.6 percent in 2006, reflecting stabilizing oil prices and the currency peg regime, despite an uptick in service prices related to the VAT introduction and increasing shipping costs (Figure 2, second panel).

Figure 1. Dominica: Economic Developments in Perspective



Sources: Dominica authorities; and Fund staff calculations.

6. **The fiscal target for 2006/07 is likely to be met by a wide margin.** Fiscal performance has been very strong, supported by tax buoyancy, in particular from the newly-introduced VAT and excise (Box 1), and sustained wage freeze effective since 2001/02 (Figure 3). Noninterest expenditures run somewhat higher than last year, mainly due to more project-related expenses and larger transfers to public sector entities. Based on preliminary information, the primary surplus before grants is projected at about 6 percent of GDP for 2006/07, even after a 3 percent increase in base salaries introduced later in the fiscal year.

Dominica: Recent Fiscal Performance

(In percent of GDP)

	2005/06	Budget 2006/07	Proj. 2006/07
Primary balance 1/	**7.3**	**3.0**	**5.9**
Revenues (excl. grants)	**33.5**	**29.3**	**32.6**
Of which Nontax revenue	**3.0**	**2.2**	**2.8**
Noninterest expenditures	**26.2**	**26.3**	**26.7**
Wages	13.3	13.0	12.9
Goods and services	5.8	6.0	6.2
Subsidies and transfers	5.8	5.8	7.1
Others 2/	1.2	1.5	0.5
Memorandum items:			
Overall balance	3.7	0.6	3.4
Total grants received	7.6	8.6	14.4

1/ Adjusted for grants and grants-related spending.

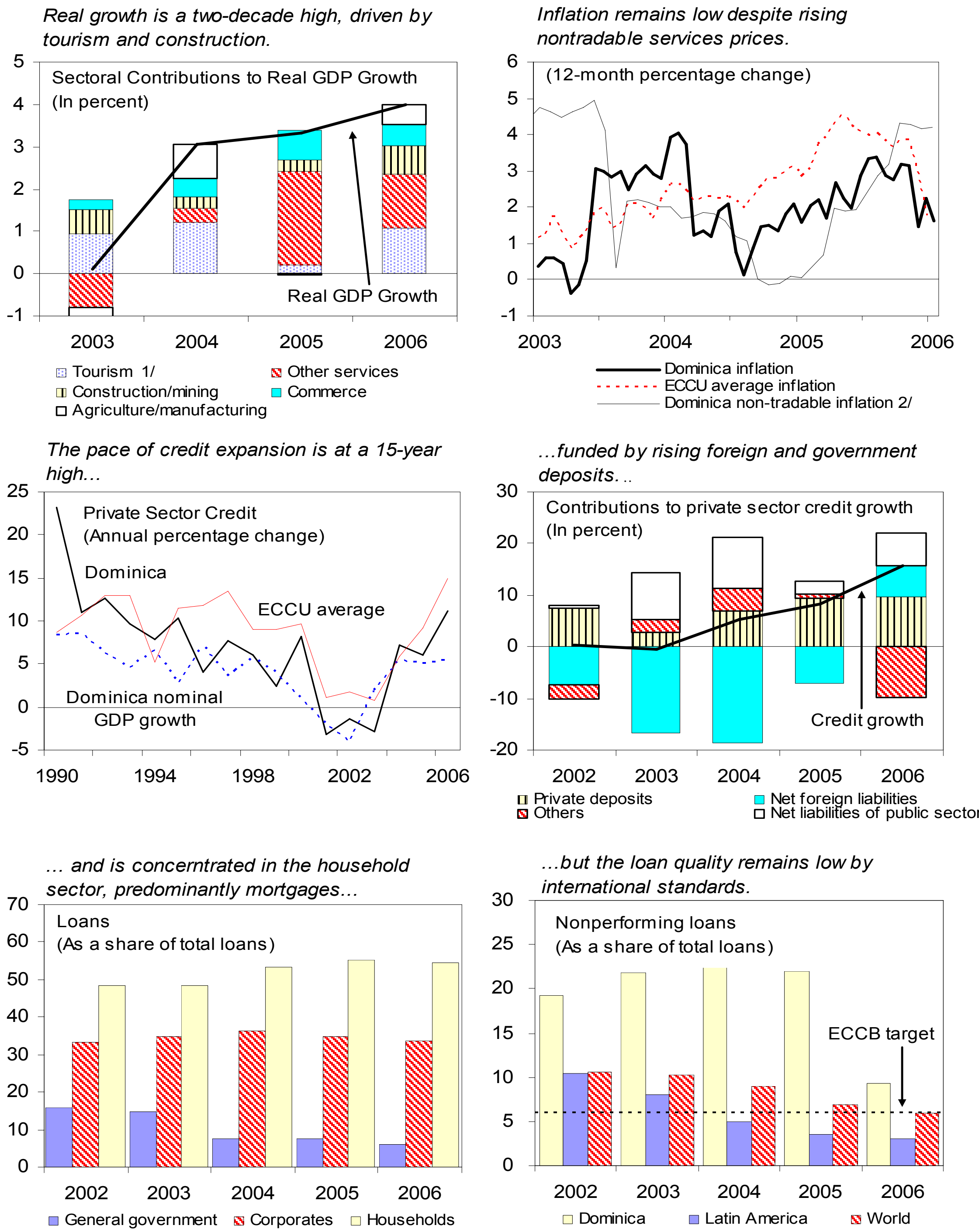
2/ Including net lending, nongrant-financed investment and statistical discrepancy.

7. **Grant flows have more than doubled the pre-crisis level.** Dominica received grants of almost 13 percent of GDP for the first nine months of this fiscal year, compared with a budget projection of 8½ percent and the average pre-crisis level of 4½ percent. The surge is mainly due to one-off disbursements from the European Union (EU) and new donors, including Venezuela and Trinidad and Tobago. A large proportion of the grants has been saved in bank accounts, reflecting limited implementation capacity and the authorities' commitment to sound spending.

8. **Credit to the private sector increased apace, underpinned by deposit growth and fiscal consolidation.** Bank credit to the private sector rose by 11 percent in 2006, the highest in 15 years (Figure 2, third panel). Private sector deposits have continued to increase in part due to strong inflows from expatriates in Europe. The increase in public savings has also contributed to funding the credit expansion (Figure 2, fourth panel). The ample liquidity as well as competition among lenders led to a 70 basis points decline in average lending rates to 9.2 percent during 2006. Bank lending remains concentrated in consumer loans, particularly mortgages (Figure 2, fifth panel).

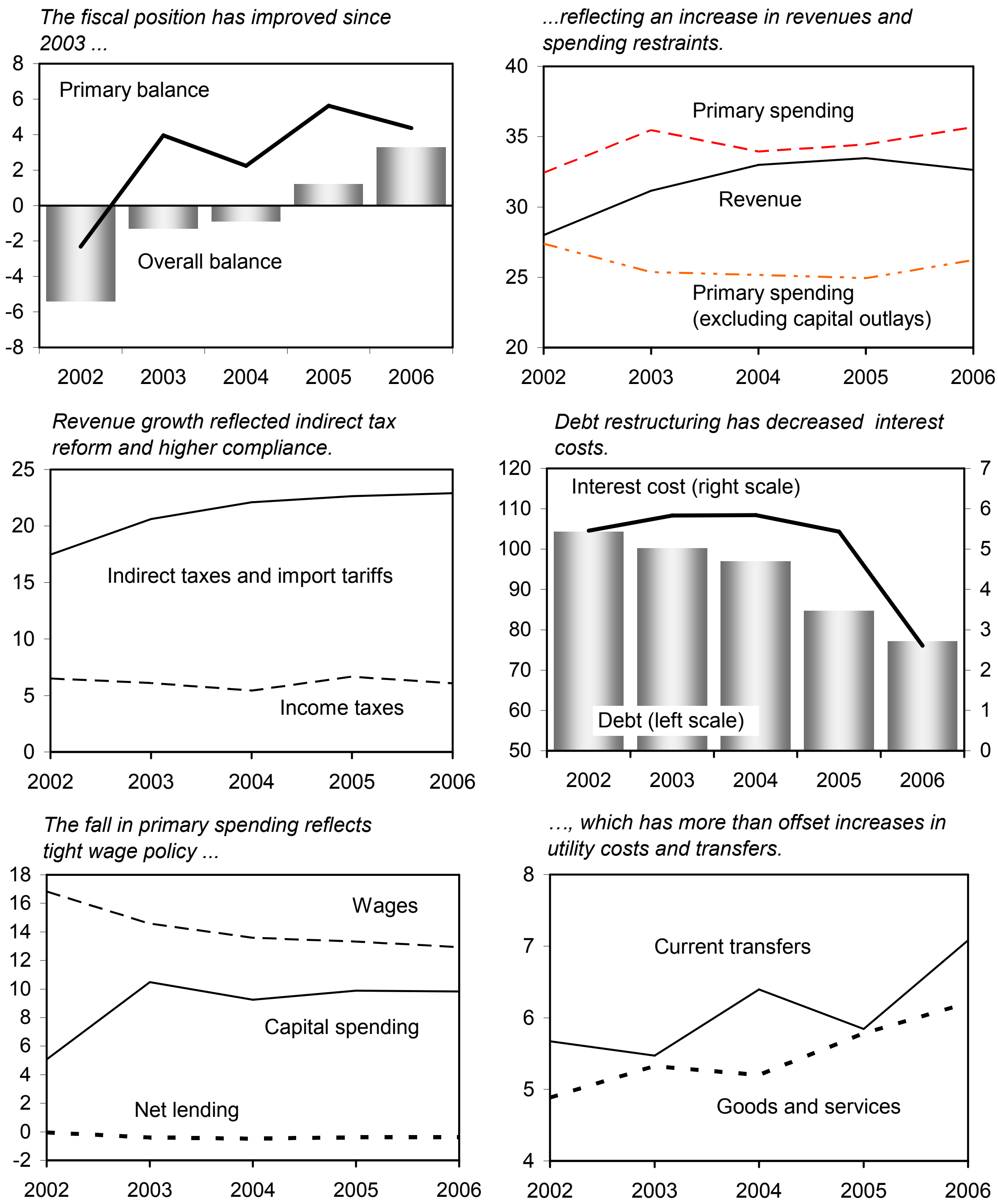
9. **Banking prudential indicators have continued to improve**. The banks are well capitalized, profitable and liquid with declining nonperforming loans (NPL). The NPL decline mainly reflects stricter enforcement of prudential guidelines by the Eastern Caribbean Central Bank (ECCB) and write-offs of large bad loans. Strong macroeconomic performance has also helped improve credit quality. Nevertheless, the average NPL ratio remains high by international standards and exceeds the ECCB prudential target of 5 percent (Figure 2, last panel). In addition, provisioning levels are low in part due to the recent write-offs, while banks face tough competition in a saturated loan and deposit market, in particular from credit unions and insurance companies.

Figure 2. Dominica: Selected Economic Indicators



Sources: Dominica authorities; ECCB; and Fund staff calculations.
1/ Tourism includes transport and hotels and restaurants.
2/ Excluding volatile fuel, electricity, and transportation prices.

Figure 3. Dominica: Fiscal Developments, 2002–06 1/
(In percent of GDP, central government)



Sources: ECCB and Fund staff estimates.
1/ Figures shown for a given calendar year relate to the fiscal year (July–June) beginning on July 1 of that year.

10. **Supervision of the nonbank financial sector remains weak.** Credit unions, whose deposits amount to about 30 percent of bank deposits, remain under-regulated despite their systemic importance. A near-insolvent Agricultural and Industrial Development Bank (AID), which mostly on-lends concessionary loans, remains to be rehabilitated. The weak supervision largely reflects resource constraints as well as delays in enacting key regulatory legislation. After much delay, a draft law providing regulatory and supervisory power to the Financial Service Unit has recently been submitted to parliament.

11. **The external current account deficit narrowed sharply in 2006.** The improvement mostly reflects stronger tourism receipts. The deficit is likely to remain large at around 20 percent of GDP this year, but continues to be covered almost fully by large capital grants and foreign direct investment.

12. **Discussions on debt restructuring continue with nonparticipating creditors.** Since the offer of restructuring terms in June 2004, 78.5 percent of eligible debt has been restructured. The authorities have maintained good-faith efforts in pursuing agreements with the nonparticipating creditors, including a recent visit by the Prime Minister to Kuwait. The negotiations with one major private creditor, the most recent of which took place in January 2007, have been particularly challenging, given a complex derivative overlaid by the creditor to finance the bond purchase.[1]

13. **Further progress has been made in structural reforms since the end of the PRGF arrangement.** The contribution rate for the Dominica Social Security was raised by 1 percentage point in March and set to be raised further in coming years as part of a comprehensive reform (see below). The authorities have recently started to merge the port and airport authorities and to breakup the National Development Corporation into a tourism board and an investment promotion agency with a view to improve their efficiency.

III. MACROECONOMIC OUTLOOK AND RISKS

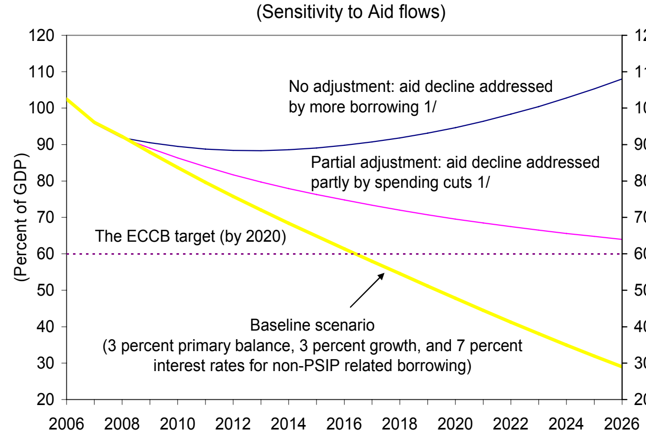
14. **Dominica's near-term economic outlook is positive.** The growth momentum is expected to slow somewhat in the near term, in part due to the closure of a major factory, but its underlying trend will remain above the historical average. Public investment will remain buoyant, funded by large aid receipts, while consumption is likely to remain robust, in part supported by the increases in public sector wages. The momentum in the tourism sector will likely be sustained, underpinned by a major diaspora event and recent promotional efforts. Ongoing efforts to improve marketing and quality controls will help boost agriculture and fishery production although their full effects will take time to materialize. Inflation is projected to remain low.

[1] See IMF Country Report No. 04/286 for details.

15. **The medium-term economic prospects hinge on the continued implementation of the authorities' reform agenda.** The authorities' reform strategy, as embodied in the GSPS, envisages above-trend output growth of 3 percent per annum and gradual reductions in unemployment and poverty, underpinned by structural reforms and prudent fiscal policy. Public investment is expected to play an important role in achieving the policy objectives by providing social and physical infrastructure critical for private-sector led growth. The strategy relies heavily on external grants to avoid an increase in public debt. The maintenance of the primary surplus at 3 percent of GDP, as envisaged in the GSPS, will bring about a gradual reduction in the debt-to-GDP ratio and enable Dominica to meet the ECCB target for the debt ratio (60 percent by 2020).

16. **Vulnerabilities remain high, notwithstanding progress made in recent years.** Public finances have been greatly strengthened through sustained fiscal consolidation, debt restructuring and, more recently, social security reform. The debt dynamics nonetheless remain vulnerable to external shocks, in part due to the bunching of debt service payments in 2009−11 as well as the high public debt. Staff projections show that, should the government react to a decline in grants to their pre-crisis level by scaling up commercial borrowing, public debt would quickly become unsustainable. In addition, natural disasters remain a main source of vulnerabilities, although somewhat mitigated by Dominica's recent participation into the Caribbean Catastrophe Insurance Facility of the World Bank.

Dominica: Debt Sustainability Analysis
(Sensitivity to Aid flows)



Source: Fund staff calculations based on data from Dominican authorities.
1/ Assumes that grants decline to the pre-crisis historical average in 2009.

IV. Report on Policy Discussions

17. **Against this background, policy discussions centered on the medium-term challenges of sustaining growth and reducing poverty.**

A. Ensuring Fiscal Sustainability

18. **The mission welcomed the authorities' medium-term fiscal framework as a sound and coherent strategy and laid out key fiscal challenges going forward.** Notwithstanding the remarkable fiscal consolidation, fiscal flexibility remains limited in Dominica due to the high debt and large investment needs under the GSPS. In addition, the recent surge in aid poses policy challenges, especially since the levels and volatility of past aid point to unsustainability of the surge (Box 2). In this regard, the mission welcomed the

authorities' fiscal framework that envisages a primary surplus of 3 percent of GDP (excluding grants and grant-related spending) and recommended saving the aid in excess of budgeted amounts. The mission stressed that the prudent fiscal policy will not only bring about a gradual decline in the debt ratio but also provide for smooth budget execution in the event of aid shortfalls. Key policy challenges are to continue to keep current expenditures under control, maintain revenue strength, and improve the management of aid and aid-related investment.

19. **The authorities agreed with the thrust of the mission's recommendations, particularly on the need to meet the primary surplus target and manage aid prudently.** They reaffirmed their commitment to the primary surplus target, and indicated that, if necessary, saving would be sought from nonwage current spending. They also stressed that the scaled-up aid would not be used to increase the overall budget envelope unless sustainability is assured. They noted however that there is scope for tax reductions, given strong revenue performance in recent years and successful reform of indirect taxes. They also noted that some measures for a major taxpayer are being considered to compensate its loss of tax privileges at the time of VAT introduction. After five years of nominal wage freeze, there is a consensus about compensating public employees adequately in consideration of strong economic activity and the need to improve and retain the quality of public services.

20. **The mission cautioned that tax cuts need to be modest and wage increases be consistent with the fiscal framework.** The mission noted that fiscal flexibility is constrained for the next year even without tax reductions. Tax revenues are likely to fall relative to GDP as the VAT refund process normalizes and the effect of the factory closure filters through the economy.[2] At the same time, current expenditures will likely remain elevated due to large project-related expenses, while the aid outlook is uncertain. The primary surplus will hence likely decline next year under the existing policies although its target will be met by a narrow margin. The mission hence emphasized the importance of not undermining underlying revenue strength while recognizing the scope for modest reductions in income taxes, in particular for low-income brackets. It also urged the authorities to keep the deviation in the wage bill to a minimum,[3] and welcomed the authorities' commitment to adopt compensatory expenditure measures, if needed to ensure meeting the primary surplus target.

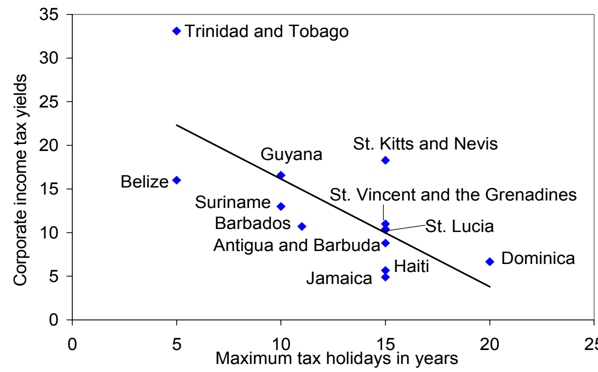
21. **The mission further advised the authorities to explore alternatives to the current tax incentive regime.** The income tax yields are very low due to a myriad of tax incentives

---

[2] The direct budgetary impact of the closure is limited due to tax holidays granted to the factory.

[3] The PRGF-supported program envisaged that the wage bill would fall from 13¾ percent of GDP in 2004/05 to 12¼ percent by 2008/09.

in place. The mission, while acknowledging intense pressure from regional tax competition, stressed the need to improve the current incentive regime, which is centered on tax holidays and exemptions that are very difficult to administer and not tied to the level of investment or employment. The authorities concurred with the mission that consideration should be given to alternative, more efficient forms of tax concessions such as investment credit and accelerated depreciation, or expenditure commitment in lieu of tax concessions. They also reaffirmed their commitment to continue to publish all government decisions on tax concessions and, to the extent possible, their cost estimates to ensure transparency.



Source: Fund staff calculations, based on 2003 data.

22. **There was agreement that maintaining the integrity of the VAT is critical for a successful implementation of the GSPS.** The VAT has performed well in terms of the revenue yield and compliance, accounting for one third of tax revenues. Given the substantial resource needs for social spending, quality public services, and crucial infrastructure investment, it would be critical not to undermine the integrity of the VAT and to continue to improve revenue administration. Legitimate concerns about small business and low-income earners would be better addressed by improving refund arrangements, raising the VAT threshold, or increasing income tax allowances, as highlighted by a recent FAD/CARTAC mission. In this regard, the mission welcomed the authorities' reaffirmation to undertake a comprehensive review of the VAT by September 2007.

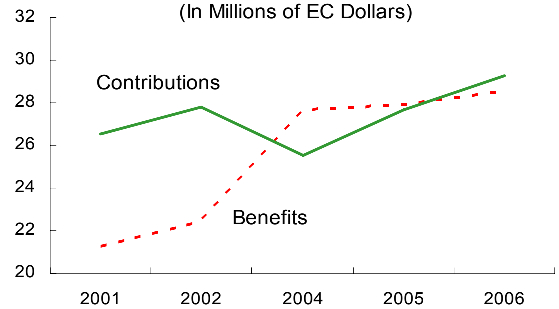
23. **The mission urged the authorities to strengthen public finance management, in particular of aid and aid-related spending.** Public investment represents about 40 percent of total investment in Dominica, with two thirds of it financed by aid. However, public investment in Dominica, while sizable, is far less productive than in countries in other regions.[4] In this regard, consideration could be given to establish an aid-coordination unit within the Ministry of Finance that integrates aid administration, including aid negotiations as well as planning and monitoring of aid-financed expenditure. Further progress will also be needed in multiyear budgeting, procurement and auditing as well as donor coordination, as highlighted by a recent EU-sponsored study. The enactment of the Financial Administration Act, as committed by the authorities, would help in this regard. The authorities agreed on the need to improve aid management but noted that donors could also play an important role by improving predictability of aid and streamlining disbursement procedures.

---

[4] See IMF Working Paper No. 07/124, "*Public Investment and Growth in the Eastern Caribbean*".

24. **The mission welcomed the progress made in social security reform.** The social security system had become unsustainable due to adverse demographics and inadequate reserves.[5] The authorities responded by adopting a comprehensive pension reform in mid-2006, the implementation of which began early this year. The reform includes gradual increases in the contribution rates and retirement ages as well as changes in the accrual rules and benefit formula, broadly in line with FAD's recommendations. In addition, the government has paid off its contribution arrears, amounting to 5 percent of GDP in 2003. These changes, together with improved administration, have increased the number of contributors significantly. Changes are also being considered to increase the fund's overseas investments by up to 5 percent of its portfolio.

Accounts of the Dominica Social Security
(In Millions of EC Dollars)



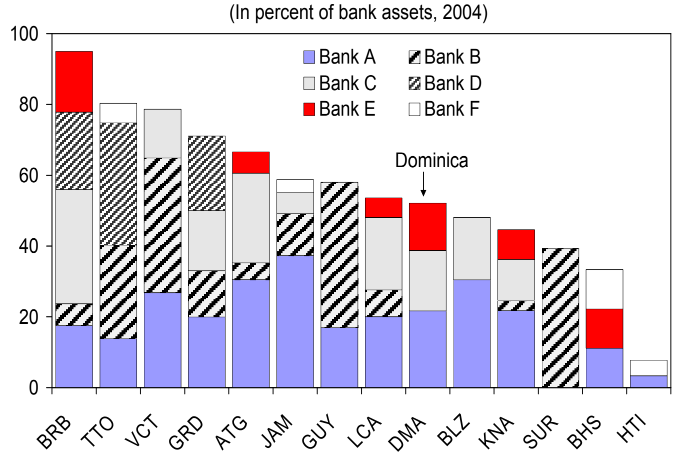
Sources: Fund Staff estimates; and Dominica Social Security reports.

25. **The mission urged further progress in debt restructuring.** It would be important that the authorities continue their good-faith efforts toward collaborative debt agreements that maintain inter-creditor equity, including making payments into the escrow account and regular attempts to discuss with the remaining holdout creditors. The authorities indicated that they are considering closing the three-year long negotiations if not much progress is in sight. The mission stressed the importance of continuing to uphold the good-faith efforts.

B. Strengthening Resilience of the Financial Sector

26. **The mission expressed concern whether supervision keeps pace with ongoing financial sector expansion.** The recent credit expansion is a positive sign of increasing domestic activity and a welcome reflection of increased confidence instilled by fiscal consolidation. Nonetheless, its rapid pace suggests the importance of being watchful about credit quality, especially given the possibility of weakening lending standards under intense competition. The low levels of loan loss provisions are also of concern. To this end, the mission suggested that the authorities encourage the ECCB to strengthen supervision—in particular

Markets Shares of Regional Banks in CARICOM
(In percent of bank assets, 2004)



Sources: Country authorities; and Fund staff estimates.

---

[5] See IMF Country Report No. 05/384 for details.

intensify on-site inspection—in order to safeguard financial sector stability. It also noted that extensive financial linkages in the region and increases in cross-border transactions require closer coordination among supervisory bodies in the region and, ultimately, the establishment of a regional framework for consolidated supervision**.**

27. **The weak oversight of the nonbank financial institutions is a matter of concern.** Given the systemic importance of the nonbank financial institutions, in particular credit unions, a proper regulatory and supervisory framework needs to be put in place as a matter of priority. Further progress is needed in rehabilitating the AID Bank and improving its supervision. In this context, the mission welcomed the progress made in enacting the Financial Services Unit Act and urged that the unit rapidly become fully operational with adequate resources and supporting legislation—in particular the amendment of the Cooperative Societies Act and new insurance legislation. The mission also noted that a regional approach to regulation and supervision would be useful given the extensive regional financial linkages as well as resource constraints.

28. **The authorities agreed that further progress is needed in improving financial sector supervision.** The authorities indicated that they are keenly aware of potential systemic risks from credit unions, and put a priority to ensuring that the Financial Services Unit is fully functioning. The lack of resources and expertise remains the biggest challenge and, in this regard, the authorities are considering outsourcing part of supervisory functions to other regulatory bodies in the region. There are also challenges in establishing a regulatory framework for credit unions due to the need to harmonize it with the position of the Caribbean Confederation of Credit Unions.

C. Fostering Growth and Reducing Poverty

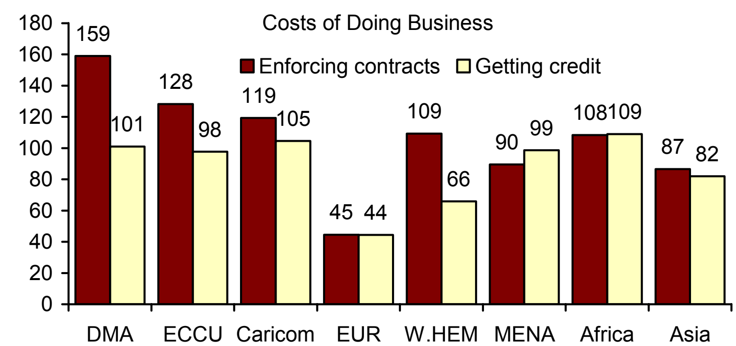
29. **Dominica, a small island economy, faces unique challenges in sustaining growth**. Structural factors—such as high transportation costs and the lack of economies of scale—continue to pose challenges to the economy, as exemplified by a recent decision of a multinational company to close one of its factories in Dominica. The economy is also more vulnerable to external shocks than larger countries. The outlook for the banana sector will likely remain challenging due to the erosion of trade preferences although the Fair Trade niche that relies on organic branding could bring some support to the sector. In addition, tourism, while promising, will remain sensitive to external factors. In this regard, the authorities agreed with the mission that efforts for diversification to nonbanana crops need to be pursued further, with a focus on improving productivity including through better marketing and quality control.

30. **The staff noted that, while some sources of vulnerability are unavoidable, sound macroeconomic policies and structural reforms would offer Dominica the best prospect for sustainable growth.** There was broad agreement between the mission and the authorities that reforms are necessary in public entities, the judiciary, utilities and customs. The mission

also discussed deficiencies in statistics, in particular the national accounts, that hinder analysis of economic developments and formulation of policy. The authorities reaffirmed their commitment to structural reforms while noting that the effects of prior structural reforms need to be assessed.

- **Public sector entities need to be streamlined along core mandates.** Many national development agencies—notably, the Dominican Export Import Agency (DEXIA), the AID Bank, and the National Development Corporation (NDC)—have not fully fulfilled their mandates and lack efficiency and adequate oversight. While the recent start of the NDC restructuring is a positive move in this regard, further progress is needed in restructuring other entities, in particular DEXIA, which remains in a large loss and is widely seen as competing with private sector activities.

- **Contract enforcement and foreclosure arrangements.** According to the World Bank, Dominica is among the weakest in the world in dispute settlement and foreclosure arrangements, hindering business transactions and raising borrowing costs. The authorities are considering taking steps to establish additional magistrate courts, streamline foreclosure arrangements, and facilitate summary proceedings.



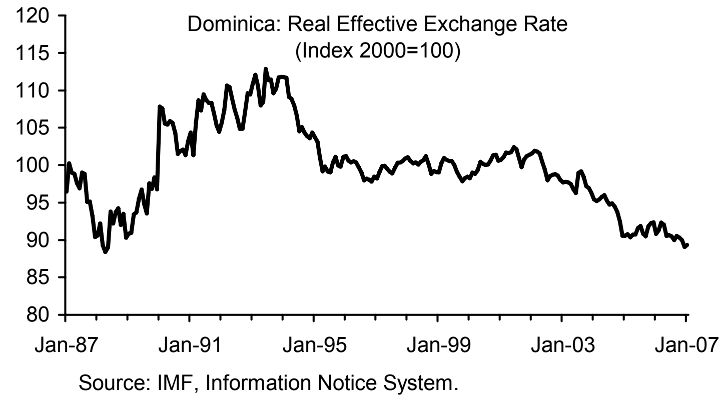
Source: World Bank. The numbers refer to world rankings among some 175 countries.

- **Utilities reform.** Notwithstanding the abundant nonhydrocarbon energy sources, electricity tariffs are among the highest in the region due in part to an outdated regulatory system. The recently approved electricity supply act is an important step forward, but a properly functioning utilities commission is needed without delay.

- **Customs reform.** Customs administration needs to modernize its operations, introduce manifest control, rationalize the appeals process and improve its efficiency, especially regarding processing time, as recommended by a recent FAD/CARTAC mission.

31. **Dominica's external competitiveness remains broadly appropriate.** The CPI-based real effective exchange rate has declined since 2001, reaching at end-2006 its lowest level in nearly 20 years. This reflects relative price stability in Dominica, associated with the fiscal consolidation, and the depreciation of the EC dollar against the currencies of trading

partners (Box 3). Other indicators of competitiveness, in particular tourism costs and recent developments in the tourism sector, as well as a comprehensive study of the EC dollar[6] also point to the same conclusion.[7] The weakening of the real exchange rate could help boost Dominica's competitiveness in key export markets, particularly in Europe and neighboring French territories, and thereby narrow the current account deficit.



32. **The authorities' poverty reduction strategy is coherent and properly balanced.** The strategy, as laid out in the GSPS, recognizes critical roles played by sustained economic growth and fiscal soundness in reducing poverty and emphasizes the importance of targeted social programs. An integral part of the strategy is to prioritize interventions with immediate and direct impact on the most vulnerable groups. In this regard, the mission welcomed the commitment of the authorities to undertake poverty assessment this year, which will help design efficient and well-targeted social safety nets. It also noted that the ongoing reform of the Dominica Social Security, which accounts for about half of total social spending, should help provide secure resources for social spending over the long term.

V. Staff Appraisal

33. **The authorities' reform efforts following the 2001/02 crisis have been bearing fruit.** Fiscal consolidation has helped re-establish macroeconomic stability and thereby contributed to strong output growth. These efforts, together with debt restructuring, have moved the debt trajectory towards a sustainable path. The continuation of sound fiscal policy is critical to attaining debt sustainability and ensuring external stability. In addition, the authorities have made substantial progress in structural reforms, in particular in indirect tax and social security reforms.

34. **The economy is poised to maintain above-trend growth, sustained by sound economic policy and continued structural reform.** Despite a near-term softening arising from the closure of a major factory, the economy's underlying growth is expected to remain

[6] Cashin, Paul and Emilio Pineda, "Is the Eastern Caribbean Dollar Overvalued?," *forthcoming Working Paper.*

[7] The upcoming toothpaste factory closure represents the implementation by a multinational company of its global business strategy, and may not reflect deterioration in Dominica's external competitiveness. The net effect of the closure is limited to an estimated 2.5 percent of total exports of goods and services in 2008, given a very high import content of the toothpaste exports.

above the historical average in coming years, with successful implementation of the authorities' reform strategy. The steady growth with low inflation will help achieve the authorities' social objectives, namely poverty reduction and job creation.

35. **The authorities are to be commended for their commitment to address remaining policy challenges.** Their medium-term reform strategy appropriately envisages the maintenance of a fiscal policy geared at achieving a primary surplus target of 3 percent of GDP and thereby bringing about a gradual reduction in the debt ratio. It also lays out a structural reform program focused on the need to foster private sector-led growth.

36. **The recent surge in budgetary aid is a welcome development but presents policy challenges as well.** The recent aid flows were extraordinarily large and unlikely to be sustained in coming years. Given the uncertain aid prospects, large investment needs and high debt, the authorities are right in smoothing spending over time and in using some of the savings to substitute expensive borrowing and reduce debt. They have recognized the need to improve budget management, in particular as regards capital expenditure, in order to use aid efficiently, transparently and consistently with macroeconomic objectives. The Fund, together with donors, will continue to provide technical assistance in this area through CARTAC.

37. **Tax cuts, while justifiable, need to be modest and accompanied by revamping the tax incentive system without undermining the integrity of the VAT.** The successful indirect tax reform provides modest scope for tax reductions, without jeopardizing the primary surplus target. Some tax incentives are unavoidable to attract investment and create jobs, especially given intense tax competition in the region. However, the current system, centered on tax holidays and exemptions, needs to be replaced with more efficient schemes such as accelerated depreciation and investment credit. Legitimate concerns about low-income earners and small businesses would be better addressed by targeted measures such as increases in allowances and VAT thresholds.

38. **Greater progress is needed in financial sector supervision.** While recent improvements in banking prudential indicators are welcome, the rapid credit expansion and low provisioning, together with strong competition from loosely-regulated nonbank financial institutions, warrant enhanced supervision over the entire financial sector. Given extensive regional financial linkages and the lack of supervisory expertise, the authorities are right in considering outsourcing part of supervisory functions to a regional pool as a short-term solution. A long-term solution could be sought from the creation of a regional regulatory body in the context of ongoing regional integration initiatives.

39. **Dominica's external competitiveness remains broadly appropriate.** The real effective exchange rate is the lowest in nearly 20 years, supported by fiscal consolidation and the EC dollar depreciation against the currencies of trading partners. This, together with other indicators such as tourism cost indices and recent developments in the tourism sector,

suggests that the real exchange rate level is broadly competitive and the exchange regime, if supported by sound fiscal policy, continues to serve Dominica well.

40. **Continued progress in structural reforms is critical for private-sector led growth.** While some structural factors such as high transportation costs and the lack of economies of scale will continue to pose a challenge to the economy, the government could play an important role through structural reforms, including reforms of public entities, utilities, the judiciary and customs. This will help reduce costs of doing business and facilitate diversification away from the waning banana sector. Improvement of the management of public investment programs would also go a long way towards enhancing productivity of the private sector.

41. **While data provision for surveillance purposes is adequate, weaknesses remain in the coverage, timeliness and dissemination.** Comprehensive, reliable, and timely data are essential for policy analysis, effective policy-making and informed public debate. Ongoing economic transformation from agriculture to services makes it all the more important to improve the statistics. Priority would need to be given to compilation of national account statistics, in particular tourism, agriculture and labor statistics, and dissemination of intra-year fiscal statistics.

42. It is proposed that the next Article IV consultation with Dominica take place on the standard 12-month cycle.

Box 1. Dominica: Reform of Indirect Taxes

The move to the new indirect tax regime has been largely successful. Dominica introduced a new VAT and excise duty regime in March 2006 to replace the sales, consumption, hotel occupancy and entertainment tax. Excise taxes covered motor vehicles, alcoholic beverages, petroleum and tobacco products. Preliminary evidence suggests that the new regime boosted indirect revenues. VAT collection in the first half of 2006/07 was much higher (10.4 percent of GDP) than budgeted (8.5 percent of GDP) although the buoyancy is likely to decline somewhat in the future with the normalization of VAT refund arrangements. The VAT yield during the same period was somewhat lower than the historical yield of the replaced taxes due to weak non-oil imports in 2006.

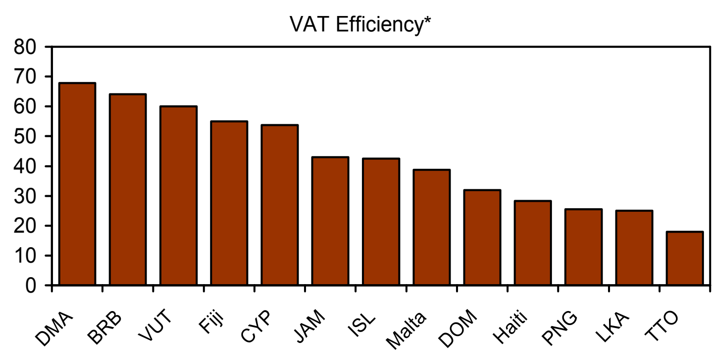
Dominica: VAT and Excises Reform

(As a percentage of GDP for the first half of a fiscal year) 1/

	FY2004/05	FY2005/06	FY2006/07
Indirect taxes 2/	10.6	11.5	11.8
Old indirect taxes 2/	10.6	11.5	-
VAT	-	-	10.4
New excises	-	-	1.4
Petroleum excise	2.4	2.2	2.7
Total	13.0	13.7	14.6

1/ First half of fiscal year covers July–December.
2/ Excludes petroleum excise.

However, challenges remain. While the VAT efficiency, measured as the VAT share in GDP divided by the standard rate, remain high relative to other small islands, the filing rate is steadily declining. There is also room for improving VAT audit and refund management. Also, experience so far indicates that the registration threshold may be too low, making the tax costly to administer.



*VAT efficiency is defined as the ratio of VAT revenues to GDP for 2002 divided by the standard rate.

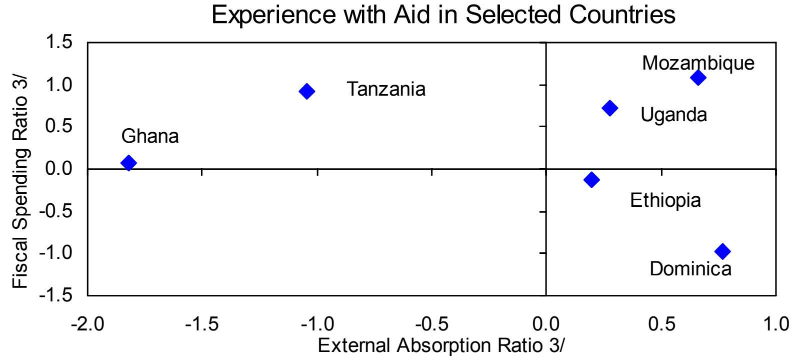
Box 2. Dominica: Managing an Aid Surge

As noted in a recent Occasional Paper,[8] a surge in aid flows, while positive in principle, presents challenges as well. Scaled-up aid flows can cause upward pressure on the real exchange rate of the recipient countries if not handled by proper macroeconomic policies. Debt sustainability could be jeopardized if the aid is volatile and come in the form of debt. Aid flows can also strain the administrative capacity of recipient governments, fragment and impair budgetary procedures, and encourage rent-seeking behavior.

Dominica's policy response to a recent aid surge helped boost private sector activity. Budgetary aid inflows rose by about 4 percent of GDP over the 2002–05 period, but as the authorities efforts led to an even larger improvement in the budget balance, the government saved more than the aid surge, reflecting the authorities' primary concern about restoring fiscal and debt sustainability. In contrast, the external current account showed little improvement during the same period as the private sector increased its absorption, almost fully offsetting the rise in public savings without raising inflation or appreciating the currency.

This pattern of response to an aid surge is uncommon among PRGF-eligible countries. Ethiopia and Ghana neither absorbed nor spent in response to an aid surge, which led to an accumulation of international reserves without raising demand pressure. Mozambique, Tanzania, and Uganda spent the incremental aid without fully absorbing it. This helped build up international reserves, yet at the risk of real exchange rate appreciation.

Experience with Aid in Selected Countries



Source: Fund staff calculations.

1/ The comparison periods are 1994–01 versus 2002–05 for Dominica, 1998–99 versus 2000–04 for Tanzania, and 1999–00 versus 2001–03 for others.

2/ Fiscal aid inflows are budgetary grants, concessional loans, and debt relief to the government. External aid flows are fiscal aid inflows and external grants to the private sector including trade preferences for banana. Net flows deduct debt services and arrears clearance from gross inflows.

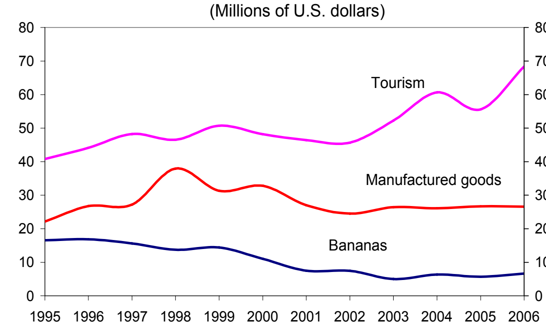
3/ The external absorption ratio measures the extent to which the non-aid current account widens in response to an increase in external aid inflows. Similarly, the fiscal spending ratio measures the extent of widening in the non-aid fiscal deficit relative to an increase in fiscal aid flows.

[8] IMF Occasional Paper No. 253.

Box 3. External Competitiveness

Dominica's export sector has been in transition since the early 1990s. The high-cost banana sector has been shrinking amid global trends of trade liberalization. Diversification to nonbanana production will likely continue as banana preferences are further eroded, although specialization in the Fair Trade niche could bring some support to the sector. Tourism is likely to maintain its expansion, supported by recent promotional efforts and new investment. In addition, the opening of a new off-shore medical school is also expected to be supportive. The future of manufacturing is more uncertain, due to structural impediments including a small domestic market and high transportation costs. The sector has potential, however, to keep a niche in regional markets for some products, given deepening trade integration in the Caribbean.

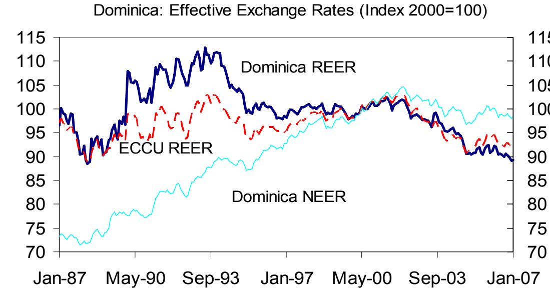
Dominica: Main exports
(Millions of U.S. dollars)



Source: Dominica authorities.

Notwithstanding the sector's diverging performances, Dominica's external competitiveness remains broadly appropriate. The tourism sector has so far been able to compensate for anemic growth in the rest of the export sector. The tourism sector has also performed well compared to other destinations in the region: (i) stay-over arrivals increased at an average annual rate of 3.7 percent during 2000–06, compared to 2.2 percent for the broader Caribbean region (World Tourism Organization); and (ii) tourism competitiveness indicators of World Travel and Tourism Council rank Dominica well compared to other Caribbean destinations. The EC dollar is broadly competitive, as in real effective terms it is nearly at a 20-year low. Its real effective rate has declined by some 14 percent since end-2000, reflecting relative domestic price stability and its depreciation against the currencies of appropriately weighted trading partners.[1/] Although Dominica's current account deficit remains high, it improved substantially in 2006 and continues to be financed mainly by capital grants and FDI.

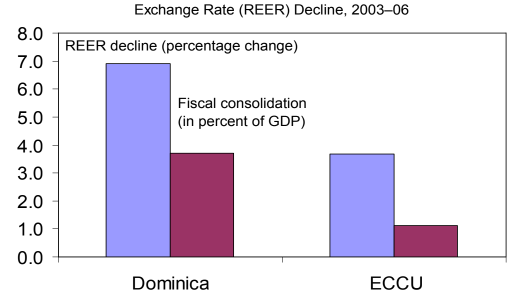
Dominica: Effective Exchange Rates (Index 2000=100)



Sources: IMF, Information Notice System; and Fund staff calculations.

Dominica's fiscal consolidation has played a role in maintaining external competitiveness. Dominica's real effective exchange rate has depreciated more than those in most of the other ECCU countries, largely reflecting fiscal consolidation in Dominica.

Fiscal Consolidation and Real Effective
Exchange Rate (REER) Decline, 2003–06



Sources: Dominica authorities; and Fund staff calculations.

1/ The weights used in these calculations are based on 1999–2001 data, and differ from those used in previous consultation reports in that they reflect, inter alia, Jamaica's increased importance as a trading partner. This change has had little impact on the real effective exchange rate, but has reduced the extent of nominal depreciation. The weights have been further adjusted to capture an ongoing structural change, and so differ from those published in IFS.

Table 1. Dominica: Selected Economic and Social Indicators

	2002	2003	2004	2005	Prog. 1/ 2006	Est. 2006	Proj. 2007	Proj. 2008
	(Annual percentage change, unless otherwise specified)							
Output and prices								
Real GDP (factor cost)	-5.1	0.1	3.0	3.3	4.1	4.0	3.2	2.8
GDP deflator (factor cost)	-0.2	0.9	2.1	1.5	1.2	1.9	1.8	1.1
Consumer prices (end of period)	0.4	2.9	0.8	2.7	2.0	1.6	1.5	1.5
Money and credit 2/								
Net foreign assets of the banking system	19.3	17.3	8.1	-8.0	5.1	17.6	4.4	-2.2
Net domestic assets of the banking system	-10.8	-16.4	-2.1	14.7	2.9	-8.0	1.6	6.4
Of which								
Net credit to the nonfinancial public sector	-5.4	-4.3	-5.1	-1.2	-2.0	-10.8	-3.5	2.5
Credit to the private sector	-1.3	-2.3	5.4	4.6	6.1	8.5	5.0	3.8
Liabilities to the private sector (M2)	8.5	1.0	5.9	6.7	8.0	9.6	6.0	4.2
Balance of payments								
Merchandise exports, f.o.b.	-1.8	-6.0	4.5	0.4	-1.0	-1.1	3.9	-17.7
Merchandise imports, f.o.b.	-11.5	9.3	14.2	14.2	0.5	0.6	1.3	3.7
Real effective exchange rate								
(end of period, depreciation -)	-3.2	-1.9	-6.0	1.9	…	-2.6	…	…
	(In millions of U.S. dollars)							
Merchandise exports, f.o.b.	43.6	41.0	42.8	43.0	42.6	42.5	44.2	36.4
Merchandise imports, f.o.b.	102.4	111.8	127.8	145.9	146.6	146.8	148.7	154.2
Current account balance	-34.7	-33.6	-46.9	-83.8	-63.9	-58.3	-53.7	-63.0
Capital and financial account balance 3/	46.9	35.0	21.2	75.5	62.7	64.9	54.2	63.1
Overall balance	12.1	1.4	-25.7	-8.3	-1.2	6.6	0.5	0.1
	(In percent of GDP, unless otherwise specified)							
Central government 4/								
Savings (incl. grants)	-0.5	8.6	7.6	10.6	11.5	12.7	9.6	10.8
Of which								
Primary savings (before grants)	0.6	5.8	7.8	8.5	5.5	6.4	5.4	5.5
Grants 5/	4.5	8.8	5.9	7.6	8.5	8.9	6.5	7.4
Capital expenditure and net lending	5.0	10.1	8.8	9.5	10.1	9.5	8.9	9.9
Primary balance 5/	-1.6	5.4	3.5	7.3	4.0	5.9	3.0	3.0
Overall balance 5/	-5.4	-1.3	-0.9	1.2	1.6	3.4	0.8	1.0
Nonfinancial public sector debt (gross) 6/								
Total	130.8	130.8	116.0	108.1	101.4	102.5	95.8	91.9
External	79.6	84.6	80.6	74.8	70.8	70.9	65.2	60.5
Domestic	51.2	46.2	35.4	33.3	30.6	31.6	30.6	31.4
External sector								
Current account balance	-13.7	-13.0	-17.3	-29.5	-21.3	-19.4	-17.0	-19.2
External public debt service 7/	11.8	19.5	20.7	17.5	13.1	13.0	9.5	11.7
Amortization	4.6	12.8	14.0	9.1	8.4	8.3	5.1	6.8
Interest	7.1	6.8	6.7	8.4	4.7	4.7	4.4	4.9
Memorandum items:								
Nominal GDP at market prices (EC$ millions)								
Calendar year	683.5	696.1	733.7	767.5	809.5	813.6	854.0	887.4
Net international reserves								
(US$ millions; end-of-period) 8/	43.6	44.0	33.6	37.6	44.2	51.9	54.5	56.6

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

1/ IMF Country Report No. 07/1, Seventh PRGF Review (November 2006).

2/ Percentage changes relative to the stock of M2 at the beginning of the period.

3/ Including errors and omissions.

4/ Figures shown for a given calendar year relate to the fiscal year (July–June) beginning on July 1 of that year.

5/ Does not include grants that were received but not spent, in line with IMF Country Report No. 05/384.

6/ For 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic.

7/ In percent of exports of goods and nonfactor services. Data are on prerestructuring terms up to 2005, and on postrestructuring terms for creditors participating in the debt restructuring and on prerestructuring terms for nonparticipating creditors .

8/ Transactions with the IMF are included as transactions of the monetary authorities.

Table 2. Dominica: Summary Accounts of the Central Government 1/

	2002/03	2003/04	2004/05	2005/06	2006/07 Prog. 2/	2006/07 Proj.	Proj. 2007/08
	(In millions of Eastern Caribbean dollars)						
Total revenue and grants	**224.1**	**285.9**	**292.0**	**325.0**	**320.1**	**346.7**	**328.6**
Current revenue	191.9	221.8	245.7	263.2	248.1	271.3	271.5
Tax revenue	167.9	193.6	213.3	239.5	227.9	248.0	250.5
Nontax revenue	23.9	28.1	32.4	23.7	20.2	23.3	21.0
Capital revenue	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Grants 3/	30.9	63.2	44.3	60.3	70.5	74.6	56.3
Total expenditure	**261.3**	**295.2**	**298.7**	**315.3**	**306.8**	**318.7**	**321.6**
Current expenditure	226.6	223.1	232.9	240.2	223.7	239.9	244.3
Wages and salaries 4/	116.1	104.2	102.0	105.3	107.1	107.9	110.0
Interest	37.6	41.7	43.9	43.0	19.8	21.2	19.2
Domestic	17.8	18.8	20.4	20.2	7.7	8.7	8.6
External	19.8	22.9	23.5	22.8	12.1	12.5	10.5
Others	72.8	77.2	87.0	91.9	96.8	110.8	115.0
Goods and services	33.7	38.1	39.0	45.7	49.3	51.7	54.0
Transfers and subsidies	39.1	39.1	48.0	46.2	47.5	59.0	61.0
Capital expenditure and net lending	34.7	72.1	65.8	75.2	83.1	78.8	77.3
Fixed investment	35.0	75.0	69.4	78.2	85.1	82.0	79.3
Net equity, net lending, and transfers	-0.3	-2.8	-3.6	-3.0	-2.0	-3.2	-2.0
Overall balance	**-37.2**	**-9.3**	**-6.6**	**9.6**	**13.3**	**28.0**	**7.0**
Statistical discrepancy 5/	-11.5	6.6	-10.6	5.1	0.0	0.0	0.0
Financing	**48.7**	**2.7**	**17.2**	**-14.8**	**-13.3**	**-28.1**	**-7.0**
Net foreign financing	44.9	47.3	25.8	9.1	0.0	-7.9	-7.8
Disbursements	47.7	78.4	26.8	7.5	12.5	5.2	6.8
Amortization	6.5	37.2	43.2	20.4	12.5	12.5	14.6
Other including rescheduling	3.8	6.1	42.3	22.0	0.0	-0.6	0.0
Net domestic financing	3.8	-44.5	-8.6	-23.9	-13.2	-20.1	0.8
Bank	-6.9	-41.4	-12.2	-16.6	-13.2	-12.4	0.8
Nonbank	10.7	-7.7	-6.6	-6.6	0.0	-5.7	0.0
Other including rescheduling	0.0	4.6	10.2	-0.7	0.0	-2.0	0.0
	(In percent of GDP)						
Total revenue and grants	**32.5**	**40.0**	**38.8**	**41.1**	**38.7**	**41.6**	**37.7**
Current revenue	27.8	31.0	32.7	33.3	30.0	32.5	31.2
Tax revenue	24.3	27.1	28.4	30.3	27.6	29.7	28.8
Nontax revenue	3.5	3.9	4.3	3.0	2.4	2.8	2.4
Capital revenue	0.2	0.1	0.3	0.2	0.2	0.1	0.1
Grants 3/	4.5	8.8	5.9	7.6	8.5	8.9	6.5
Total expenditure	**37.9**	**41.3**	**39.7**	**39.9**	**37.1**	**38.2**	**36.9**
Current expenditure	32.8	31.2	31.0	30.4	27.0	28.8	28.1
Wages and salaries 4/	16.8	14.6	13.6	13.3	12.9	12.9	12.6
Interest	5.5	5.8	5.8	5.4	2.4	2.5	2.2
Domestic	2.6	2.6	2.7	2.6	0.9	1.0	1.0
External	2.9	3.2	3.1	2.9	1.5	1.5	1.2
Others	10.6	10.8	11.6	11.6	11.7	13.3	13.2
Goods and services	4.9	5.3	5.2	5.8	6.0	6.2	6.2
Transfers and subsidies	5.7	5.5	6.4	5.8	5.7	7.1	7.0
Capital expenditure and net lending	5.0	10.1	8.8	9.5	10.1	9.5	8.9
Overall balance	**-5.4**	**-1.3**	**-0.9**	**1.2**	**1.6**	**3.4**	**0.8**
Statistical discrepancy 5/	-1.7	0.9	-1.4	0.6	0.0	0.0	0.0
Financing	**7.1**	**0.4**	**2.3**	**-1.9**	**-1.6**	**-3.4**	**-0.8**
Net foreign financing	6.5	6.6	3.4	1.2	0.0	-1.0	-0.9
Disbursements	6.9	11.0	3.6	1.0	1.5	0.6	0.8
Amortization	0.9	5.2	5.8	2.6	1.5	1.5	1.7
Other including rescheduling	0.6	0.9	5.6	2.8	0.0	-0.1	0.0
Net domestic financing	0.5	-6.2	-1.1	-3.0	-1.6	-2.4	0.1
Bank	-1.0	-5.8	-1.6	-2.1	-1.6	-1.5	0.1
Nonbank	1.6	-1.1	-0.9	-0.8	0.0	-0.7	0.0
Other including rescheduling	0.0	0.6	1.4	-0.1	0.0	-0.2	0.0
Memorandum items:							
Capital expenditure less total grants	0.6	1.7	3.3	2.3	1.8	0.9	2.6
Primary balance 6/	**-1.6**	**5.4**	**3.5**	**7.3**	**4.0**	**5.9**	**3.0**
Overall balance (excluding grants)	-9.9	-10.1	-6.8	-6.4	-6.9	-5.6	-5.7
Total grants received 7/	4.5	8.8	5.9	7.6	8.5	14.4	3.5
Primary balance (including all grants received) 6/	-1.6	5.4	3.5	7.3	4.0	11.4	0.0
Nominal GDP at market prices (EC$ million)	689.8	714.9	750.6	790.5	827.2	833.8	870.7

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

1/ Fiscal years beginning July 1.

2/ IMF Country Report No. 07/1, Seventh Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Assurances Review (November 2006).

3/ Does not include grants that were received but not spent, in line with IMF Country Report No. 05/384.

4/ 2005/06 includes a reclassification of EC$2.3 million (0.3 percent of GDP) to other expenditure, reflecting a transfer of teachers from the government payroll to that of the State College.

5/ Difference between identified financing and overall above-the-line balance .

6/ Computed using overall deficit measured from below-the-line. Reported grants exclude resources received but not spent.

7/ Historical data are subject to reconciliation with authorities.

Table 3. Dominica: Balance of Payments
(In millions of U.S. dollars)

					Prog. 1/	Est.	Projections					
	2002	2003	2004	2005	2006		2007	2008	2009	2010	2011	2012
Current account balance	**-34.7**	**-33.6**	**-46.9**	**-83.8**	**-63.9**	**-58.3**	**-53.7**	**-63.0**	**-65.2**	**-64.6**	**-64.8**	**-64.9**
Trade balance	-58.7	-70.8	-84.9	-102.9	-104.0	-104.3	-104.6	-117.8	-122.2	-126.2	-130.9	-135.5
Exports (f.o.b.)	43.6	41.0	42.8	43.0	42.6	42.5	44.2	36.4	37.8	39.2	40.7	42.4
Of which												
Bananas	8.1	5.9	7.2	6.4	7.5	7.5	7.3	7.2	7.0	6.7	6.2	6.1
Imports (f.o.b.)	102.4	111.8	127.8	145.9	146.6	146.8	148.7	154.2	160.0	165.5	171.5	177.9
Of which												
Mineral fuels 2/	9.6	12.1	14.1	19.3	24.2	22.7	23.2	25.8	26.5	26.6	27.0	27.6
Services balance	26.0	32.8	40.0	31.5	43.7	45.5	51.1	55.4	57.1	60.8	64.7	68.7
Exports of services	79.7	77.3	86.3	83.5	96.2	97.9	104.1	110.4	114.1	119.9	125.9	132.2
Travel	45.7	52.3	60.1	55.7	66.9	68.4	73.2	78.3	80.5	84.7	89.1	93.8
Other	34.0	25.0	26.2	27.8	29.2	29.5	31.0	32.2	33.6	35.2	36.8	38.4
Imports of services	53.7	44.6	46.3	52.1	52.5	52.4	53.1	55.0	57.1	59.0	61.2	63.5
Net income	-18.4	-12.1	-21.8	-33.9	-21.5	-21.6	-22.4	-23.7	-24.1	-24.4	-24.9	-25.6
Interest payments (public sector) 3/	-8.8	-8.0	-8.6	-10.7	-6.5	-6.5	-6.5	-7.2	-6.9	-6.4	-6.2	-6.0
Net current transfers	16.4	16.6	19.8	21.5	18.0	22.1	22.1	23.0	24.1	25.1	26.3	27.5
Private	12.6	12.4	18.4	19.5	18.0	21.1	22.1	23.0	24.1	25.1	26.3	27.5
Public	3.8	4.2	1.4	1.9	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial account	**32.1**	**22.4**	**22.1**	**71.0**	**62.7**	**51.2**	**54.2**	**63.1**	**63.6**	**67.7**	**68.3**	**68.4**
Capital account	20.5	18.8	26.8	20.9	25.5	42.8	27.2	17.7	26.8	33.3	34.8	36.4
Public capital transfers	17.7	15.9	23.8	17.8	22.5	39.8	24.0	14.4	23.3	29.7	31.0	32.5
Private capital transfers	2.8	2.9	3.0	3.1	3.0	3.0	3.2	3.3	3.4	3.6	3.8	3.9
Financial account	11.6	3.7	-4.7	50.2	37.2	8.4	27.0	45.4	36.8	34.4	33.5	32.0
Public sector	25.8	8.9	-0.7	-3.8	-7.1	-9.0	-5.1	-7.4	-6.8	-5.7	-3.9	-2.5
Budgetary flows (net)	25.0	8.9	-0.7	-3.8	-7.1	-9.0	-5.1	-7.4	-6.8	-5.7	-3.9	-2.5
Disbursements	30.7	24.0	17.4	7.8	4.5	2.6	2.5	2.5	5.5	5.6	5.8	5.9
Repayments 3/	5.7	15.1	18.1	11.5	11.7	11.7	7.6	9.9	12.3	11.3	9.7	8.4
Nonbudgetary flows (net)	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	-14.1	-5.2	-4.0	53.9	44.3	17.4	32.1	52.9	43.6	40.1	37.5	34.6
Direct investment	11.4	19.8	18.1	18.0	24.0	24.1	25.3	26.3	27.5	28.7	30.0	31.4
Commercial banks	-24.1	-33.9	-26.9	21.4	-5.4	-26.6	-8.6	8.8	-0.2	0.0	0.0	0.0
Other private flows	-1.5	8.8	4.8	14.5	25.7	19.9	15.3	17.8	16.3	11.4	7.4	3.2
Errors and omissions	**14.7**	**12.5**	**-0.9**	**4.5**	**0.0**	**13.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**12.1**	**1.4**	**-25.7**	**-8.3**	**-1.2**	**6.6**	**0.5**	**0.1**	**-1.6**	**3.1**	**3.5**	**3.6**
Overall financing	**-12.1**	**-1.4**	**25.7**	**8.3**	**1.2**	**-6.6**	**-0.5**	**-0.1**	**1.6**	**-3.1**	**-3.5**	**-3.6**
Net international reserves	-12.1	-1.4	10.3	-4.0	-6.6	-14.3	-2.6	-2.1	-2.6	-2.7	-2.8	-2.9
Gross reserves (increase = -)	-15.1	-6.2	9.4	-7.2	-8.3	-16.1	-0.1	-2.1	-1.8	-1.6	-1.0	-0.6
IMF reserve liabilities (purchase = +)	3.0	4.8	0.9	3.2	1.8	1.8	-2.5	0.0	-0.8	-1.1	-1.8	-2.3
Exceptional financing	0.0	0.0	15.4	12.3	7.7	7.7	2.1	2.0	4.1	-0.4	-0.7	-0.6
Memorandum items:												
Current account balance	-13.7	-13.0	-17.3	-29.5	-21.3	-19.4	-17.0	-19.2	-19.0	-18.1	-17.4	-16.7
Current account balance including												
net capital transfers	-5.6	-5.7	-7.4	-22.2	-12.8	-5.2	-8.4	-13.8	-11.2	-8.8	-8.1	-7.3
External public debt service (as a percent of exports of goods and nonfactor services)												
External public debt service ratio 4/	11.8	19.5	20.7	17.5	13.1	13.0	9.5	11.7	12.6	11.1	9.5	8.3
Amortization	4.6	12.8	14.0	9.1	8.4	8.3	5.1	6.8	8.1	7.1	5.8	4.8
Interest	7.1	6.8	6.7	8.4	4.7	4.7	4.4	4.9	4.5	4.0	3.7	3.4
External public debt	79.6	84.6	80.6	74.8	70.8	70.9	65.2	60.5	56.3	51.4	46.9	43.0

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

1/ IMF Country Report No. 07/1, Seventh Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Financing Assurances Review (November 2006).

2/ Projections based on WEO's baseline oil prices projections of February 2007.

3/ Data are on prerestructuring terms up to 2005, and on postrestructuring terms for creditors participating in the debt restructuring and on prerestructuring terms for nonparticipating creditors.

4/ As a percent of exports of goods and services. For 2005 it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic.

Table 4. Dominica: Summary Accounts of the Banking System

					Prog. 1/	Est.	Proj.	
	2002	2003	2004	2005	2006	2006	2007	2008
(In millions of Eastern Caribbean dollars, end of period)								
I. Consolidated Banking System and Monetary Authorities								
Net foreign assets	**193.8**	**289.0**	**333.7**	**286.8**	**319.0**	**397.2**	**427.8**	**411.7**
Net domestic assets	**355.4**	**265.5**	**253.6**	**340.2**	**358.1**	**290.0**	**300.8**	**347.3**
Net credit to the nonfinancial public sector	74.8	51.1	23.0	15.8	14.0	-51.6	-75.8	-57.3
Of which								
Central government	64.2	55.9	45.6	67.3	52.6	10.7	-10.4	10.7
Net credit to nonbank financial institutions	-46.6	-81.8	-75.9	-59.9	-62.5	-68.6	-67.9	-67.7
Credit to the private sector	433.2	420.6	450.7	477.8	516.1	531.2	565.6	593.3
Other items (net) 2/	-106.1	-124.5	-144.2	-93.6	-109.4	-121.0	-121.0	-121.0
Broad money 3/	**549.2**	**554.5**	**587.4**	**627.0**	**677.1**	**687.2**	**728.6**	**759.0**
II. Operations of the Monetary Authorities								
Imputed net international reserves	**117.8**	**118.7**	**90.8**	**101.5**	**119.3**	**140.2**	**147.1**	**152.9**
Net domestic assets	**12.1**	**7.0**	**26.0**	**20.8**	**15.4**	**7.7**	**6.7**	**4.0**
Monetary base	**129.9**	**125.7**	**116.8**	**122.3**	**134.6**	**147.9**	**153.8**	**156.9**
Currency in circulation	35.5	34.2	37.6	39.0	42.4	45.4	48.2	50.2
Commercial bank reserves	94.4	91.5	79.2	83.4	92.2	102.5	105.6	106.7
III. Commercial Banks								
Net foreign assets	**79.0**	**170.4**	**242.9**	**185.3**	**199.8**	**257.1**	**280.7**	**258.8**
Net claims on ECCB	**98.2**	**85.6**	**73.8**	**77.7**	**85.9**	**99.9**	**98.4**	**99.4**
Net domestic assets	**336.6**	**264.3**	**233.1**	**325.1**	**349.0**	**284.8**	**301.3**	**350.6**
Net credit to the nonfinancial public sector	53.4	26.3	-10.8	-23.5	-20.8	-85.6	-111.0	-89.9
Net credit to nonbank financial institutions	-46.6	-81.8	-75.9	-59.9	-62.5	-68.6	-67.9	-67.7
Credit to the private sector	433.2	420.6	450.7	477.8	516.1	531.2	565.6	593.3
Other (net)	-103.5	-100.7	-130.9	-69.4	-83.7	-92.3	-85.4	-85.2
Private sector deposits 3/	**513.7**	**520.3**	**549.8**	**588.0**	**634.7**	**641.7**	**680.4**	**708.8**
IV. Consolidated Banking System								
(Annual percentage change)								
Credit to the private sector	-1.4	-2.9	7.1	6.0	8.0	11.2	6.5	4.9
Private sector deposits	7.6	1.3	5.7	7.0	7.9	9.1	6.0	4.2
Broad money	8.5	1.0	5.9	6.7	8.0	9.6	6.0	4.2
(Contributions to liquidity growth) 4/								
Net foreign assets	**19.3**	**17.3**	**8.1**	**-8.0**	**5.1**	**17.6**	**4.4**	**-2.2**
Net domestic assets	**-10.8**	**-16.4**	**-2.1**	**14.7**	**2.9**	**-8.0**	**1.6**	**6.4**
Net credit to the nonfinancial public sector	-5.4	-4.3	-5.1	-1.2	-2.0	-10.8	-3.5	2.5
Net credit to nonbank financial institutions	-1.8	-6.4	1.1	3.0	-0.4	-0.9	0.1	0.0
Credit to the private sector	-1.3	-2.3	5.4	4.6	6.1	8.5	5.0	3.8
Other items (net)								
Memorandum items:								
Interest rates 5/								
Time deposit rate	5.6	6.0	4.7	4.8	5.1	5.1	…	…
Weighted average lending rate	...	11.9	9.8	10.0	9.2	9.2	…	…

Sources: ECCB; and Fund staff estimates and projections.

1/Program figures as shown in the Seventh Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Financing Assurances Review (November 2006). Transactions with the IMF are included as transacations with the monetary authorities.

2/ Includes interbank float.

3/ Including deposits denominated in U.S. dollars.

4/ Percentage changes relative to broad money at the beginning of the period.

5/ Commercial banks; end-of-period rates for local currency, percent per annum.

Table 5. Dominica: Medium-Term Macroeconomic Framework

	2002	2003	2004	2005	2006 Prog. 1/	2006 Est.	2007	2008	2009	2010	2011	2012
							Projections					
(Annual percent change)												
National income and prices												
GDP at constant (1990) prices	-5.1	0.1	3.0	3.3	4.1	4.0	3.2	2.8	3.2	2.8	3.0	3.0
Implicit GDP deflator (factor cost)	-0.2	0.9	2.1	1.5	1.2	1.9	1.8	1.1	1.8	1.1	1.5	1.5
(In percent of GDP, unless otherwise specified)												
Savings and investment												
Gross domestic investment	**20.8**	**25.5**	**28.6**	**30.1**	**26.6**	**27.0**	**27.2**	**27.0**	**27.5**	**27.5**	**27.5**	**27.5**
Public	7.5	9.4	12.0	11.4	10.6	11.1	10.5	10.6	11.3	11.4	11.4	11.4
Of which												
Central government	5.5	7.8	9.9	9.6	10.4	9.9	9.5	9.6	10.3	10.4	10.4	10.4
Of which												
Other public sector	1.9	1.6	2.2	1.8	0.3	1.2	1.0	1.0	1.0	1.0	1.0	1.0
Private	13.4	16.1	16.6	18.8	16.0	15.9	16.7	16.4	16.2	16.1	16.1	16.1
Gross national saving 2/	**15.2**	**19.7**	**21.2**	**8.0**	**13.8**	**21.8**	**18.8**	**13.2**	**16.3**	**18.7**	**19.4**	**20.2**
Public	0.0	5.9	10.7	11.5	10.2	13.4	12.6	11.5	12.3	12.5	12.7	12.8
Of which												
Central government	-1.4	4.4	8.8	9.7	9.9	12.2	11.6	10.5	11.3	11.5	11.7	11.8
Of which												
Other public sector	1.4	1.5	2.0	1.8	0.3	1.2	1.0	1.0	1.0	1.0	1.0	1.0
Private	15.2	13.8	10.5	-3.6	3.6	8.5	6.3	1.7	4.0	6.2	6.8	7.4
Savings-investment balance	**-5.6**	**-5.7**	**-7.4**	**-22.2**	**-12.8**	**-5.2**	**-8.4**	**-13.8**	**-11.2**	**-8.8**	**-8.1**	**-7.3**
Public savings investment	-7.4	-3.4	-1.3	0.2	-0.4	2.3	2.1	0.9	1.0	1.2	1.3	1.4
Private savings investment	1.8	-2.3	-6.1	-22.3	-12.4	-7.4	-10.5	-14.7	-12.2	-10.0	-9.4	-8.8
Central government finances 3/												
Current revenue	27.8	31.0	32.7	33.3	30.0	32.5	31.2	30.9	30.8	30.7	30.7	30.7
Capital revenue	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Current expenditure	32.8	31.2	31.0	30.4	27.0	28.8	28.1	27.6	27.9	27.7	27.5	27.4
Overall balance (incl. grants) 4/	-5.4	-1.3	-0.9	1.2	1.6	3.4	0.8	1.0	1.1	1.2	1.4	1.5
Grants	4.5	8.8	5.9	7.6	8.5	8.9	6.5	7.4	8.3	8.3	8.3	8.3
Capital spending	5.1	10.5	9.3	9.9	10.3	9.8	9.1	10.2	10.4	10.4	10.4	10.4
Primary balance	-1.6	5.4	3.5	7.3	4.0	5.9	3.0	3.0	3.0	3.0	3.0	3.0
Memorandum items:												
Nonfinancial public sector debt 5/	130.8	130.8	116.0	108.1	101.4	102.5	95.8	91.9	87.5	83.2	79.2	75.2
External	79.6	84.6	80.6	74.8	70.8	70.9	65.2	60.5	56.3	51.4	46.9	43.0
Domestic	51.2	46.2	35.4	33.3	30.6	31.6	30.6	31.4	31.2	31.9	32.2	32.3

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

1/ Program figures as shown in the Seventh Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Financing Assurances Review (November 2006).

2/ Calculated using the external current account including net external capital transfers.

3/ Calculated on a fiscal year basis, with the figure shown relating to the fiscal year beginning in July.

4/ Does not include grants that were received but not spent, in line with IMF Country Report No. 05/384.

5/ For 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic.

Table 6. Dominica: Financial and External Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	Est. 2006
Financial indicators						
Broad money (percent change, 12-month basis)	7.4	8.5	1.0	5.9	6.7	9.6
Private sector credit (percent change, 12-month basis)	-3.2	-1.4	-2.9	7.1	6.0	11.2
Unsatisfactory assets/total loans	22.6	19.2	21.7	22.5	22.0	9.3
Provision for loan losses/total loans	6.8	7.0	7.6	7.3	5.9	2.4
Total capital/risk weighted assets (locally incorporated banks)	35.4	34.1	28.7	23.5	26.2	21.7
Tier 1 capital/risk weighted assets (locally incorporated banks)	34.1	32.9	28.1	23.0	25.8	18.9
Net profit before taxes/average assets	3.0	1.3	1.4	1.2	1.2	1.5
Three-month treasury bill rate (end of period)	6.4	6.4	6.4	6.4	6.4	6.4
Three-month treasury bill rate (real) 1/	6.4	6.4	6.4	6.4	6.4	6.4
External indicators						
Exports of goods and nonfactor services (percent change, 12-month basis in U.S. dollars)	-16.9	2.7	-4.0	9.2	-2.0	9.6
Imports of goods and nonfactor services (percent change, 12-month basis in U.S. dollars)	-9.5	-5.8	0.2	11.3	13.7	0.6
Current account balance	-18.7	-13.7	-13.0	-17.3	-29.5	-19.4
Capital and financial account balance 2/	19.2	18.5	13.6	7.8	26.6	20.9
Net official reserves (in millions of U.S. dollars, end of period) 3/	30.4	43.6	44.0	33.6	37.6	51.9
Net official reserves to broad money (percent, end of period) 3/	16.2	21.4	21.4	15.5	16.2	20.4
Net official reserves to imports of goods and services (percent, end of period)	18.3	28.0	28.1	19.3	19.0	26.1
Net official reserves to short-term external debt (percent, end of period) 4/	533.5	288.9	242.8	291.4	322.6	685.2
Public sector external debt	67.5	79.6	84.6	80.6	74.8	70.9
External debt (end of period) to exports of goods and nonfactor services (percent) 5/	147.1	163.4	184.2	169.5	168.0	153.2
External interest payments to exports of goods and nonfactor services (percent) 5/	6.4	7.1	6.8	6.7	8.4	4.7
External amortization payments to exports of goods and nonfactor services (percent) 5/	4.5	4.6	12.8	14.0	9.1	8.3
Exchange rate (per U.S. dollar, end of period)	2.7	2.7	2.7	2.7	2.7	2.7
REER appreciation (end of period; depreciation -)	0.8	-3.2	-1.9	-6.0	1.9	-2.6

Sources: ECCB; and Fund staff estimates and projections.

1/ Treasury bill rate adjusted by end-of-period inflation.
2/ Includes errors and omissions.
3/ Imputed reserves at the ECCB until 2001. From 2002, transactions with the IMF are included as transactions of the monetary authorities.
4/ Debt at remaining maturity basis.
5/ Refers to public sector debt.

Table 7. Dominica: Millennium Development Goals 1/2/

	1990	1994	1997	2000	2003	2004	2005
Goal 1: Eradicate extreme poverty and hunger							
Percentage share of income or consumption held by poorest 20 percent	...	...	...	...	...	...	...
Population below $1 a day (percent)	...	...	...	...	...	...	...
Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...	...	...
Poverty gap ratio at $1 a day (incidence x depth of poverty)	...	...	...	...	...	...	...
Poverty headcount, national (percent of population)	...	...	...	...	...	...	...
Prevalence of underweight in children (under five years of age)	...	...	...	...	...	...	...
Goal 2: Achieve universal primary education							
Net primary enrollment ratio (percent of relevant age group)	...	...	*83*	95	93	88	...
Primary completion rate, total (percent of relevant age group)	...	...	*93*	94	103	107	...
Percentage of cohort reaching grade 5 (percent)	75	...	...	86	84	...	...
Youth literacy rate (percent ages 15–24)	...	...	...	...	...	...	...
Goal 3: Promote gender equality and empower women							
Proportion of seats held by women in national parliament (percent)	10	...	9	9	19	19	13
Ratio of girls to boys in primary and secondary education (percent)	...	...	*103*	103	101	99	...
Ratio of young literate females to males (percent ages 15–24)	...	...	...	...	...	...	...
Share of women employed in the nonagricultural sector (percent)	...	...	47	...	...	...	...
Goal 4: Reduce child mortality							
Immunization, measles (percent of children ages 12–23 months)	88	99	99	99	99	99	...
Infant mortality rate (per 1,000 live births)	15	*14*	...	13	...	13	...
Under 5 mortality rate (per 1,000)	17	*15*	...	14	...	14	...
Goal 5: Improve maternal health							
Births attended by skilled health staff (percent of total)	...	...	...	*100*	100	...	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	...	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases							
Contraceptive prevalence rate (percent of women ages 15–49)	...	...	*50*	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	19	18	17	17	16	15	
Number of children orphaned by HIV/AIDS	...	...	...	...	...	...	...
Prevalence of HIV, total (percent of population aged 15–49)	...	...	...	...	...	...	...
Tuberculosis cases detected under DOTS (percent)	...	...	84	...	*36*	...	...
Goal 7: Ensure environmental sustainability							
Access to an improved water source (percent of population)	...	...	...	...	97	97	...
Access to improved sanitation (percent of population)	...	...	...	...	83	84	...
Access to secure tenure (percent of population)	...	...	...	...	...	...	...
CO_2 emissions (metric tons per capita)	1	1	1	1	2	...	...
Forest area (percent of total land area)	67	...	...	63	...	61	...
GDP per unit of energy use (2000 PPP $ per kg oil equivalent)	...	...	...	...	...	...	...
Nationally protected areas (percent of total land area)	...	...	...	...	...	...	...
Goal 8: Develop a global partnership for development							
Aid per capita (current US$)	272.8	237.2	202.2	213.5	153.5	409.0	...
Debt service (percent of exports)	6.0	7.0	8.0	7.0	9.0	...	...
Fixed line and mobile phone subscribers (per 1,000 people)	161.0	231.0	274.0	335.0	612.0	879	...
Internet users (per 1,000 people)	...	5.1	28.0	84.0	239.0	259	...
Personal computers (per 1,000 people)	...	...	...	77.0	112.0	126	...
Unemployment, youth female (percent of female labor force ages 15–24)	...	...	46.3	...	...	...	...
Unemployment, youth male (percent of male labor force ages 15–24)	...	...	36.4	...	...	...	...
Unemployment, youth total (percent of total labor force ages 15–24)	...	...	40.6	...	...	...	...

Source: World Development Indicators database, September 2006.

1/ The goals, targets, and relevant indicators to assess progress over the period from 1990 to 2015 when targets are expected to be met, are explained in http://millenniumindicators.un.org/unsd/mi/mi_goals.asp and http://ddp-ext.worldbank.org/ext/MDG/home.do

2/ Figures in italics refer to periods other than those specified.

INTERNATIONAL MONETARY FUND

DOMINICA

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

July 2, 2007

Contents Page

Appendices
I. Fund Relations 2
II. World Bank Relations 4
III. Relations with the Caribbean Development Bank (CDB) 7
IV. Statistical Issues 8

Appendix I. Dominica: Fund Relations

(As of April 30, 2007)

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	9.24	112.71
Reserve position in Fund	0.01	0.11

III. SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	0.59	100.00
Holdings	0.07	11.10

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
PRGF Arrangements	7.69	93.76
Stand-By Arrangements	1.05	12.81

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	7.69
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

Projected Payments to the Fund on an Obligation Basis (SDR Million)[1]:

	Forthcoming				
	2007	**2008**	**2009**	**2010**	**2011**
Principal	0.82	0.23	0.50	0.72	1.07
Charges/Interest	0.09	0.07	0.06	0.06	0.05
Total	**0.91**	**0.30**	**0.56**	**0.78**	**1.13**

[1] Based on existing use of resources and present holdings of SDRs.

VI. **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.

VII. **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. A safeguards assessment was completed in 2003, and concluded that the ECCB had in place appropriate mechanisms to manage resources, including Fund disbursements and that the vulnerabilities that remained do not present an undue risk. The safeguards assessment proposed specific measures to address these vulnerabilities, which have been substantially implemented by the ECCB. An update safeguards assessment is currently being completed. The update assessment has not noted any new significant vulnerabilities

VIII. **Article IV consultation**: The last Article IV consultation was concluded by the Executive Board on October 25, 2005; the relevant documents are IMF Country Report No. 05/384 and IMF Country Report No. 05/383. Dominica is on a 24-month cycle.

IX. **Technical assistance:** In January 2007 an **FAD** and **Caribbean Regional Technical Assistance Center (CARTAC)** mission provided technical assistance on revenue administration and tax policy. In 2006, an **MCM mission** provided technical assistance in drafting an action plan for AID Bank. In 2005, an **MCM mission** provided technical assistance in strengthening the supervisory framework for AML/CFT in the nonbank sector. **FAD missions** have provided technical assistance on tax policy and administration, and social security reform. The most recent missions include: pension reform options (2005); TA on fiscal responsibility laws (2004); VAT implementation (1999); urban property taxation (1997); and tax policy and administration, and expenditure control (1995). Technical assistance from MFD and FAD has complemented the assistance that has been provided by the **CARTAC** in Barbados. **LEG** has been providing assistance with the drafting and interpretation of the VAT legislation.

X. **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. A detailed assessment of the AML/CFT regimes of Dominica was conducted in September 2003 by the Caribbean Financial Action Task Force (CFATF). The Financial System Stability Assessment (FSSA) was discussed by the Executive Board on May 5, 2004, and subsequently published on the IMF's external website, including the Report on the Observance of Standards and Codes (ROSC) on Banking Supervision.

Appendix II. Dominica: World Bank Relations[2]

(As of May 31, 2007)

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 the implementation of the Government's Growth and Social Protection Strategy. The Bank will lead the policy dialogue on key structural reforms, including public sector reform, regulatory framework for electricity, 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 technical assistance to Dominica on macroeconomic management issues jointly with the Caribbean Regional Technical Assistance Center (CARTAC).

Bank Group strategy: The World Bank's Management presented to its Board the Eastern Caribbean Sub-Region Country Assistance Strategy (CAS), on September 13, 2005. The World Bank Group's strategy for the four years covered by this CAS (FY2006–09) supports the sub-region's development agenda through two main pillars: (1) stimulating growth and improving competitiveness; and (2) reducing vulnerability, by promoting greater social inclusion and strengthening disaster risk management. Recognizing the OECS countries' high debt ratios, Bank activities will focus on leveraging available donor grant financing. Following the recommendations of the recently completed growth and competitiveness study for the OECS, IBRD and IDA support would focus on providing technical and financial assistance for interventions to support the two main pillars. An indicative Base Case lending scenario consists of about US$51.3 million in IDA resources for the four OECS blend countries (Dominica, Grenada, St. Lucia and St. Vincent and the Grenadines). This envelope includes the estimated IDA country allocations for each of the four countries during FY2006–09, and an IDA Regional allocation of US$15.2 million for two regional projects: US$14 million for Catastrophe Risk Insurance and US$3.2 million for Infrastructure and Utilities Reform. Planned lending to Dominica amounts to US$10.2 million under the Base Case lending scenario.

Ongoing projects: There are currently three ongoing World Bank project in Dominica:

(i) The *OECS Telecommunications and ICT Development Project:* The Telecommunications and ICT Development Project (approved in September 2005) aims at improving the access, quality, and use of telecommunications and ICT services to achieve socio-economic development in the Organization of Eastern Caribbean States (OECS). The project has the following four components: Component (1) will strengthen the national and regional regulatory frameworks and

[2] Source: World Bank.

promote additional competition in the telecommunications sector. Emphasis will be given to capacity building of Eastern Caribbean Telecommunications Authority (ECTEL) and the National Telecommunications Regulatory Commissions (NTRCs) by providing them with assistances to revise the regional and national sector legislation, and develop a modem interconnection regime; Component (2) will review current universal access policy, create related guidelines, and provide financial support to establish a Universal Service Fund (USF); Component (3) will improve growth and competitiveness in ICT-enabled services through utilization of broadband infrastructure; and Component (4) will ensure management and administration of the overall project. The project will finance related technical assistance by providing complementary resources. Dominica's share of the US$2.7 million loan is US$0.54 million.

(ii) *OECS Catastrophe Insurance Project:* The Caribbean Catastrophe Risk Insurance Facility (CCRIF) was approved in January, 2007. This is the world's first ever multi-country catastrophe insurance pool. The bank has approved a US$4.5 million IDA credit for Dominica to finance their contribution to the fund over three years. The Facility will enable governments to purchase catastrophe insurance coverage against adverse natural events, such as a major earthquake or hurricane. The CCRIF allows participating countries to pool their country-specific risks into one, better-diversified portfolio, resulting in a substantial reduction in the premium cost of 45–50 percent.

(iii) *Growth and Social Protection Technical Assistance Project:* The objectives of the project are to enhance the capacity of the public sector to implement focused reforms geared at improving the public sector delivery of services as well as creating the institutional and policy framework to facilitate private sector-led growth. In addition, the proposed financing will also support the strengthening of government's capacity to plan and administer its social protection programs to ensure that the benefits from growth are equitably distributed for poverty reduction. The project has the following five components: Component (1) will focus on making the public sector more efficient and effective through support to implement the government's public sector modernization strategy; Component (2) will target improvement of the investment climate through the strengthening of the institutional and regulatory framework for attracting investment into Dominica; Component (3) will focus on reforming the regulatory framework for the energy sector and support the creation of a framework for the development of alternative sources of energy; Component (4) addresses the improvement of the existing social safety net programs; Component (5) deals with the management of the overall project. The total project cost is US$2.6 million, of which the World Bank is providing US$1.45 million and the EU is providing US$0.58 million of grant financing.

Economic and Sector Work: The Bank has completed a series of analytical work relating to: public sector capacity in the OECS including the Institutional and Organizational Capacity Review, the OECS Procurement Assessment Review, the OECS Financial Accountability Assessment and an Infrastructure Services Studies. In conjunction with the IMF, a Financial Sector Assessment Program (FSAP) was completed in early 2004. The Bank also recently completed an OECS study on Growth and Competitiveness. Work is ongoing on a review of large-scale energy options for the OECS, under the Energy Sector Management Assistance Program. The Bank also recently completed a Caribbean Air Transport Rationalization report. For Dominica specifically the Bank recently completed an Analysis of Fiscal Issues, which examines the management and allocation of public expenditure.

Dominica will also benefit from ongoing and planned analytical and advisory activities to support the new CAS' two main pillars including the following activities: A Caribbean Skills and Curriculum Study, Caribbean Financial Sector and Regulation report, OECS Private Sector Financing Study, Caribbean Social Protection Strategy Review, a regional study on Crime and Violence.

Financial Relations: Gross Disbursements and Debt Service During Fiscal Year

(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006	2007
Total disbursements	2.1	0.5	1.7	2.7	4.3	1.7	0.0	1.2
Repayments	0.1	0.1	0.1	0.3	0.6	0.7	0.8	1.0
Net disbursements	1.9	0.4	0.6	2.3	3.7	1	-0.8	0.2
Cancelled	0	0	1	2.3	0	0	0	0
Interest and fees	0.2	0.3	0.3	0.3	0.4	0.4	0.38	0.3

Data as of May 31, 2007.

Appendix III. Dominica: Relations with the Caribbean Development Bank (CDB)

(As February 28, 2007)

As at end-February 2007, CDB had approved loans totalling US$148.9 million of which US$10.2 million are undisbursed. CDB operations continue to centre on implementing critical infrastructure projects in the road subsector, as well as projects designed to boost tourism activity and build IT related capacity in the public sector. No new projects were approved in 2006.

Major projects under implementation include:

1. ***Seventh Consolidated Line of Credit***—to assist DAIDB in continuing to finance its lending program in the following areas: Agricultural and Industrial Credit, Housing and Student Loans. US$7.0 million is approved and US$1.5 million is undisbursed.

2. ***Upgrading of Ecotourism Sites***—the construction of access roads and reception centres, related infrastructure as well as site trails at five major tourism sites across the island. US$3.1 million is approved and US$0.6 million is undisbursed

3. ***Student Loan Scheme (Seventh Loan)***—to provide DAIDB with resources to continue financing its student loan programme. US$7.0 million is approved and US$2.3 million is undisbursed.

4. ***Shelter Development Project***—to establish a framework for developing the shelter sector on a sustainable basis with particular reference to low-income households. US$2.3 million is approved and US$1.6 million is undisbursed.

5. ***Road improvement Project***—to improve safety, decrease vehicular operating costs and improve access to tourism sites. US$5.5 million is approved with no disbursements made to date.

Dominica: Loan Disbursement

(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006
Net disbursement	10.50	3.66	8.46	10.39	3.99	0.91
Disbursement	13.20	6.25	11.26	20.61	6.34	2.14
Amortization	2.70	2.59	2.80	10.22	2.35	1.23
Interest and charges	1.76	1.90	2.03	2.25	2.44	1.54
Net resource flow	8.74	1.76	6.43	8.14	1.55	-0.63

Appendix IV. Dominica: Statistical Issues

While data provision for surveillance purposes is adequate, certain areas need to be improved. There are weaknesses in coverage, accuracy, frequency, and timeliness that continue to hamper effective economic analysis and policy formulation. Priority should need to be given to compilation and dissemination of national accounts, in particular tourism, agriculture and labor statistics. Despite progress significant weaknesses remain in the compilation of fiscal accounts, and the balance of payments.

Dominica participates in the General Data Dissemination System. However the metadata for national accounts, external sector and government finance statistics have not been updated since December 2002.

Real sector

Annual nominal GDP data are compiled using the production and the expenditure approaches. Estimates by economic activity are compiled using production approach at 1990 prices. GDP estimates are available about four months after the end of the year. The data are revised frequently and are usually finalized with a two-year lag following completion of the National Accounts Survey. There is a program to improve national accounts data primarily through the development of the supply and use table (SUT). A CARTAC mission is scheduled in July 2007 to examine GDP compilation. In late 2007 the authorities intend to undertake a comprehensive assessment of the GDP methodology and data, with the assistance of the ECCB. CPI data are compiled with a two-month lag. The weights are based on the 1997/1998 Household Expenditure Survey. There is a program to develop export and import price indices (XMPIs), but a shortage of staff working on price statistics limits developments in CPI methodology and the likelihood that XMPIs will be developed in the near future. Data on employment are limited and there are no official data on producer prices or wages in the private sector. Results of the 2001 population census have not yet been published.

Government finance

Statistical capacity problems affect the timely production of quality government finance statistics. In particular, the data are subject to frequent revisions stemming in part from omissions and misclassifications. Data on central government operations are incomplete and must be supplemented with additional information from external sources. For instance, some operations are undertaken outside the consolidated fund. These include certain investment spending, loan and grant receipts, and on-lending and transfers to public enterprises. As a result, capital expenditure data, recorded by the Treasury, must be supplemented with additional donor financing information, particularly because the public sector investment program (PSIP) data are not timely. Delays in the reporting of the PSIP data reportedly stem from reporting delays from the line ministries.

Several ongoing initiatives to strengthen expenditure management, should help minimize the extent of this problem. There is an ongoing effort to automate the expenditure execution process. A new automation technology was installed in all line ministries in 2005. With this technology all local purchase orders (LPOs) are generated electronically and tracked. Commitments are charged against a specific budget allocation once the LPOs are generated. All ministries and suppliers of goods and services are compelled to use the new system.

Only limited financing data are available. Although 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.

The authorities do not provide consolidated nonfinancial public sector data. 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.

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

Monetary statistics

Monetary statistics are compiled and reported to the Fund by the ECCB on a monthly basis based on a standardized report form since July 2006. The institutional coverage of monetary statistics needs to be improved by including the accounts of mortgage companies, building societies, credit unions, and insurance companies. In this respect, close coordination between the ECCB and the single regulatory unit (which supervises financial corporations other than those licensed under the Banking Act) is crucial.

Balance of payments

Balance of payments data are compiled by the ECCB on an annual basis but are not reported in the format recommended in the fifth edition of the IMF's Balance of Payments Manual. Data reported to STA are becoming more timely, but still suffer from relatively numerous and volatile errors and omissions.

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. Data from the two databases are not consolidated, requiring further adjustments to measure total debt stock. In addition, information on payments by creditor (actual and scheduled) should be available to the compilation agencies at least on a monthly basis, in order to produce timely debt stock data.

Dominica: Table of Common Indicators Required for Surveillance

(As of June 6, 2007)

	Date of latest observation	Date received [7]	Frequency of Data [7]	Frequency of Reporting [7]	Frequency of Publication [7]
Exchange Rates[1]	Fixed Rate	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1, 2]	March 2007	4/22/07	M	M	Q
Reserve/Base Money	March 2007	4/22/07	M	M	Q
Broad Money	March 2007	4/22/07	M	M	Q
Central Bank Balance Sheet	March 2007	45/22/07	M	M	Q
Consolidated Balance Sheet of the Banking System	March 2007	4/22/07	M	M	Q
Interest Rates[3]	March 2007	4/22/07	Q	Q	Q
Consumer Price Index	March 2007	4/22/07	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	2006	05/8/07	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	April 2007	5/22/07	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[6]	March 2007	5/07/07	M	M	A
External Current Account Balance	2005	10/13/06	A	A	A
Exports and Imports of Goods and Services	March 2007	5/07/07	M	Q	A
GDP/GNP	2006	05/02/07	A	A	A
Gross External Debt	March 2007	5/7/07	M	M	A

[1] Dominica is a member of the Eastern Caribbean Currency Union, in which the common currency of all member states (E.C. dollar) is pegged to the U.S. dollar at US$1=EC$2.70.
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government and state and local governments.
[6] Currency and maturity composition are provided annually.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA); Not applicable (n.a).

INTERNATIONAL MONETARY FUND

DOMINICA

Debt Sustainability Analysis

Prepared by the staff of the International Monetary Fund

In consultation with World Bank Staff

July 2, 2007

This debt sustainability analysis (DSA) assesses the sustainability of Dominica's public and external debt. The analysis shows that Dominica has improved its debt sustainability outlook since the last Article IV consultation, primarily due to stronger than expected fiscal performance and output growth, the initiation of a reform to the pension system, and the recent participation in the Caribbean Catastrophe Insurance Facility—a regional insurance pool organized by the World Bank. The outlook still presents, nevertheless, large risks, as Dominica's debt remains high and the country is exposed to potentially large shocks (including volatility of aid flows, natural disasters, among others).

I. Introduction

1. After a restructuring of its public sector debt, a strong fiscal turnaround, and a rebound of economic activity, Dominica has been able to improve its debt sustainability outlook. The debt restructuring that started in 2004, jointly with donors help, allowed a reduction in debt's face value and improved the terms of a large portion of the existing debt. The central government primary balance, which had been in deficit since 1997, has exhibited sound surpluses in the last three years in the context of a PRGF program (concluded in December 2006). Growth rebounded under program and the government has started the implementation of the Growth and Social Protection Strategy (GSPS), which constitutes a comprehensive strategy to foster private sector-led growth and reduce poverty while maintaining prudent fiscal policy.

II. Underlying DSA Assumptions

2. Staff has prepared a baseline scenario whose main parameters are consistent with the authorities projections under the GSPS, and with staff projections and assumptions in the 2005 Article IV consultation DSA.

Box 1. Baseline Macroeconomic Assumptions (2007–27)

- Real GDP growth is projected at 3 percent (as in GSPS and 2005 Article IV DSA). While this assumption implies a rate of growth higher than the average observed in the 1990s (2 percent), it seems consistent with the stronger growth observed in the period 2004–06, with the reforms envisaged, and with the projected international environment (see Box 2). Inflation is projected to remain low (1.5 percent per year), consistent with historical averages.

- Primary balance of the central government remains at 3 percent of GDP over the projection period (as in GSPS and 2005 Article IV DSA), while public enterprises run an overall deficit of 0.5 percent of GDP. The assumption about the government primary balance is consistent with the strong fiscal turnaround Dominica has had in recent years. The assumption on public enterprises follows the average observed during the period 1999–2006. External grants are assumed to remain at 8.3 percent of GDP broadly in line with the GSPS. This number is high by historical standards although it is lower than the grants actually received and not out of bound given the authorities' attempt to improve the management of aid and aid-related expenditures. Given the uncertain grants outlook, we undertake a stress test below.

- Annual disbursements of external concessional debt reach 1.5 percent of GDP (as in 2005 Article IV DSA), consistent with the country's public sector investment program (PSIP). The financing terms are similar to those of existing external debt. New domestic financing is projected to be available at an interest rate of 7 percent (as in 2005 Article IV DSA).

- The current account deficit is assumed to remain high in a transition period (2007–12), while gradually falling to a level fully financed by the projected external grants and FDI. This assumes that: (i) banks continue to use their external assets to extend domestic credit and that the government draws down its deposits to finance its investment program (government deposits in domestic banks have increased substantially given the recent increase in grants received. Banks have allocated a large fraction of those deposits to external assets); and (ii) the loss of export revenue associated with the closure of a large factory is partially and temporarily compensated by a decline in private agent's foreign assets.

- FDI is assumed to remain at the 2006 level (8 percent of GDP). While this number is higher than its historical average (so helping finance the current account), its actual net impact is not large since it is linked in the projections to foreign firms' retained earnings (which increase the current account deficit).

III. Evaluation of Public Sector Debt Sustainability

Dominica's public debt as of end-2006

3. As of end-2006 Dominica's public sector debt stood at 102 percent of GDP, of which 71 percent of GDP represented external debt and the remaining 31 percent represented domestic debt. Regarding the external debt, the largest share is owed to multilateral creditors (around 43 percent of GDP, with the Caribbean Development Bank holding around two thirds of that), followed by the debt with bilateral and commercial creditors (around 16 and

12 percent of GDP, respectively). In the domestic front, the largest creditor is Dominica's own Social Security System (around 13 percent of GDP) followed by a commercial bank with a significant government stake. In NPV terms, public sector debt stood at around 88 percent of GDP, due to the concessionality attached to most of the external debt (whose NPV was around 56 percent of GDP).[1]

The baseline scenario

4. Under the baseline scenario (Table 1a.), all the indicators show a progressive improvement in terms of debt sustainability. The only indicator that does not decline continuously is the debt service to revenue ratio, which temporarily shows an upward trend and then a decline in 2011.[2] Even though the increase in the indicator is temporary, it is important, however, to take into account that it remains high for several years, which calls for maintaining fiscal discipline in order to avoid liquidity constraints. Under this scenario, Dominica would reach a public debt to GDP ratio of 60 percent—the guidance of the ECCB—by 2017.

Alternative scenarios and stress tests

Changes in growth and primary balance

5. Economic growth and the primary balance are the two key drivers of Dominica's debt path and both are subject to large exogenous shocks, such as volatility of grants (see below) and of foreign growth (see Box 2).

6. The sensitivity analysis illustrates two important points (Table 1b.). First, if Dominica's primary balance and economic growth return to their averages of the last ten years (a primary deficit of 0.1 percent and annual growth of 0.9 percent), then public debt starts rising again (Scenario A.1), although the path of the debt increase is not steep. Second, if Dominica can maintain the fiscal effort projected for 2007 (a primary balance of 4.8 percent) public debt stays on a declining path (Scenario A.2).

7. In addition, the sensitivity analysis shows the importance of sustaining growth. In the alternative Scenario A.3, in which growth falls to 2.3 percent per year, debt initially declines but later returns to an ascending path. This is because as output growth slows, fiscal revenues

---

[1] The figures could change somewhat depending on the final agreement with hold-out creditors (since different options have different hair-cuts). These final agreements, however, should not have a material impact on the debt sustainability paths given that all restructuring options available for restructuring have the same NPV. The simulations in this appendix assume that hold-out creditors take the intermediate bond, which carries a hair-cut of 20 percent. The discount rate for the NPV calculations is 5 percent.

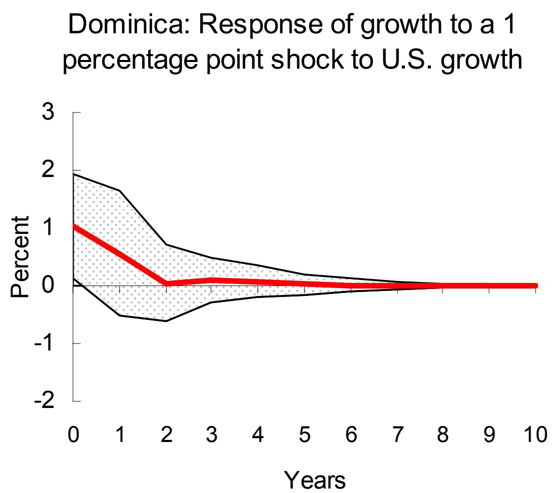
[2] The initial upward trend is mainly caused by the early repayment clause that was included in Dominica's debt restructuring agreement. Under that clause, there is an increase in amortization starting in 2009 and a bunching of payments up to 2011.

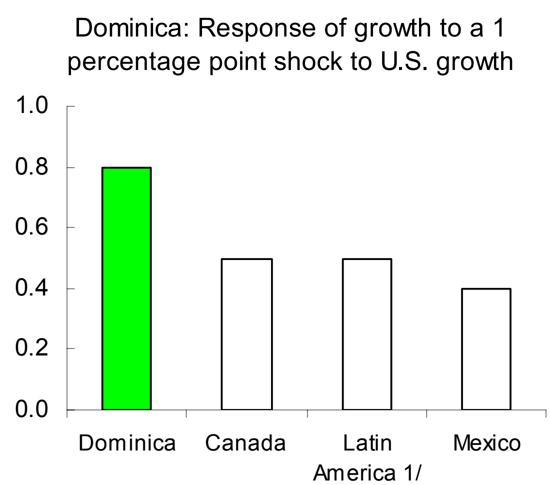
are projected to decline relative to the baseline scenario while expenditures are assumed to remain constant relative to the baseline scenario (which produces a deterioration of the primary balance). Figure 2 shows the individual contributions of growth and primary balance to the debt path. The importance of growth in debt sustainability is clear from the second panel, but it is also clear that public debt remains on a declining path if Dominica is able to maintain a primary balance of 3 percent of GDP even if growth were to decline to an annual rate of 1 percent.

Box. 2. Dominica: External Shocks and Growth

Since independence in 1978, Dominica has gone through periodic difficulties. The island was ravaged by hurricanes; experienced with banana-driven booms and busts; and more recently suffered from a debt and economic crisis. The lack of economies of scale and accessibility increases business costs. Also, as a small state, it faces more volatile growth and terms of trade, more prone to natural disasters, and more vulnerable to external shocks.

External shocks are a key challenge to sustaining growth in Dominica. In a standard vector auto-regression analysis,[3] staff found that a 1 percentage point shock to the U.S. output affects Dominica output roughly by the same magnitude, doubles the effect on some larger countries in the region, such as Mexico and Canada. Similarly, staff found that Dominica is particularly vulnerable to other external shocks: more than half of its growth volatility can be explained by growth volatility of its main trading partners; and typical shocks to annual banana prices (about 14 percentage points) and aid inflows (about 2¾ percent of GDP) affect Dominica GDP by ¾–1 percentage point over a year or two.





Source: Fund staff estimates.
1/ Argentina, Brazil, Chile, Colombia, Mexico and Peru.

[3] Based on the methodology used in World Economic Outlook, April 2007, Chapter 4.

Decline in external grants

8. External grants to the central government are expected to reach around 8 percent of GDP in the fiscal year 2006–07[4], around 3 percentage points above its historical average. Figure 2 (lower panel) illustrates the impact of a 3 percent of GDP decline in external aid from 2009 on. The results present two alternative scenarios: (i) the partial adjustment scenario, which assumes that government cuts investment spending by around 1.5 percent of GDP and finances the rest of the aid decline with larger borrowing (the increase in borrowing is assumed to increase interest rates by 1 percentage point). The other scenario assumes no cuts in public investment. The aid decline is financed entirely via higher borrowing, which increase interest rates by 2 percentage points. In both scenarios, the new borrowing is assumed to be domestic.

9. As the figure illustrates, under the no adjustments scenario, public debt quickly starts rising again due to the cascading effects of rising debt and higher refinancing rates. The debt to GDP ratio stabilizes at around 62 under the partial adjustment scenario.

Other shocks

10. We also assessed shocks to interest rates, the impact of natural disasters, and the balance sheet implications of a depreciation of the U.S. dollar against other major international currencies.

- **Natural disasters** produce an initial increase in debt but the latter returns to a declining trajectory after growth is restored and fiscal costs of reconstruction have ended.[5]

- **Interest rates** shocks have little impact on Dominica's public debt path of most of its debt, including domestic debt, has fixed interest rates.

- **A depreciation of the U.S. dollar against other major currencies** would have a modest balance sheet effect on Dominica's public debt: around 70 percent of the external debt is denominated in the U.S. dollar, 19 percent in SDR (where the U.S. dollar weigh is about 50 percent), and around 4 percent is denominated in the Euro.

---

[4] Measured as grants spent, in line with IMF Country Report No. 05/384.

[5] It is assumed that the shock costs the government 9 percent of GDP over a three-year period (thus exhausting the primary surpluses assumed under the baseline scenario) and causes real growth to decline to zero over the same period. This shock is costlier than the standard shock reported in IMF Country Report No. 04/335, in particular. In addition, the actual impact of this shock could be lower given the recent participation of Dominica into the Caribbean Catastrophe Insurance Facility—a regional insurance pool organized by the World Bank—has lowered the costs of catastrophe insurance and is expected to mitigate fiscal costs in the event of extreme hurricanes.

The rest is denominated in the EC dollar, and other currencies that are pegged to the U.S. dollar.

IV. EVALUATION OF EXTERNAL DEBT SUSTAINABILITY

11. Dominica's external debt is mostly owed by the public sector, since private sector borrowing takes place with domestic commercial banks. Due to this feature, the external DSA has to a large extent the same properties as the public sector DSA.

12. External debt remains on a declining path in the baseline scenario (Table 2a.). Similarly to the public debt DSA, the only indicators of debt sustainability that do not decline continuously are those related to the share of external debt service as a percent of exports and public sector revenues. Both indicators increase up to 2010 as a consequence of the features of the debt restructuring and then start declining. The closure of operations of a large foreign manufacturing company also contributes to the increase of the debt service as a share of exports. The large residuals observed in the first five years of the projections period reflect our assumptions regarding the temporary financing of part of the current account deficit by a reduction in bank's and private agents' net foreign assets.

13. Sensitivity tests show a picture similar to the public debt DSA (Table 2b.). If key variables were to return to their historical averages (Scenario A.1) external debt would return to an ascending path, as lower grants, lower FDI, and lower growth would push external debt up. Higher interest rates (Scenario A.2) do not significantly impact the external debt paths as in the baseline scenario Dominica faces low financing needs (see previous section).

V. CONCLUSIONS AND COMPARISON WITH THE 2005 ARTICLE IV CONSULTATION DSA

14. Dominica has improved its debt sustainability outlook since the previous Article IV consultation (2005), mostly due to stronger than projected fiscal performance and economic growth. Public debt for end-2007 is currently projected at 96 percent of GDP, which is 3.5 percentage points lower than the projections made in the last Article IV consultation. At the same time, Dominica has introduced a reform to its pension system, which targets one of the main vulnerabilities to debt sustainability identified in the 2005 Article IV consultation. Dominica has also made progress in reducing debt-related vulnerabilities, particularly by joining the Caribbean Catastrophe Insurance Facility.

15. In spite of the progress achieved, important debt-related vulnerabilities remain, as: (i) public debt is high (over 100 percent of GDP), which gives the government little room to maneuver in case of unforeseen events; (ii) there is a bunching of payments between 2009 and 2011; (iii) the arrival of new grants is uncertain; and (iv) the country is exposed to external shocks and natural disasters.

16. The government's medium-term reform strategy, which appropriately envisages the maintenance of a fiscal policy geared at achieving a primary surplus target of 3 percent of

GDP and thereby bringing about a gradual reduction in the debt ratio, constitutes, therefore, a step in the right direction. The structural reforms proposed in the government strategy will—via its positive impact on economic growth—also help to attain the objective of reducing debt related vulnerabilities.

Table 1a.Dominica: Public Sector Debt Sustainability Framework, Baseline Scenario, 2004–27

(In percent of GDP, unless otherwise indicated)

	Actual					Est.	Projections								
	2004	2005	2006	Historical Average 1/	Standard Deviation 1/	2007	2008	2009	2010	2011	2012	Average 2007–12	2017	2027	Average 2013–27
Public sector debt 2/	116.0	108.1	102.5			95.8	91.9	87.5	83.2	79.2	75.2		57.2	23.4	
Of which: Foreign-currency denominated 3/ 4/	80.6	74.8	70.9			65.2	60.5	56.3	51.4	46.9	43.0		30.6	21.2	
Change in public sector debt	-14.8	-7.8	-5.7			-6.7	-3.9	-4.4	-4.3	-4.1	-3.9		-3.5	-3.4	
Identified debt-creating flows 5/	-12.0	-9.1	-9.1			-6.7	-3.9	-4.4	-4.3	-4.1	-3.9		-3.5	-3.4	
Primary deficit	-4.4	-4.5	-6.9	0.1	5.3	-4.8	-3.3	-3.2	-3.2	-3.2	-3.1	-3.5	-3.0	-3.1	-3.1
Revenue and grants	48.7	48.9	50.1			49.4	48.7	49.6	50.1	50.1	50.1		50.1	50.1	
of which: grants	6.0	6.8	8.3			7.7	7.0	7.9	8.3	8.3	8.3		8.3	8.3	
Primary (noninterest) expenditure	44.4	44.4	43.1			44.7	45.5	46.4	46.9	46.9	47.0		47.0	46.9	
Automatic debt dynamics	-2.1	-2.1	-2.9			-1.9	-0.7	-1.2	-1.1	-0.9	-0.8		-0.4	-0.3	
Contribution from interest rate/growth differential	-2.1	-2.7	-3.0			-2.1	-1.3	-1.4	-1.3	-1.2	-1.0		-0.6	-0.4	
Of which: Contribution from average real interest rate	1.8	1.0	1.2			1.1	1.4	1.2	1.2	1.3	1.3		1.2	0.4	
Of which: Contribution from real GDP growth	-3.9	-3.7	-4.1			-3.1	-2.6	-2.7	-2.5	-2.4	-2.3		-1.8	-0.8	
Contribution from real exchange rate depreciation	0.0	0.6	0.0			0.2	0.6	0.3	0.3	0.2	0.2		...	...	
Other identified debt-creating flows	-5.6	-2.5	0.8			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	-2.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	-0.9	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other) 6/	-4.6	-0.6	0.8			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-2.8	1.3	3.4			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of public sector debt	35.4	93.3	87.7			82.8	80.1	76.8	73.6	70.4	67.3		52.1	20.9	
Of which: Foreign-currency denominated	0.0	60.0	56.1			52.2	48.8	45.6	41.7	38.2	35.1		25.5	18.6	
Of which: External	...	60.0	56.1			52.2	48.8	45.6	41.7	38.2	35.1		25.5	18.5	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 7/	6.7	0.5	-0.9			1.5	3.0	3.4	4.4	4.2	3.8		1.0	-1.0	
NPV of public sector debt-to-revenue and grants ratio (in percent)	72.6	190.9	175.2			167.5	164.4	154.8	146.9	140.6	134.4		104.1	41.7	
NPV of public sector debt-to-revenue ratio (in percent)	82.9	221.8	209.9			198.2	191.8	183.9	176.1	168.6	161.1		124.8	49.9	
Of which: External 8/		142.6	134.4			125.0	116.7	109.2	99.8	91.4	83.9		61.0	44.3	
Debt service-to-revenue and grants ratio (in percent)	22.7	10.2	12.0			12.8	12.9	13.3	15.1	14.6	13.7		8.1	4.3	
Debt service-to-revenue ratio (in percent) 9/	25.9	11.8	14.4			15.1	15.0	15.8	18.1	17.5	16.5		9.7	5.2	
Primary deficit that stabilizes the debt-to-GDP ratio	10.5	3.4	-1.3			1.9	0.7	1.2	1.1	0.9	0.8		0.4	0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.0	3.3	4.0	0.9	3.1	3.2	2.8	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Average nominal interest rate on forex debt (in percent)	3.9	2.0	2.2	3.5	1.2	2.1	2.5	2.5	2.4	2.4	2.3	2.4	2.3	3.2	2.5
Average real interest rate on domestic currency debt (in percent)	0.7	3.5	3.2	5.8	3.4	3.2	3.5	3.2	3.3	3.5	3.7	3.4	4.0	3.0	3.8
Real exchange rate depreciation (in percent, + indicates depreciation)	0.0	0.8	0.1	0.3	1.0	0.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.1	1.5	1.9	1.5	0.9	1.8	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Growth of real primary spending (deflated by GDP deflator, in percent)	4.3	3.2	0.9	2.7	11.6	6.8	4.6	5.1	4.1	3.1	3.1	4.5	3.0	2.9	3.0
Grant element of new external borrowing (in percent)	...	...	...			17.9	17.9	17.9	17.9	17.9	17.9	17.9	17.9	17.9	...

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

1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

2/ Nonfinancial public sector (includes debt with Dominica's Social Security System).

3/ Refers to external debt. Assumes that nonpartcipating creditors receive the intermediate bond. Excludes external interest arrears. Arrears with participating creditors have been settled as part of the debt restructuring. Arrears with nonparticipating creditors are either in dispute or expected to be settled when an agreement is reached. Undisputed interest arrears are approximately 0.4 percent of GDP

4/ For 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic

5/ Fiscal year aggregates are averaged to estimate calendar year figures.

6/ In 2004/05, it is assumed that all nonparticipating creditors received the intermediate bond, which carries a face value reduction of 20 percent.

7/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

8/ Revenues excluding grants.

9/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.

Table 1b.Dominica: Sensitivity Analysis for Key Indicators of Public Debt 2007–27

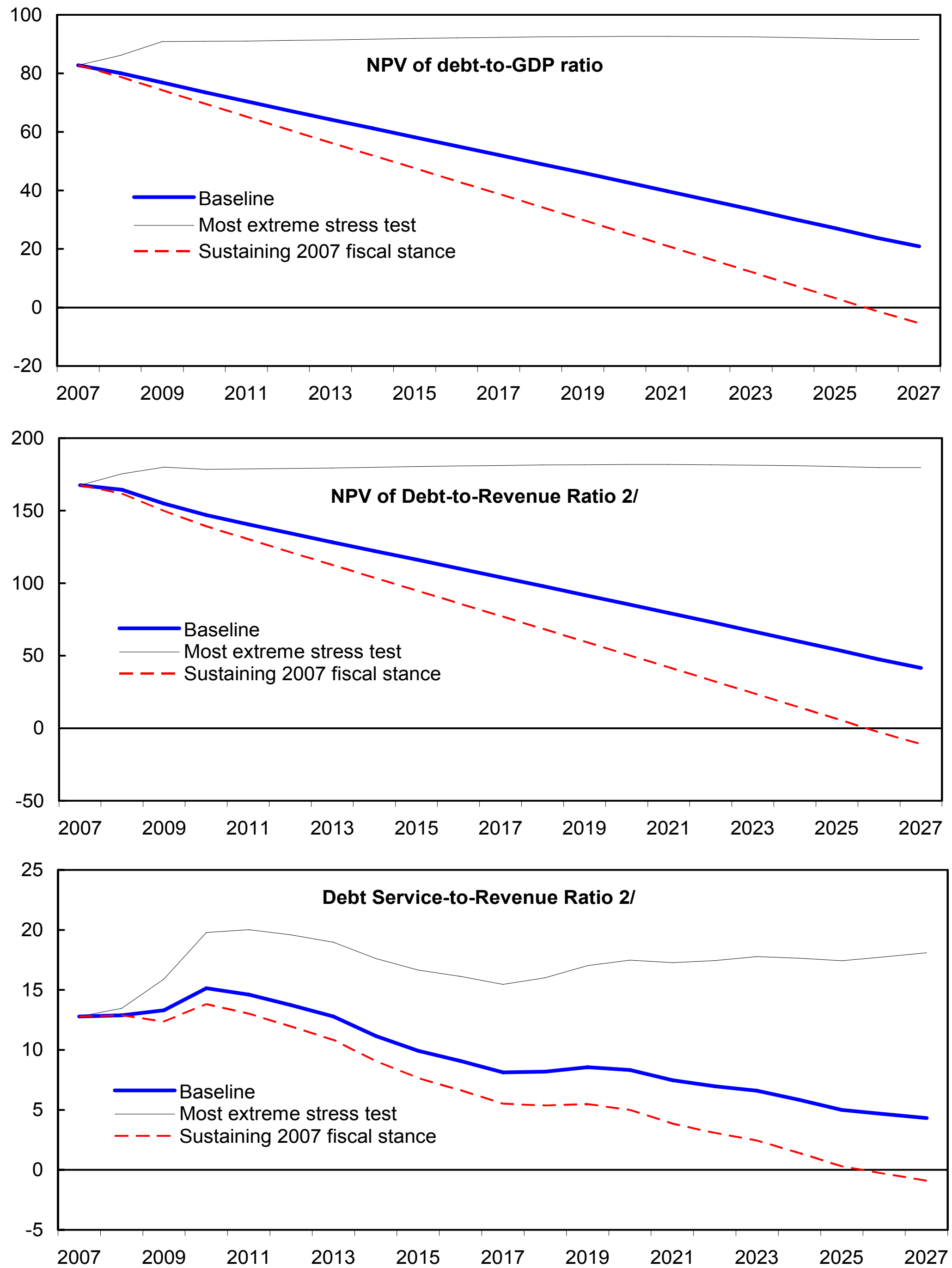
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	83	80	77	74	70	67	52	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	83	85	86	87	88	89	96	105
A2. Primary balance is unchanged from 2007	83	79	74	70	65	61	39	-5
A3. Permanently lower GDP growth 1/	83	81	79	77	75	73	69	77
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008–09	83	86	91	91	91	91	92	92
B2. Primary balance is at historical average minus one standard deviations in 2008–09	83	88	92	88	84	81	66	33
B3. Combination of B1–B2 using one half standard deviation shocks	83	88	93	89	85	81	63	26
B4. One-time 30 percent real depreciation in 2008	83	103	100	96	93	89	72	37
B5. 10 percent of GDP increase in other debt-creating flows in 2008	83	89	85	82	78	75	60	28
NPV of Debt-to-Revenue Ratio 2/								
Baseline	168	164	155	147	141	134	104	42
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	168	173	172	172	174	175	184	194
A2. Primary balance is unchanged from 2007	168	162	150	139	130	121	77	-11
A3. Permanently lower GDP growth 1/	168	166	158	152	149	146	137	149
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008–09	168	175	180	178	179	179	181	180
B2. Primary balance is at historical average minus one standard deviations in 2008–09	168	180	184	175	169	162	131	67
B3. Combination of B1-B2 using one half standard deviation shocks	168	180	185	175	168	161	125	51
B4. One-time 30 percent real depreciation in 2008	168	212	201	192	185	178	144	74
B5. 10 percent of GDP increase in other debt-creating flows in 2008	168	182	171	163	157	150	120	56
Debt Service-to-Revenue Ratio 2/								
Baseline	13	13	13	15	15	14	8	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	13	16	19	19	19	15	20
A2. Primary balance is unchanged from 2007	13	13	12	14	13	12	6	-1
A3. Permanently lower GDP growth 1/	13	13	14	16	16	15	12	15
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008–09	13	13	16	20	20	20	15	18
B2. Primary balance is at historical average minus one standard deviations in 2008–09	13	13	19	23	18	16	10	7
B3. Combination of B1-B2 using one half standard deviation shocks	13	13	18	21	18	16	9	5
B4. One-time 30 percent real depreciation in 2008	13	14	15	17	16	15	9	6
B5. 10 percent of GDP increase in other debt-creating flows in 2008	13	13	20	18	16	15	9	6

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period)

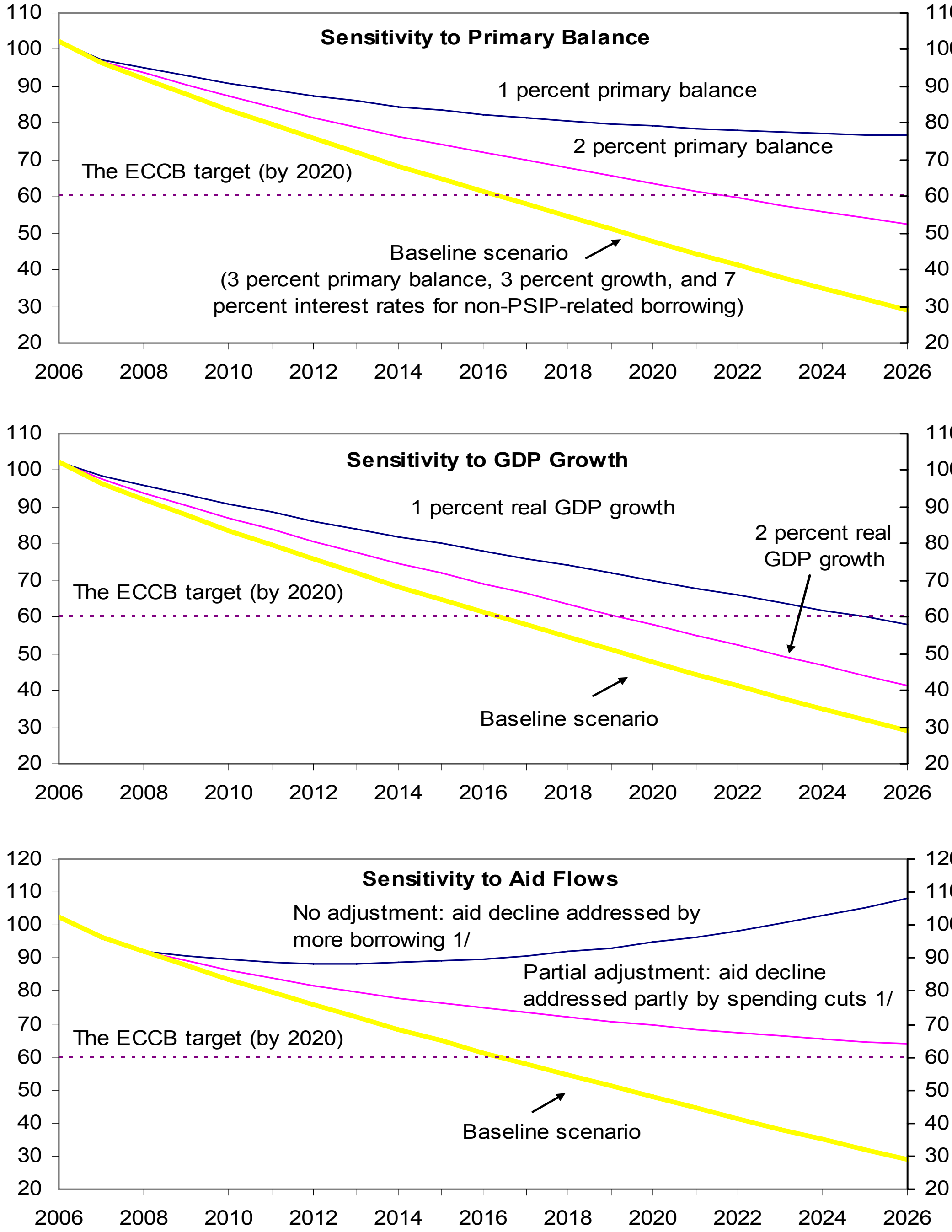
2/ Revenues are defined inclusive of grants.

Figure 1. Dominica: Indicators of Public Debt Under Alternative Scenarios, 2007–27 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017.
2/ Revenue including grants.

Figure 2. Dominica: Debt Sustainability Analysis
(In percent of GDP)



Source: Fund staff calculations based on data from Dominica authorities.
1/ Assumes that grants decline to the pre-crisis historical average in 2009.

Table 2a. Dominica: External Debt Sustainability Framework, Baseline Scenario, 2004–27 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections									
	2004	2005	2006	Average 2/	Deviation 2/	2007	2008	2009	2010	2011	2012	Average 2007–12	2017	2027	Average 2013–27
External debt (nominal) 1/	80.6	74.8	70.9			65.2	60.5	56.3	51.4	46.9	43.0		30.6	21.1	
Of which: Public and publicly guaranteed (PPG)	80.6	74.8	70.9			65.2	60.5	56.3	51.4	46.9	43.0		30.6	21.1	
Change in external debt	-4.0	-5.8	-3.9			-5.7	-4.7	-4.2	-4.9	-4.4	-3.9		-1.7	-0.3	
Identified net debt-creating flows	0.3	12.8	-1.2			-0.8	2.4	1.4	0.1	-0.5	-3.1		-1.9	-0.8	
Noninterest current account deficit	14.1	27.9	17.8	14.9	6.0	15.5	17.6	17.5	16.7	16.1	13.5		14.6	15.5	14.8
Deficit in balance of goods and services	16.5	25.1	19.5			16.9	19.0	19.0	18.2	17.6	17.0		16.6	17.5	
Exports	47.5	44.5	46.6			46.9	44.7	44.2	44.3	44.3	44.5		44.5	44.5	
Imports	64.1	69.7	66.1			63.8	63.6	63.2	62.5	62.0	61.5		61.1	62.0	
Net current transfers (negative = inflow)	-7.3	-7.6	-7.3	-6.3	1.1	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0		-7.0	-7.0	-7.0
Of which: Official	-0.5	-0.7	-0.3			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	4.9	10.4	5.6			5.6	5.6	5.6	5.5	5.5	3.5		5.0	5.0	
Net FDI and capital grants (negative = inflow)	-12.7	-13.2	-16.3	-12.5	4.0	-15.7	-15.0	-15.9	-16.3	-16.3	-16.3		-16.3	-16.3	-16.3
Endogenous debt dynamics 3/	-1.2	-2.0	-2.7			-0.7	-0.2	-0.3	-0.3	-0.3	-0.3		-0.2	0.0	
Contribution from nominal interest rate	3.2	1.5	1.6			1.4	1.6	1.4	1.3	1.2	1.0		0.7	0.7	
Contribution from real GDP growth	-2.4	-2.6	-2.8			-2.1	-1.8	-1.7	-1.6	-1.5	-1.3		-0.9	-0.6	
Contribution from price and exchange rate changes	-1.9	-1.0	-1.4			…	…	…	…	…	…		…	…	
Residual 4/ 5/	-4.2	-18.5	-2.7			-4.9	-7.1	-5.6	-5.0	-3.9	-0.8		0.2	0.4	
Of which: Exceptional financing	-4.6	-0.6	0.8			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 6/	...	...	56.1			52.2	48.8	45.6	41.7	38.2	35.1		25.5	18.5	
In percent of exports	...	...	120.5			111.4	109.1	103.2	94.2	86.1	78.8		57.3	41.6	
NPV of PPG external debt	...	...	56.1			52.2	48.8	45.6	41.7	38.2	35.1		25.5	18.5	
In percent of exports	...	...	120.5			111.4	109.1	103.2	94.2	86.1	78.8		57.3	41.6	
In percent of government revenues	...	...	134.4			125.0	116.7	109.2	99.8	91.4	83.9		61.0	44.3	
Debt service-to-exports ratio (in percent)	20.7	12.6	8.6			9.8	10.3	10.4	12.1	11.1	10.0		5.5	3.6	
PPG debt service-to-exports ratio (in percent)	20.7	12.6	8.6			9.8	10.3	10.4	12.1	11.1	10.0		5.5	3.6	
PPG debt service-to-revenue ratio (in percent)	23.0	13.3	9.6			11.0	11.0	11.0	12.8	11.7	10.6		5.9	3.8	
Total gross financing need (billions of U.S. dollars)	30.6	58.0	16.7			14.1	23.7	21.6	20.7	17.7	6.3		3.9	6.1	
Noninterest current account deficit that stabilizes debt ratio	18.1	33.7	21.7			21.3	22.3	21.7	21.6	20.5	17.4		16.3	15.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.0	3.3	4.0	0.9	3.1	3.2	2.8	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
GDP deflator in U.S. dollar terms (change in percent)	2.3	1.2	1.9	1.6	0.8	1.8	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate (percent) 7/	3.9	2.0	2.2	3.5	1.2	2.1	2.5	2.5	2.4	2.4	2.3	2.4	2.3	3.2	2.5
Growth of exports of goods and services (U.S. dollar terms, in percent)	9.2	-2.0	10.9	2.3	10.1	5.6	-1.0	3.5	4.7	4.7	4.9	3.7	4.5	4.5	4.5
Growth of imports of goods and services (U.S. dollar terms, in percent)	11.3	13.7	0.6	2.5	7.3	1.3	3.7	3.8	3.4	3.7	3.7	3.3	5.1	4.5	4.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	17.9	17.9	17.9	17.9	17.9	17.9	17.9	17.9	17.9	17.9
Aid flows (in millions of US dollars) 8/	75.4	61.7	67.7			68.0	64.3	78.3	86.1	89.9	93.9		117.2	182.9	
Of which: Grants	16.4	19.4	25.0			24.2	22.9	27.0	29.8	31.2	32.6		40.7	63.5	
Of which: Concessional loans	18.4	7.8	2.6			2.5	2.5	5.5	5.6	5.8	5.9		7.4	11.5	
Grant-equivalent financing (in percent of GDP) 9/	...	...	...			7.8	7.1	8.1	8.6	8.6	8.6		8.6	8.6	8.6
Grant-equivalent financing (in percent of external financing) 9/	...	...	...			92.3	91.9	86.1	87.0	87.2	87.4		87.4	87.4	87.5
Memorandum items:															
Nominal GDP (billions of US dollars)	271.7	284.3	301.3			316.3	328.7	343.6	359.2	375.5	392.6		490.3	764.7	
(NPVt-NPVt-1)/GDPt-1 (in percent)						-1.3	-1.6	-1.0	-2.0	-1.8	-1.5	-1.5	-0.1	1.0	0.0

Source: Staff simulations.

1/ Only includes both public sector external debt.

2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

5/ In 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic. It also includes a negative FDI flow reflecting extraordinary dividends paid by a foreign company (5 percent og GDP), which were made out of an account in a foreign bank.

6/ Assumes that NPV of private sector debt is equivalent to its face value.

7/ Current-year interest payments divided by previous period debt stock.

8/ Defined as grants, concessional loans, and debt relief.

9/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

Table 2b. Dominica: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007–27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	**2017**	2027
NPV of debt-to-GDP ratio								
Baseline	52	49	46	42	38	35	**25**	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–27 1/	52	49	48	46	46	48	**62**	90
A2. New public sector loans on less favorable terms in 2008–27 2/	52	49	46	43	39	37	**29**	26
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008–09	52	51	51	46	42	39	**28**	21
B2. Export value growth at historical average minus one standard deviation in 2008–09 3/	52	51	54	50	47	44	**34**	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008–09	52	49	46	42	39	35	**26**	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008–09 4/	52	56	60	56	53	49	**39**	27
B5. Combination of B1-B4 using one-half standard deviation shocks	52	52	56	51	47	44	**34**	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	52	69	65	59	54	50	**36**	26
NPV of debt-to-exports ratio								
Baseline	111	109	103	94	86	79	**57**	42
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	111	110	108	105	104	108	**140**	202
A2. New public sector loans on less favorable terms in 2007–26 2/	111	110	104	96	89	83	**65**	59
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008–09	111	109	103	94	86	79	**57**	42
B2. Export value growth at historical average minus one standard deviation in 2008–09 3/	111	123	148	137	127	118	**92**	64
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008–09	111	109	103	94	86	79	**57**	42
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008–09 4/	111	125	136	127	119	111	**89**	60
B5. Combination of B1-B4 using one-half standard deviation shocks	111	115	127	117	108	100	**76**	53
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	111	109	103	94	86	79	**57**	42
Debt service-to-exports ratio								
Baseline	10	10	10	12	11	10	**6**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–27 1/	12	10	11	13	12	12	**9**	14
A2. New public sector loans on less favorable terms in 2008–27 2/	12	10	10	12	11	10	**6**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008–09	12	10	10	12	11	10	**6**	4
B2. Export value growth at historical average minus one standard deviation in 2008–09 3/	12	11	13	16	14	13	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008–09	12	10	10	12	11	10	**6**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008–09 4/	12	10	11	13	12	11	**8**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	12	10	11	14	13	12	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	12	10	10	12	11	10	**6**	4

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

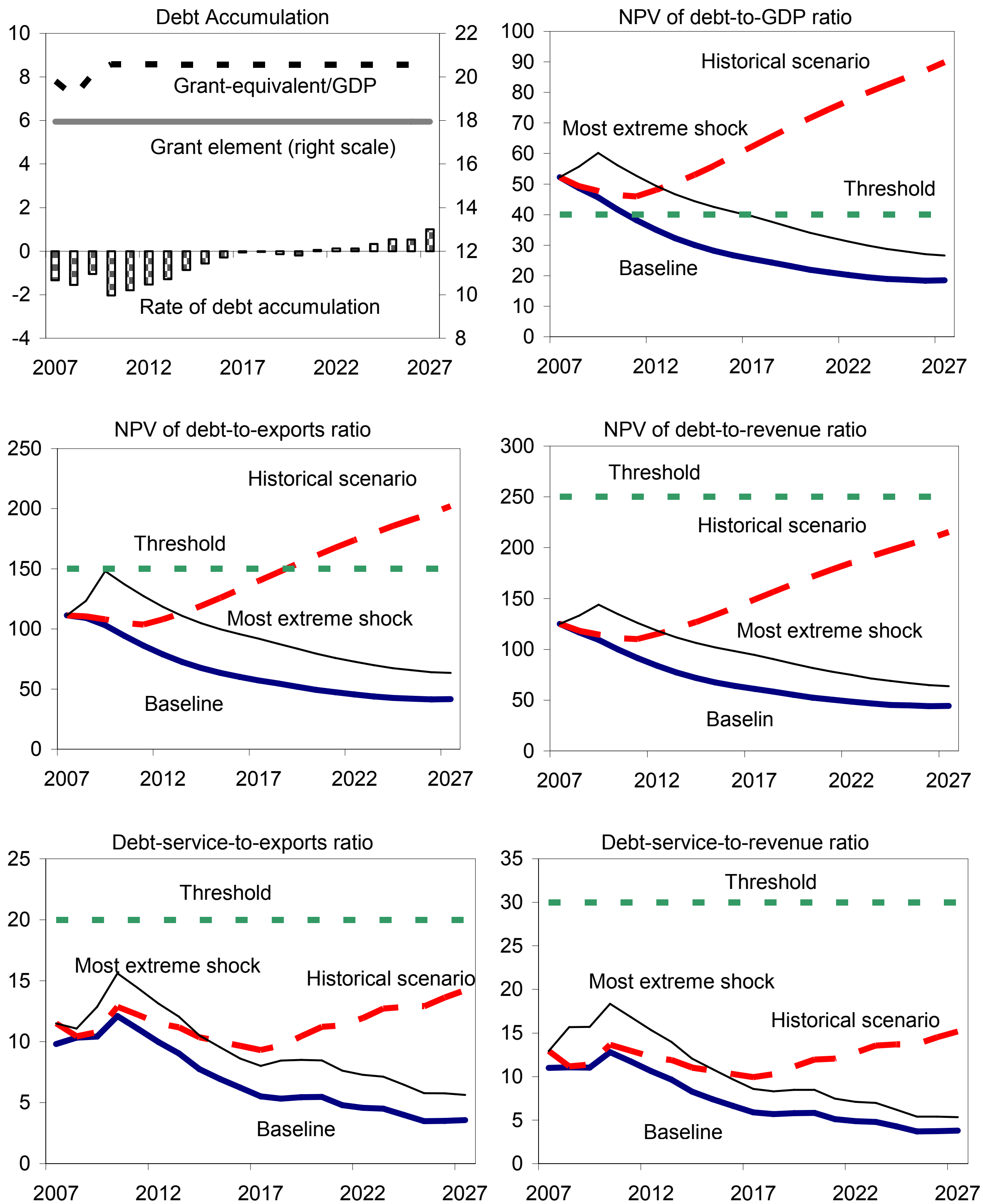
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

Figure 3. Dominica: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2007–27



Source: Staff projections and simulations.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/105
FOR IMMEDIATE RELEASE
August 16, 2007

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

IMF Executive Board Concludes 2007 Article IV Consultation with Dominica

On July 16, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the 2007 Article IV consultation with Dominica.[1]

Background

Dominica has fully recovered from the 2001–02 economic and financial crisis. Output growth has rebounded, reaching 4 percent in 2006—the highest in two decades—and it is expected to remain above trend in 2007. The rebound is driven by a pickup in tourism, recovery in banana production, and buoyant construction and offshore school activity. Inflation has remained subdued, reflecting stabilizing oil prices, and is projected to remain low. The external current account deficit narrowed sharply in 2006 and is likely to remain large at around 20 percent of GDP this year, financed mainly by foreign direct investment and large capital grants. External competitiveness remains broadly adequate due to fiscal adjustment and to a lesser extent the depreciation of the U.S. dollar against major currencies.

Fiscal balances have improved significantly. The central government primary surplus, before grants, is projected to reach 5.9 percent of GDP in 2006/07, a significant turnaround from the primary deficit in 2001/02. Tax buoyancy (partly due to the newly-introduced VAT and excise taxes), sustained expenditure restraint and continued output growth have contributed to the

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

strong fiscal performance. Grants received have more than doubled the average pre-crisis level, reaching almost 13 percent of GDP for the first nine months of 2006/07.

Monetary aggregates have continued to increase rapidly, underpinned by expansion in deposits and private credit. Continued fiscal consolidation in recent years has helped expand private credit by 11 percent in 2006. Banking prudential indicators have improved, reflecting in part stricter enforcement of prudential guidelines by the Eastern Caribbean Central Bank and strong macroeconomic performance. Nevertheless, nonperforming loans remain high and loan loss provisioning is low by international standards.

Further progress has been made in structural reforms. The contribution rate for the Dominica Social Security was raised by 1 percentage point in March 2007 as part of an ongoing comprehensive reform strategy. The authorities have recently started to merge the port and airport authorities and to breakup the National Development Corporation into a tourism board and an investment promotion agency to raise efficiency. A draft law on the Financial Sector Unit has recently been submitted to parliament, albeit after much delay. The authorities have maintained good-faith efforts in pursuing debt restructuring agreements with the remaining creditors.

Executive Board Assessment

Executive Directors commended the authorities for continuing to implement sound economic policies, which have been pivotal in Dominica's remarkable recovery from the economic crisis in 2001−02. They noted that, under the authorities' comprehensive program, supported by the Fund, Dominica had successfully restored macroeconomic stability and reversed the debt build-up, while sustaining above-trend growth. They agreed that, with the implementation of the authorities' reform strategy reflected in the Growth and Social Protection Strategy, real GDP growth could remain above the historical average in coming years.

Directors commended the authorities for their strong commitment and efforts to address long-standing policy challenges. They agreed that the government's medium-term primary surplus target of 3 percent of GDP was consistent with the government's strategy of reducing vulnerabilities. Directors applauded the authorities for the progress made in reforming Dominica's Social Security System, which had been identified as a major risk to the public finances in the last Article IV consultation. Directors noted the authorities' good-faith efforts in pursuing debt restructuring agreements with non-participating creditors.

Directors welcomed the recent surge in budgetary aid to Dominica, but highlighted the associated policy challenges. Given the still high public debt ratio and the volatility of aid, Directors were encouraged by the authorities' commitment to continue with the strategy of smoothing the spending of the scaled-up aid over time and to use some of these resources to substitute expensive borrowing and reduce debt. A few Directors also called on donors to establish streamlined and more predictable procedures for the disbursement of aid. Directors also welcomed the authorities' intention to improve budget management, in particular regarding capital expenditure, in order to use aid in an efficient and transparent manner and consistent with macroeconomic objectives.

Directors stressed the importance of ensuring that modifications of the indirect taxes lead to an improvement in the efficiency of the tax system and be consistent with sustaining fiscal consolidation. While recognizing the regional dimension of tax competition, they noted that tax cuts need to be modest and accompanied by the revamping of the tax incentive system to try to make it more efficient, while safeguarding the integrity of the recently introduced value-added tax. They reaffirmed the willingness of the Fund to continue to provide technical assistance as needed, specifically to reform tax incentives.

Directors supported the authorities' commitment to achieving greater progress in financial sector supervision. The recent improvements in banking prudential indicators are a welcome development, but the rapid credit expansion, low provisioning, and strong competition from loosely-regulated nonbank financial institutions warrant enhanced supervision over the financial sector. Given extensive regional financial linkages and the lack of supervisory expertise, Directors agreed that the authorities consider delegating part of supervisory functions over the nonbanks, including to other regulatory bodies in the region.

Directors agreed that the overall level of Dominica's external competitiveness is adequate. They viewed that the real exchange rate level is broadly competitive, in part reflecting fiscal consolidation and the EC dollar depreciation against the currencies of trading partners. They also observed that the exchange regime, if supported by sound fiscal policy, continues to serve Dominica well.

Directors called for further progress in the implementation of structural reforms as envisaged in Dominica's Growth and Social Protection Strategy. They observed that priority be given to efforts to reduce the cost of doing business in Dominica and to foster private sector-led growth, including by streamlining public sector entities, improving contract enforcement and foreclosure arrangements and reforming the utilities and customs administration. They welcomed the authorities' commitment to undertake a poverty assessment this year, which will help design efficient and well-targeted social safety nets.

Directors encouraged the authorities to continue to improve the quality of economic and social statistics that are key for effective surveillance.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Dominica: Selected Economic Indicators

	2003	2004	2005	Prog. 1/ 2006	Est. 2006	Proj. 2007
(Annual percentage change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	0.1	3.0	3.3	4.1	4.0	3.2
GDP deflator (factor cost)	0.9	2.1	1.5	1.2	1.9	1.8
Consumer prices (end of period)	2.9	0.8	2.7	2.0	1.6	1.5
Money and credit 2/						
Net foreign assets of the banking system	17.3	8.1	-8.0	5.1	17.6	4.4
Net domestic assets of the banking system	-16.4	-2.1	14.7	2.9	-8.0	1.6
Of which						
Net credit to the nonfinancial public sector	-4.3	-5.1	-1.2	-2.0	-10.8	-3.5
Credit to the private sector	-2.3	5.4	4.6	6.1	8.5	5.0
Liabilities to the private sector (M2)	1.0	5.9	6.7	8.0	9.6	6.0
Balance of payments						
Merchandise exports, f.o.b.	-6.0	4.5	0.4	-1.0	-1.1	3.9
Merchandise imports, f.o.b.	9.3	14.2	14.2	0.5	0.6	1.3
Real effective exchange rate						
(end of period, depreciation -)	-1.9	-6.0	1.9	…	-2.6	…
(In percent of GDP, unless otherwise specified)						
Central government 3/						
Savings (incl. grants)	8.6	7.6	10.6	11.5	12.7	9.6
Of which						
Primary savings (before grants)	5.8	7.8	8.5	5.5	6.4	5.4
Grants 4/	8.8	5.9	7.6	8.5	8.9	6.5
Capital expenditure and net lending	10.1	8.8	9.5	10.1	9.5	8.9
Primary balance 4/	5.4	3.5	7.3	4.0	5.9	3.0
Overall balance 4/	-1.3	-0.9	1.2	1.6	3.4	0.8
Nonfinancial public sector debt (gross) 5/						
Total	130.8	116.0	108.1	101.4	102.5	95.8
External	84.6	80.6	74.8	70.8	70.9	65.2
Domestic	46.2	35.4	33.3	30.6	31.6	30.6
External sector						
Current account balance	-13.0	-17.3	-29.5	-21.3	-19.4	-17.0
External public debt service 6/	19.5	20.7	17.5	13.1	13.0	9.5
Amortization	12.8	14.0	9.1	8.4	8.3	5.1
Interest	6.8	6.7	8.4	4.7	4.7	4.4
Memorandum items:						
Nominal GDP at market prices (EC$ millions)						
Calendar year	696.1	733.7	767.5	809.5	813.6	854.0
Net international reserves						
(U.S. dollars millions; end-of-period)	44.0	33.6	37.6	44.2	51.9	54.5

Sources: Dominica authorities; Eastern Caribbean Central Bank (ECCB); and IMF staff estimates and projections.
1/ IMF Country Report No. 07/1, Seventh PRGF Review (November 2006).
2/ Change relative to the stock of M2 at the beginning of the period.
3/ This refers to the fiscal year (July–June) beginning July of the reference year.
4/ Does not include grants that were received but not spent.
5/ For 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic.
6/ In percent of exports of goods and nonfactor services. Up to 2005 data are on pre-restructuring terms. After that, data are on post-restructuring terms for creditors participating in the debt restructuring and on pre-restructuring terms for creditors not participating.