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**Dominica:** Letter of Intent, Supplement Memorandum of Economic Policies, and Technical Memorandum of Understanding

February 16, 2005

The following item is a Letter of Intent of the government of Dominica, which describes the policies that Dominica intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Dominica, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Roseau, Dominica  
February 16, 2005

Mr. Rodrigo de Rato,  
Managing Director,  
International Monetary Fund  
700 19<sup>th</sup> Street, NW,  
Washington, DC 20431  
USA

Dear Mr. de Rato,

1. The letter of intent and memorandum of economic policies (MEP) of December 10, 2003, requesting an arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF), outlined the Government's strategy to address the economic crisis facing Dominica and resolve our fiscal and debt difficulties. We further defined these policies in the context of the first two reviews of the programme, concluded in March and August 2004, respectively.
2. Performance under the programme has remained satisfactory. All (but one) performance criteria for the period June-December 2004 were met, with significant margins in most cases. We have also made progress at structural reforms and all the structural benchmarks established under the programme have now been implemented, except for the further reform of the electricity sector. On the latter, Cabinet considered the issue recently and we remain committed to implementing the reform after further public consultations. This resolute commitment to the programme is already yielding visible benefits. Despite being hit by a significant earthquake late last year, the economy is growing and our fiscal position has improved.
3. We have made significant progress in collaboratively restructuring our debt. We have decided to close our debt exchange offer, which had been maintained open for several months even after its formal deadline of June 11, 2004 had passed. We will continue good faith efforts to reach agreements with our non-participating creditors.
4. The attached supplement to our MEP lays out our policies for 2005. These policies are designed to consolidate the gains we have made so far and establish the basis for sustained economic growth. We request that the existing indicative targets for end-March 2005 be maintained, those for end-June 2005 be converted into performance criteria, and new indicative targets be established for end-September 2005 (Table 1). Proposed structural benchmarks and performance criteria are indicated in Table 2 of the MEP.
5. We have put in place strong procedures to ensure adherence to the performance criterion related to external debt service. On this basis, we request a waiver for the breach of



**SUPPLEMENT MEMORANDUM OF ECONOMIC POLICIES  
OF THE GOVERNMENT OF DOMINICA**

**I. BACKGROUND**

1. **We continue to make progress in addressing the severe macroeconomic imbalances that resulted in the economic crisis.** These imbalances followed from a series of shocks to the economy and the inadequate policy response, which led to a rapid buildup of government debt to unsustainable levels. The magnitude of the crisis was severe—output contracted by 10 percent during 2001–03 and investment declined. Against this background, the Government adopted and has been implementing a comprehensive strategy to stabilize the fiscal position and tackle the structural weaknesses.

2. **Since its inception, our strategy has comprised four key pillars.**

- **Collaborative debt restructuring.** Recognizing that our debt had reached unsustainable levels, we approached our creditors at end-2003 for debt restructuring.
- **Fiscal reform.** The cornerstone of our macroeconomic framework has been a fiscal effort to achieve a sustainable primary surplus of 3 percent of GDP, representing an adjustment of 4½ percent of GDP over the programme period.
- **Budgetary reform and financial sector strengthening.** These reforms aim to address weaknesses in budgetary planning and implementation that were at the root of the macroeconomic imbalances, and to forestall vulnerabilities in the financial sector.
- **Structural reforms to create an enabling environment for growth.** Our efforts are focused on strengthening the investment climate through deregulation and improved competition, which are critical to realizing the economy's growth potential.

3. **Our policy framework is built around these objectives, which remain crucial for Dominica to emerge decidedly from the crisis and realize sustainable economic growth.** Accordingly, our budget for this year contains a series of bold policy initiatives to bring the fiscal position further toward sustainability. As we transition beyond the initial stages of stabilization, our medium-term programme will be guided by the Growth and Social Protection Strategy Paper (GSPSP) that is being finalized along the lines envisaged in our interim poverty reduction strategy paper adopted at the end of 2003.

**II. RECENT PERFORMANCE UNDER THE GOVERNMENT'S PROGRAMME**

4. **Macroeconomic stability has been achieved.** Growth resumed during 2004 on the back of strong performance of agriculture, manufacturing and construction and despite a severe earthquake, which struck Dominica late in the year. Monetary and financial developments have also been favorable—inflation was subdued in 2004 and banking sector

credit to the economy is growing again after having contracted for several years. However, buildings and roads were considerably impaired by the earthquake and the heavy flooding, which preceded it—damage to public infrastructure alone from these events is estimated at 7 percent of GDP.

5. **Macroeconomic performance under the PRGF-supported programme remains satisfactory.** Although some external arrears were temporarily incurred, all other quantitative performance criteria during June–December 2004 were met, in some cases with significant margins. In each of the instances of missed payments, the errors were corrected promptly. On the fiscal front, stepped-up enforcement of compliance and collection of one-off items have resulted in revenues higher than initially envisaged, and the improving economy has also contributed to this outcome. These receipts mostly went towards reducing our overdraft balances at commercial banks and meeting larger-than-budgeted upfront costs associated with unforeseen delays in executing our debt strategy, including reduction of arrears and pre-payments into escrow accounts. As regards expenditures, the implementation of the public investment program has been slower than anticipated, on account of both delays in disbursements of project-related external grants and slower than expected execution. Domestically-financed capital expenditures have, however, picked up, including on account of some of the emergency recovery and rehabilitation work following the earthquake. As regards current expenditures, while savings from the wage bill have been larger than expected, they have been offset by higher subsidies and transfers.

6. **Structural reforms are progressing.** We completed the review of statutory tax exemptions in June, and Cabinet approved the key parameters for the VAT ahead of schedule in August. In January 2005, Parliament passed legislation increasing the retirement age for public employees, which maintains the option of early retirement. And, following a visit by a World Bank technical assistance team in December 2004, Cabinet considered the package of measures to reform the regulatory framework for electricity supply. The draft legislation for the reform has been prepared and the pricing formula has been specified but we consider it important to engage in further public consultations on this important matter before the changes are submitted for consideration to Parliament—we hope this will occur by June 2005.

7. **Our debt restructuring strategy has passed a critical point.** The debt exchange offer had been kept open past its formal deadline of June 11, 2004. We have decided that, as of September 30, the offer is no longer open and we have sent letters to all nonparticipating creditors to that effect. Parliament also passed legislation in January 2005 stopping the earmarking of tax revenues to service debt held by some nonparticipating creditors. We consider this to be an important step in restoring debt sustainability over the medium term. For all creditors who have thus far not participated in the debt restructuring, we calculated the accrued interest up to June 11 on original terms and made payments on their behalf into an escrow account at the Eastern Caribbean Central Bank (ECCB). Thereafter, as interest payments came due (under the existing agreements) to such creditors, we continued to make deposits into the escrow account but on restructured terms, along the lines envisaged in the

2004/05 government budget. We will maintain dialogue and continue to share with creditors relevant non-confidential information. We will also continue the practice of making deposits under restructured terms into the escrow accounts for non-participating creditors. We are hopeful that our difficult decisions will prompt remaining creditors to join in our debt restructuring effort.

### III. POLICIES FOR 2005

#### A. Macroeconomic and Fiscal Policy

8. **Our macroeconomic framework remains broadly unaltered from that underpinning the budget at the time of its approval.** Economic growth for 2004 is estimated at upwards of 2 percent, higher than had been envisaged. Despite some recent moderation in the growth of the agricultural sector, we expect economic activity during 2005–06 to remain strong and receive a boost from the expected stepping-up of the public investment program. Growth for 2005 is therefore likely to be upward of 2½ percent of GDP. Inflationary developments have largely been in line with expectations during 2004. Accordingly, the projection for inflation for 2005 is being maintained, also at 1½ percent.

9. **We remain committed to implementing the 2004/05 budget approved by Parliament.** The public sector retrenchment effort will also continue as planned—we are fully on target to realize the savings programmed for the 2004/05 fiscal year and will aim to generate additional savings by keeping vacated positions largely unfilled. This will ease the task of attaining the further planned reduction of the wage bill next year. Except for earthquake-related expenditures, line items will be held at budgeted levels. Emergency relief and rehabilitation operations at end-2004 following the earthquake were financed with a mixture of budgetary savings and additional grants. Much of the damage from the earthquake, however, remains to be addressed. Accordingly, in the context of preparing the budget for the next fiscal year, we will reassess the medium-term public investment program to prioritize earthquake-related reconstruction, which we hope will be financed mainly from grants. Nevertheless, some of the necessary repairs cannot wait further, and while we will maintain the program targets for this fiscal year, we will use any budgetary savings above programmed amounts for earthquake-related expenditures. There is also some possibility that transfers will need to be made within this fiscal year to set up the Caribbean Court of Justice, for which provisions had not been made in the approved budget. In that eventuality, we would adjust the program targets accordingly.

10. **At the time of the next review, we will comprehensively reevaluate the primary surplus that we need to achieve over the medium term.** This assessment will take into account the revised public investment program and the final outcome of the debt strategy on which we hope there will be greater clarity. In the context of our reassessment, we will also consider the possible need for contingency funds to safeguard against the economic impact of natural disasters, to which Dominica and neighboring countries are vulnerable because of their geographic location. Pending the preparation of the FY 2005/06 budget, we have adopted indicative targets for end-September 2005 to guide our policies (Table 1). For the

time-being, these targets continue to be predicated on achieving an annual primary surplus of 3 percent of GDP, our original medium-term objective. However, we will review and update these targets, as appropriate, in the context of the next review, which will also establish performance criteria for the remainder of the next fiscal year.

11. **We will continue our efforts to reform the tax system.** The Government remains committed to introducing the VAT during FY 2005/06. We have, however, decided to postpone its introduction from the start of the fiscal year to allow sufficient time for public education and for the inland revenue service to prepare adequately. This will help ensure that the VAT is indeed a success when it is introduced. As regards tax exemptions, by July 2005 we will, with technical assistance, carry out detailed cost-benefit analyses of the impact of those statutory exemptions that account for a significant share of revenue foregone, as indicated in the June 2004 review. Depending on the findings and recommendations of these analyses, we will propose changes to the legislation to repeal some provisions for concessions. Also, we reiterate our previous commitment to the policy of significantly reducing discretionary exemptions.

12. **We are also improving the administrative regime for the granting and monitoring of tax concessions.** Pending a more comprehensive review of administrative and procedural arrangements planned for later this year, the Ministry of Finance will assist in processing, monitoring and assessing the impact of tax exemptions with immediate effect. Specifically, a designated official from the Ministry will give support to the work of officials from initiating Government agencies, starting with the stage of screening the application for relief and preparing supporting documentation. The Ministry of Finance will also report regularly to the Cabinet on the operation of the concessions regime, including contribution to the economy and quarterly revenues foregone from all tax concessions granted and utilised. With a view to increasing transparency, the Government will publish in the official Gazette, a list of concessions granted. This list will be published in July 2005 in respect of concessions granted during FY 2004/05, and monthly thereafter in respect of each preceding month. Among other things, it will identify decisions taken, the legal basis for granting the tax relief, the length of time for which the relief will be in effect, the expected benefit from the individual concessions granted, and (where applicable), an estimate of revenue foregone in each case.

13. **Steps are being taken to strengthen the budgetary process.** By April 30, 2005 the Ministry of Finance and Planning will prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These discussions will assist in informing the preparation of the 2005/06 budget. In addition to providing numerical targets and procedures to follow in the design of the budget, these amendments will aim to improve processes and structures to strengthen accountability, reporting requirements and fiscal transparency. The passage of such legislation during FY 2005/06 will help ensure fiscal discipline over the medium term.

14. **We are improving public expenditure management practices.** Specifically, the system of reporting and analysis is being strengthened to ensure that all Government cash transactions are properly captured, outstanding commitments accurately established, and compliance with expenditure targets continually monitored. To this end we have made tremendous progress with our bank reconciliations; all ancillary accounts have been reconciled, and we expect the main account to be completed by March 2005. Updated balances will be adjusted in the General Ledger on completion of the (Smartstream) system review. Future reconciliations are expected to take place on a monthly basis. All transactions conducted through Government bank accounts will be captured in the General Ledger by end-June 2005. Other cash management measures that we implemented (with effect from end-December 2004) are as follows: (i) all Government purchases of goods and services are required to be supported by a Local Purchase Order (LPO) or a contract approved by the Ministry of Finance (except for authorized petty cash flows); (ii) all LPOs above EC\$1,000 are now required to be co-approved by the Ministry of Finance; and, (iii) all executed LPOs are being reported to the Ministry of Finance on a monthly basis. We also implemented at end-2004, a system for the comprehensive capture of transactions, most importantly those related to capital expenditures that were previously left out of the treasury accounting system.

#### **B. The Financial Sector and Social Security**

15. **Vulnerabilities in the financial system represent potential costs for the State and we are implementing a number of initiatives to strengthen prudential oversight.** The new uniform banking act for the Eastern Caribbean Currency Union (ECCU) has been submitted to Parliament. As part of our efforts to improve the supervision of nonbank financial institutions (NBFIs), a Financial Services Unit (FSU) has recently been established within the Ministry of Finance with the intention of making it the sole regulatory authority for such institutions. The legislative basis for the FSU's authority to supervise credit unions is already in place, and the consultative process for putting in place enhanced supervision of insurance companies is expected to commence by March 2005 (subject to the date of the general elections), with a view to bringing the necessary legislation to Parliament during FY 2005/06. Work is expected to start soon on empowering the FSU to regulate other NBFIs, including the Agriculture and Industrial Development Bank (AID Bank). Starting with the credit unions, we will put in place internal regulations and guidelines, revise reporting requirements as necessary, and empower the FSU to impose penalties and sanctions for regulatory noncompliance by all nonbank financial institutions. To enhance the FSU's technical capacity, we have requested technical assistance from CARTAC for the latter to assist the FSU in developing its capacity to carry out on-site examinations of credit unions—we expect this to occur by end-March 2005. Thereafter, the FSU will update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU), which will, *inter alia*, follow up on the status of measures outlined in the 2003 draft memorandum of understanding between RCCU and the Department of Cooperatives.

16. **A key priority for the Government is to assess the financial condition of the Dominica Social Security Fund (DSS).** Prior to the debt restructuring, it had been estimated that DSS would continue to generate cash surpluses for a number of years even as its long-term actuarial balance was in deficit because of the demographic structure. The bulk of DSS's assets are, however, concentrated on Government instruments. Hence, the debt restructuring is likely to have an adverse impact on the DSS's cash flow position and its reserves. There is also a pressing need to ensure that the investment portfolio and risk management practices of DSS reflect best practices. We will, therefore, request external assistance to carry out a comprehensive pension system review during this fiscal year. We expect the review, *inter alia*, to help determine whether the current structure of contributions and benefits needs to be altered to ensure the long-term health of DSS. The review will also consider the implications of the increase in the public employee retirement age for the medium-term financial position of the enlarged Government (including DSS); we stand ready to make any further changes to the pension system that may be appropriate in light of this study.

### C. Advancing the Growth Agenda

17. **Building on the initial gains in stabilization, the Government is elaborating the long-term growth strategy for Dominica.** In late October 2004, we organized a number of meetings with the general public, the business community, and other stakeholders (including donors). The purpose of these meetings was to help identify bottlenecks in key sectors and areas where the Government can take steps to improve the enabling environment for private-sector led growth, without increasing direct Government involvement in commercial activity or providing subsidies. The outcomes of these meetings will be important ingredients in the formulation of the GSPSP. We have launched a series of consultations with stakeholders on the draft GSPSP early this year, with the aim of having the final document endorsed by Cabinet ahead of the start of FY 2005/06. In the period ahead, we are placing special emphasis on fleshing out and prioritizing sectoral strategies and linking them to the overall macroeconomic framework.

18. **The aid programme agreed with People's Republic of China will allow us to further expand investment without adding to the debt burden.** We have identified a series of infrastructure projects that will be sequentially financed with this assistance over the next several years. There will be a domestic labor component to the projects to be financed by the grants. Most of the financing is, however, expected to go towards paying for the necessary imports of goods and services. The aid programme will be fully incorporated into the public sector investment programme and the Government budget will show both the disbursements of the grants and the corresponding expenditures as they occur.

19. **Government will continue to reassess the functions and operations of a number of key growth agencies in order to maximize the efficiency of Government services in the post-stabilization environment.** To this end, Government will undertake strategic reviews of the AID Bank, Dominica Export Import Agency (DEXIA) and the National Development Corporation (NDC). We intend to begin the assessment of the AID Bank

during this fiscal year. The Government will prepare an action plan for DEXIA and NDC that will address issues of reorganization. It is expected that this plan will be submitted to Cabinet in 2005. We will also ensure that the 2004 audited financial accounts for all three of these bodies will be tabled to Parliament by June 2005.

Table 1. Dominica: Quantitative Performance Criteria and Indicative Targets  
Under the PRGF, June 2004–September 2005 1/

	2004			2005		
	June 30 Actual 2/	Sept. 30 Actual 3/	Dec. 31 Actual 3/	Mar. 31 Program 3/	June 30 Program 3/	Sept. 30 Targets 6/
<b>I. Performance Criteria (PC)</b>						
(In millions of Eastern Caribbean dollars)						
Central government primary balance	40.1	0.1	14.0	11.0	14.7	4.5
Central government wage bill	104.2	25.3	51.5	78.5	102.7	24.9
Banking system net credit to central government	-41.4	4.0	-2.2	0.0	0.0	4.8
Net changes in central government arrears to private domestic parties	-7.2	3.2	4.4	15.0	15.0	3.0
(In millions of U.S. dollars)						
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year	27.6	2.9	3.4	8.0	10.0	2.0
Net changes in the outstanding stock of contracted or guaranteed short-term external debt of the central government (with maturity of less than one year) 4/	Met	Met	Met	0.0	0.0	0.0
Net changes in external payments arrears of the central government 4/ 5/	Met	Not met	Not met	0.0	0.0	0.0
<b>II. Indicative Targets (IT)</b>						
(In millions of Eastern Caribbean dollars)						
Central government overall balance	-1.6	-13.5	-8.2	-25.6	-31.6	-8.9
Central government revenues	221.6	55.3	116.4	160.3	210.6	57.0
Central government primary savings	41.4	12.5	27.6	29.6	36.3	13.7

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

1/ All variables and any adjustors that apply, are defined in the Technical Memorandum of Understanding.

2/ Cumulative amounts from June 30, 2003.

3/ Cumulative amounts from June 30, 2004.

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

5/ External arrears that were known at the time of the Executive Board discussion on August 4, 2004, were waived.

6/ Cumulative amounts from June 30, 2005. Targets for September 30, 2005 are all indicative targets.

**Table 2. Structural Benchmarks**

**For Fifth Review**

Update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU) with technical assistance, and follow up on the status of measures outlined in the 2003 memorandum of understanding (end-May, 2005).

Prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These proposals will include numerical targets and procedures to be followed in the design of the annual budget (end-April, 2005).

Approval of 2005/06 budget, containing a primary balance target consistent with the programme (end-June, 2005).

**For Sixth Review**

Establish legislative basis for the Financial Services Unit (FSU) to supervise insurance companies and regulate all nonbank financial institutions, including the Agriculture and Industrial Development Bank (end-September, 2005).

Endorsement by Cabinet of an action plan for DEXIA and NDC that will address issues of reorganization and cost effectiveness (end-September, 2005).

## TECHNICAL MEMORANDUM OF UNDERSTANDING

1. Dominica's performance under the Poverty Reduction and Growth Facility (PRGF), described in the letter of the Government of Dominica dated February 16, 2005, will be assessed by the IMF on the basis of the observance of quantitative performance criteria as well as compliance with structural performance criteria and benchmarks. This Technical Memorandum of Understanding (TMU) sets out and defines the quantitative performance criteria, indicative targets, and benchmarks specified in Tables 1 and 2 of the Supplement Memorandum of Economic Policies (SMEP), as well as the monitoring and reporting requirements.
2. The Dominican authorities are committed to transmit to the Fund staff the best data available. All revisions or expectations thereof shall be promptly reported to the Fund staff.
3. The variables mentioned herein for the purpose of monitoring the performance criteria, which are not explicitly defined, are consistent with the Government Financial Statistics (GFS). For variables omitted from the TMU which are relevant for the program targets, the authorities of Dominica shall consult with the Fund staff on their appropriate treatment, based on GFS principles and Fund program practices.

### IV. FISCAL TARGETS

#### **Indicative Target on the Overall Balance of the Central Government**

4. The **central government overall balance** will be measured from the financing side as the sum of the net domestic borrowing plus net external borrowing.
5. **Net domestic financing** by the central government is the sum of: (i) net domestic bank financing as measured by the change in the domestic banking system credit to the central government net of deposits, as reported by the consolidated balance sheet of the monetary authorities<sup>1</sup> and commercial banks, including special tranches from the ECCB and excluding net changes in (a) "double signature accounts"<sup>2</sup> and (b) the deposits of the cash grants from the People's Republic of China; (ii) net nonbank financing as measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions; (iii) the change in the stock of domestic arrears of the central

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<sup>1</sup> Consolidating the ECCB's balance sheet (excluding the government's IMF operating account) and the government's transactions with the IMF.

<sup>2</sup> The "double signature accounts" include the accounts 115002797, 115002976, 115002220, 115001912, 115003051, 115001911, 115003025, 115001471, 115001523, 115003053, 115001710, and 100038724 held in the National Commercial Bank of Dominica (NBD), and any new account in which grant receipts are deposited and which requires a signature of an external party for the release of its funds. It is expected that the forthcoming grants from the European Union in early 2005 will be released through a "double signature account."

government defined as net changes in unpaid checks issued, unprocessed claims, pending invoices, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid; (iv) gross receipts from divestment; (v) financing from debt restructuring measured as domestic debt service payments (principal and interest) on a due basis less actual debt service payments; and (vi) any other exceptional financing.<sup>3</sup>

6. **Net external financing** of the central government is defined as the sum of (i) disbursements of project and nonproject loans, including securitization, but excluding the use of IMF resources; (ii) proceeds from bonds issued abroad; (iii) exceptional financing (rescheduled principal and interest), net changes in cash deposits held outside the domestic banking system, (iv) net changes in short-term external debt; (v) any change in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid; (vi) financing from debt restructuring measured as external debt service payments (principal and interest) on a due basis less actual debt service payments; (vii) any other exceptional financing; and less (viii) payments of principal on current maturities for bonds and loans on a due basis but excluding the use of IMF resources, and including any prepayment of external debt.

7. The programmed amounts of debt service on a due basis are shown in Table 1 below:

**Table 1. Domestic and External Debt Service Payments on a Due Basis**

	External interest payments	External amortization payments	Domestic interest payments	Domestic amortization payments
(in millions of Eastern Caribbean dollars)				
<b>Cumulative flows (from June 30, 2004)</b>				
End-September 2004	8.4	7.2	5.2	0.8
End-December 2004	12.0	36.2	10.2	1.7
End-March 2005	20.4	38.9	15.3	2.5
End-June 2005	23.4	43.2	20.4	3.4
<b>Cumulative flows (from June 30, 2005)</b>				
End-September 2005	8.3	3.2	5.1	0.9

<sup>3</sup> Treasury bills will be recorded at face value, except for those held by the banking system which will be recorded on a purchase price basis.

8. The program floors on the overall balance are reported in Table 2 below.

**Table 2. Indicative Target on the Overall Balance of the Central Government**

(in millions of Eastern Caribbean dollars)	
<b>Cumulative balance (from June 30, 2004)</b>	
End-September 2004 (actual)	-13.5
End-December 2004 (actual)	-8.2
End-March 2005 (indicative target)	-25.6
End-June 2005 (indicative target)	-31.6
<b>Cumulative balance (from June 30, 2005)</b>	
End-September 2005 (indicative target)	-8.9

9. The floor on the overall balance of the central government will be adjusted as follows:

- (i) Upward<sup>4</sup> to the extent that **budgetary grants** exceed programmed amounts. Budgetary grants are defined as grant receipts that are not earmarked for capital outlays, and including the drawdown of deposits of the cash grants from China. For the purpose of this adjustor, the budgetary grants cumulated from June, 30, 2004 amount to: US\$5.1 million by end-December 2004, US\$6.0 million by end-March 2005, and US\$7.0 million by end-June 2005.<sup>5</sup> Budgetary grants cumulated from June, 30, 2005 amount to US\$1.0 million by end-September 2005.
- (ii) Downward by the amount severance payments and the administrative expenditures linked to the debt restructuring operations exceed the grants targeted to these programs.
- (iii) Downward by up to the full amount of EC\$5.94 million, if the funds earmarked for the Caribbean Court of Justice (CCJ) and currently in escrow are disbursed.

### **Performance Criterion on the Central Government Primary Balance**

10. **The central government primary balance** is defined as the central government overall balance (from the financing side as defined in paragraph 4) plus domestic and external interest payments on a due basis. Interest payments do not include either domestic or external interest payments made by the central government on behalf of other parties.

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<sup>4</sup> Upward adjustment means lower deficit.

<sup>5</sup> It is expected that forthcoming grants to cover severance payments will be received as capital grants. However, if these are received as budgetary grants, then the programmed amounts of budgetary grants will be higher than stipulated by the expenditures in both these programs.

11. The program floors on the central government primary balance are reported in Table 3 below.

**Table 3. Performance Criterion on the Central Government Primary Balance**

(in millions of Eastern Caribbean dollars)	
<b>Cumulative balance (from June 30, 2004)</b>	
End-September 2004 (actual)	0.1
End-December 2004 (actual)	14.0
End-March 2005 (indicative target)	11.0
End-June 2005 (performance criterion)	14.7
<b>Cumulative balance (from June 30, 2005)</b>	
End-September 2005 (indicative target)	4.5

12. The same adjustors described in paragraph 9 apply to the primary balance.

**Performance Criterion on the Central Government Wage Bill**

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

14. The program ceilings on the central government wage bill are shown in Table 4 below:

**Table 4. Performance Criterion on the Central Government Wage Bill**

(in millions of Eastern Caribbean dollars)	
<b>Cumulative flows (from June 30, 2004)</b>	
End-September 2004 (actual)	25.3
End-December 2004 (actual)	51.5
End-March 2005 (indicative target)	78.5
End-June 2005 (performance criterion)	102.7
<b>Cumulative flows (from June 30, 2005)</b>	
End-September 2005 (indicative target)	24.9

### **Performance Criterion on the Central Government Arrears Accumulation to Domestic Private Parties**

15. **Net changes in central government arrears to domestic private parties** is defined as changes in the sum of all pending payments by government for goods and services already purchased from these parties, as well as pending unpaid checks for payments into the escrow account set up for debt restructuring. Private domestic parties exclude DOWASCO, Dominica Social Security, National Development Corporation, Dominica Broadcasting Corporation, DEXIA, and the Ports Authority. The measure used will be unpaid checks issued and pending invoices for which payment is overdue.

16. The program ceilings on the central government arrears accumulation to domestic private parties are reported in Table 5 below.

**Table 5. Performance Criterion on the Central Government Arrears Accumulation to Domestic Private Parties**

		(in millions of Eastern Caribbean dollars)
<b>Cumulative flows (from June 30, 2004)</b>		
End-September 2004 (actual)		3.2
End-December 2004 (actual)		4.4
End-March 2005 (indicative target)		15.0
End-June 2005 (performance criterion)		15.0
<b>Cumulative flows (from June 30, 2005)</b>		
End-September 2005 (indicative target)		3.0

### **Indicative Targets on Revenues of the Central Government**

17. **Central government revenues** are defined as the tax collections and nontax revenues reported in the treasury accounts (economic classification), excluding: (i) revenues from the economic citizenship program, (ii) foreign and domestic grant receipts, (iii) repayment of loans, (iv) wage refunds, and (v) privatization receipts, and includes income tax refunds.

18. The program floors on the revenues of the central government are reported in Table 6 below.

**Table 6. Indicative Targets on Revenues of the Central Government**

(In millions of Eastern Caribbean dollars)	
<b>Cumulative flows (from June 30, 2004)</b>	
End-September 2004 (actual)	55.3
End-December 2004 (actual)	116.4
End-March 2005 (indicative target)	160.3
End-June 2005 (indicative target)	210.6
<b>Cumulative flows (from June 30, 2005)</b>	
End-September 2005 (indicative target)	57.0

**Indicative Targets on the Primary Savings of the Central Government**

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

20. The program ceilings on the central government primary savings are reported in Table 7 below.

**Table 7. Indicative Targets on the Primary Savings of the Central Government**

(in millions of Eastern Caribbean dollars)	
<b>Cumulative flows ( from June 30, 2004)</b>	
End-September 2004 (actual)	12.5
End-December 2004 (actual)	27.6
End-March 2005 (indicative target)	29.6
End-June 2005 (indicative target)	36.3
<b>Cumulative flows ( from June 30, 2005)</b>	
End-September 2005 (indicative target)	13.7

**Monitoring discretionary tax exemptions**

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

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

## V. MONETARY TARGETS

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

23. **Net credit of the banking system** is defined as in paragraph 5. The program ceilings on the net credit of the banking system to the central government are reported in Table 8 below.

**Table 8. Performance Criterion on the Net Credit of the Banking System to the Central Government**

(in millions of Eastern Caribbean dollars)	
<b>Cumulative flows (from June 30, 2004)</b>	
End-September 2004 (actual)	4.0
End-December 2004 (actual)	-2.2
End-March 2005 (indicative target)	0.0
End-June 2005 (performance criterion)	0.0
<b>Cumulative flows (from June 30, 2005)</b>	
End-September 2005 (indicative target)	4.8

24. The ceiling on net credit of the banking system will be adjusted upward (downward) to the extent that actual interest payments are higher (lower) than the programmed amounts on a cash basis. The programmed amounts of interest payments on a cash basis are shown in Table 9 below.

**Table 9. Interest Payments on a Cash Basis**

	Total interest payments	Domestic interest payments	External interest payments
(in millions of Eastern Caribbean dollars)			
<b>Cumulative flows (from June 30, 2004)</b>			
End-September 2004	9.0	2.7	6.3
End-December 2004	13.4	5.3	8.1
End-March 2005	19.5	8.2	11.3
End-June 2005	24.5	10.8	13.7
<b>Cumulative flows (from June 30, 2005)</b>			
End-September 2005	5.5	3.3	3.2

## VI. EXTERNAL SECTOR TARGETS

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

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

26. The program ceilings on disbursements of nonconcessional external central government or central government guaranteed debt with maturity of at least one year are reported in Table 10 below.

**Table 10. Performance Criterion on Disbursements of Nonconcessional External Central Government or Central Government Guaranteed Debt with Maturity of at Least One Year**

	(In millions of U.S. dollars)
<b>Cumulative flows (from June 30, 2004)</b>	
End-September 2004 (actual)	2.9
End-December 2004 (actual)	3.4
End-March 2005 (indicative target)	8.0
End-June 2005 (performance criterion)	10.0
<b>Cumulative flows (from June 30, 2005)</b>	
End-September 2005 (indicative target)	2.0

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

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

- (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
  - (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and
  - (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.
- (b) Under the definition of debt set out in point 21(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.”

28. **Nonconcessional debt** is defined as debt having a grant element (in net present value relative to face value) **of less than 35 percent**, based on the currency- and maturity-specific Commercial Reference Rates (CIRR), published monthly by the OECD.<sup>6</sup> The limit excludes the disbursements of short-term import-related debts, the use of Fund resources, and refinancing operations.

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

29. The **stock of short-term external debt outstanding** is defined as debt with original maturity of less than one year contracted or guaranteed by the central government. The term debt is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with

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<sup>6</sup> For loans with a maturity of at least 15 years, the 10-year average commercial interest reference rates and for loans with shorter maturities, the 6-month average CIRRs, as of February 2005 published by the OECD will be used as the discount rates. To both the 10-year and 6-month averages, the following margins for differing repayment periods will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 years or more.

Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000) (see paragraph 27 above), but excludes normal import-related credits.

30. No short-term external debt with original maturity of less than one year, will be contracted or guaranteed by the central government. This ceiling will be monitored on a continuous basis.

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

31. **Central government and central government guaranteed external payment arrears** are defined as overdue payments (principal or interest) on debt contracted or guaranteed by the central government. The definition of external payment arrears under the program **excludes**: (i) debt claims that were irrevocably tendered in the debt exchange closed on September 31, 2004 (the "Debt Exchange"), (ii) debt claims that were eligible to participate in the Debt Exchange but have not been tendered, and (iii) debts claims of official bilateral creditors which are under rescheduling or refinancing negotiation. It also does not include outstanding subscription payments to regional and international organizations, for which understandings will be reached to ease payment obligations consistent with the program.

32. No external payment arrears of the central government and central government guaranteed debt, will be allowed in the program. This ceiling will be monitored on a continuous basis.

## VII. STRUCTURAL BENCHMARKS

### **For Fifth Review**

- Update the earlier on-site inspection of Roseau Cooperative Credit Union (RCCU) with technical assistance, and follow up on the status of measures outlined in the 2003 memorandum of understanding (end-May, 2005).
- Prepare for discussion by Cabinet and the general public, proposals for amendments to the Finance Administration Act. These proposals will include numerical targets and procedures to be followed in the design of the annual budget (end-April, 2005).
- Approval of 2005/06 budget containing a primary balance target consistent with the program (end-June, 2005)

### **For Sixth Review**

- Establish legislative basis for the Financial Services Unit (FSU) to supervise insurance companies and regulate all nonbank financial institutions, including the Agriculture and Industrial Development Bank (end-September, 2005).
- Endorsement by Cabinet of an action plan for DEXIA and NDC that will address issues of reorganization and cost effectiveness (end-September, 2005).

### VIII. PERIODIC REPORTING

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

- Data for monitoring the program's performance criteria and monthly indicative targets, including
  - Fiscal sector
    - (i) Central government budgetary accounts.
    - (ii) Dominica Social Security Balance Sheet, showing amounts receivable from central government for contributions and interest.
    - (iii) Central government domestic debt data.
    - (iv) Current grant inflows.
    - (v) Stock of unpaid checks issued and stock of unprocessed claims due and invoices pending.
    - (vi) Capital expenditure (project by project) and composition of financing, including revised projections for the remainder of the fiscal year.
    - (vii) Balances in the debt servicing account linked to the Royal Merchant Bank Bond Issue.
    - (viii) Total number of exemptions issued (by type of exemption).
    - (ix) Severance payments and administrative expenditures linked to the debt restructuring operations, and details about how they were financed.
  - Financial sector
    - (x) Monetary survey for Dominica as prepared by the Eastern Caribbean Central Bank, including balances in central government double signature accounts.
  - External and real sectors
    - (xi) Imports and exports data by product.

- (xii) Detailed (creditor by creditor) external debt report from the Debt Unit in the Ministry of Finance and Planning, showing fiscal year-to-date disbursements, amortization, interest payments, and outstanding stocks, for the central government, public enterprises and AID Bank.
- (xiii) Total disbursements/grant receipts, monthly, disaggregated into: (a) budgetary support (by type—either loans or external “bonds” and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.
- (xiv) Stock of external payment arrears of the NFPS, including amortization and interest payment arrears, and supplier arrears for the central government, public enterprises, and AID Bank.
- (xv) Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.
- (xvi) Consumer price index.
- (xvii) Real sector indicators

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

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

➤ External and real sectors

(xviii) GDP and its components.

(xix) Balance of payments accounts.

35. Other reporting will include:

➤ Reports of legislative changes pertaining to economic matters.