

Roseau, Dominica
September 8, 2005

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

Dear Mr. de Rato,

1. It has been more than a year and a half since Dominica requested an arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF) to cope with the economic crisis that had emerged and resolve our fiscal and debt difficulties. The government outlined its economic policies in the letter of intent and memorandum of economic policies (MEP) of December 10, 2003 and redefined them subsequently in the context of the programme reviews.
2. Performance under the programme remains satisfactory. All quantitative performance criteria for end-June 2005 were met, except for the performance criterion on nonobservance of external payments arrears. An external debt service payment on a government-guaranteed loan was inadvertently delayed for a few days due to an operational error by the borrowing institution. Government has made progress in structural reforms and all the structural benchmarks for the fifth review were implemented. We have also made considerable progress in the collaborative restructuring our debt, and will continue our good faith efforts to reach agreements with our nonparticipating creditors.
3. Dominica remains committed to the arrangement under the PRGF and the attached supplementary MEP outlines our policies for FY 2005/2006. The proposed indicative targets, performance criteria, and structural benchmarks are indicated in Tables 1 and 2. On this basis, we request a waiver for the nonobservance of the continuous performance criteria on external payments arrears, completion of the fifth review of the programme and the release of the associated disbursement under the arrangement.
4. We also request the extension of repurchase expectations arising in the one-year period commencing on December 22, 2005 totaling an amount equivalent to SDR 1,268,444. We believe that meeting these repurchase expectations would impose undue hardship and risk at a crucial time, and we therefore request instead that these repurchases be made on an obligations basis starting on December 22, 2006.

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

I. BACKGROUND

1. Our economy continues to recover from the economic crisis and financial disarray in 2001–02 triggered by the build-up of public debt to unsustainable levels. Reflecting the comprehensive economic reforms that the Government of the Commonwealth of Dominica has pursued in the last few years, public finances are on a firmer footing and economic growth has recovered—with output expansion set to exceed the historical average for the second straight year in 2005.

2. **Sustaining the improved growth performance to better the standard of living of all Dominicans remains the central objective of our economic policies.** To this end, our economic reform strategy retains its four elements, with the emphasis now decidedly shifting to the policies necessary to sustain high economic growth. Specifically:

- With creditor participation in our **collaborative debt restructuring** past 70 percent, our objective is to try to reach agreement with all remaining nonparticipating creditors;
- Our **fiscal stance** will be consistent with reducing the public debt burden to sustainable levels;
- **Fiscal reforms** are being undertaken to improve the transparency and effectiveness of the tax regime and the budgetary process; and
- Critically, we are also determined to improve the **enabling environment for private sector investment**, which will require measures to enhance the efficiency of the public service and re-orient our public sector investment programme towards the provision of physical and human capital investment.

II. PERFORMANCE UNDER THE PROGRAMME

3. **Macroeconomic outcomes were strong in 2004 and the first half of 2005.** Output growth in 2004, estimated at some 3½ percent, was broad-based, with transportation, agriculture, manufacturing and construction all showing signs of a robust recovery from the 2001–02 slump. This rebound in activity was mirrored in a sharp rebound in credit growth, which had been contracting since early 2001, but accelerated sharply last year to an annual growth of 7 percent. While inflation has been somewhat volatile in recent months, it nonetheless averaged 1½ percent in 2004. Export growth has remained modest at some 9 percent in 2004, while imports have surged reflecting the economic recovery and higher energy prices. The same broad trends are evident in developments in the first half of this year.

4. **All but one performance criteria for the fifth review have been met.** Reflecting one-off revenues which contributed to arrears reduction and lower spending on goods and services, end-March 2005 indicative targets were met with large margins as were all end-June quantitative performance criteria. The primary balance in FY 2004/05 was 4.4 percent of GDP, about 2½ percent above the target notwithstanding the fact that unexpected one-off expenditures related to the Caribbean Court of Justice and emergency reconstruction costs following last November's earthquake had to be accommodated into the budget. The margin on the wage bill performance criterion was smaller at less than EC\$1 million. However, due to a technical glitch, there was a temporary delay (about a week) in debt service payment by DOMLEC on a government guaranteed loan causing the continuous performance criteria on nonaccumulation of external arrears to be unobserved.

5. **All three structural benchmarks for the fifth review under the programme have been now been observed:**

- The on-site inspection of the Roseau Cooperative Credit Union was completed on schedule. Concerns about the level of nonperforming assets, account-handling practices, and the quality of the audit process were flagged.
- Amendments to the Finance Administration Act for Cabinet and public discussion were prepared in May. Proposals for numerical targets were prepared separately in August, and submitted to Cabinet with the amendments. Public consultation began in September.
- The 2005/06 budget was approved by Parliament on August 4, with a primary balance target consistent with the programme.

6. **We are also making considerable progress in identifying and implementing other structural reforms.**

- The Government of Dominica has decided to publish in the Official Gazette all Cabinet decisions granting new tax and duty concessions—a step that will enhance the transparency of public finances. Concessions granted in 2004/05 were sent to the publishers in August. Going forward, publication will occur on a monthly basis (with a one month lag). The published material will identify the beneficiary of the tax exemption as well as the legal basis for the concession.
- In the area of public expenditure management, the main government account is now being reconciled on a monthly basis. In addition, all transactions conducted are now being captured in the general ledger, and opening balances will be adjusted by end-December. Moreover, all local purchase orders are now generated electronically.
- In an effort to strengthen the accountability and financial management of public enterprises and statutory bodies and ensure greater reporting to the general public, we will submit to Parliament the audited financial accounts for the year ending in 2004

for AID Bank, DOWASCO, and DEXIA by end-2005. The accounts for the NDC are being prepared for audit by end-December and will be submitted to Parliament early in 2006. We will continue this practice going forward.

- With the help of an IMF/World Bank technical assistance mission, a review of the financial condition of Dominica Social Security (DSS) was completed in June. The study shows that the pension system's finances are on a highly unsustainable trajectory. However, the study also identified reforms that, if implemented promptly, can address the very large threat to public finances.

7. **We remain committed to engaging our creditors in good faith negotiations.** We have signed agreements with all our domestic creditors, including DSS (see below). As a sign of our commitment to making good faith efforts to reach agreement with remaining external nonparticipating creditors, we continue to make payments on the new restructured terms into an escrow account on their behalf. We also expect to shortly pass legislation to allow the debentures that we have issued to the creditors that participated in the restructuring to be traded on the Eastern Caribbean Stock Exchange (ECSE).

III. ENABLING GROWTH AND REDUCING VULNERABILITIES

8. **The government is in the process of finalizing its growth and social protection strategy (GSPS) paper to guide our policies over the medium term.** The growth strategy seeks to make the private sector the engine of economic growth, with the government playing a facilitating role. The social protection aspects will focus on reducing the vulnerabilities during the period of adjustment.

9. **The key growth sectors will be tourism, energy, services, agriculture, light manufacturing, and offshore education.** The potential for heritage, health, and ecotourism is largely untapped; we will focus on improvement of related infrastructure and product development, which will facilitate private sector investments. We are working with potential investors to tap our geothermal resources, to satisfy both export and domestic demand. We expect a substantial lowering of the cost of electricity over the medium term as this project develops, which would help spur light manufacturing, including agro-processing. On agriculture, the development of the tourism sector and the agro-processing sub sector should lead to increased demand for agricultural produce. We also hope to target niche markets, including in the region, for agricultural exports. There is also potential for further development of offshore educational institutions and linking them further with the domestic economy. The recent liberalization of the telecommunications sector has created potential for the development of related services. On this basis, we expect the economy to grow at around 3 percent per annum over the medium term. This should allow us to make inroads towards lowering unemployment and consequently reduce the incidence of poverty. In the short term, however, we intend to strengthen the social safety nets by ensuring better targeting.

10. Consistent with the broad strategy laid out in the GSPS, the government's programme to improve the enabling environment for increased private sector activity includes several important initiatives for the immediate period ahead.

- We intend to obtain parliamentary approval (by end-December, 2005) of amendments to the Electricity Supply Act and related legislation with a view to demonopolizing the sector to inter alia allow new entrants, establish a regulatory commission, and put in place a tariff structure more reflective of production costs and other economic circumstances. Beyond strengthening the regulatory framework for electricity supply, these changes are important to attract investors to exploit our substantial geo-thermal energy capacity—the exploitation and export of such electricity would, in addition to helping boost growth, provide foreign exchange earnings, and reduce vulnerabilities to high oil prices.
- To improve the effectiveness of the financial sector and ensure its viability is sustained, we will take the necessary steps by end-October 2005 to allow the FSU (with external technical assistance), to conduct an on-site inspection of AID Bank (by end-March 2006). Relatedly, a memorandum of understanding has been signed with the Roseau Cooperative Credit Union (RCCU) to address the issues identified during the recent on-site inspection. The FSU will ensure that these measures are adopted by end-December to bring the RCCU in full regulatory compliance.
- There is a need to redefine the role of the public sector outside of the central government, to realign it towards the requirements of private sector-led growth and ensure high quality of public services. To this end, plans are under way to complete strategic reviews and establish action plans (by end-December 2005) for the operations of the AID Bank, DEXIA and NDC, with a view to enhancing their efficiency, streamlining their functions and improving accountability. The reviews will consider the justification for the continued existence of all of these three agencies in an environment where the government's role in the growth process is to provide a supportive environment for the private sector. An important objective of these reforms is a one-stop shop that will streamline the process and shorten the time required for establishing businesses—to be put in place by end-March 2006.
- We recognize the need to reduce red tape in order to encourage investments, including from the Dominican Diaspora. We continue to consider additional ways in which the Diaspora can contribute to the development of Dominica. We are in the process of streamlining paperwork and other requirements related to the importation of goods into Dominica. We will also make such requirements transparent by publishing them in government websites.

IV. THE 2005/06 BUDGET

11. The macroeconomic framework underpinning our budget assumes growth will be sustained at 3 percent this year and next. These rates of growth are higher than the

historical average, but not unduly optimistic taking into account the spare capacity in the economy and the expected boost to activity from higher public sector investment. Inflation is expected to remain subdued at 1½ percent in 2005/06.

12. **Further debt consolidation is an important pillar of our macroeconomic policies.** The 2005/06 budget targets a primary surplus of 3 percent of GDP, broadly in line with that realized in 2004/05 and consistent with reducing our high debt burden to sustainable levels over the medium term. A still higher primary balance would be prudent given our country's vulnerability to natural disasters—as last November's earthquake attests—and the need to prepare for the steep increase in pension costs projected for the coming years. But this needs to be weighed against the near-term investments needs. The 3 percent primary surplus for 2005/06 and beyond strikes the appropriate balance.

13. **The budget is underpinned by a number of revenue and expenditures measures, including:**

- As announced in the budget speech, the VAT is expected to come into effect on March 1, 2006. The switch from the consumption and sales taxes to VAT is expected to be revenue neutral, but with substantial benefits in terms of expanding the tax base and economic efficiency.
- As originally legislated, the 5 percent cut in civil servants wages imposed at the outset of the stabilization programme has been restored in the 2005/06 budget. This would imply a wage bill of some 13.7 percent of GDP, which is very high even by the standards of other small island economies. Accordingly, measures are being taken to avoid the wage bill crowding-out other essential and productive expenditures and adjusting the wage scale over time to allow the government to retain and attract more highly qualified personnel (see below).
- To make the state college financially independent over time, starting in FY 2005/06, the college is being treated as an independent entity from the budget, with financial support limited to an explicit transfer. The plan is to make the college rely increasingly on nonbudgetary sources of funding.
- The public sector investment programme (PSIP) will be kept to a level consistent with our implementation capacity, and focused on projects that will yield the highest rates of return.
- We will use budget-support grants in excess of programmed amounts to pay down our debt and build up bank balances. The next review will reassess the outlook for revenues and expenditures and revisit the fiscal programme targets as appropriate.

V. STRUCTURAL FISCAL REFORMS

14. **Large unfunded liabilities in the pension system are a major threat to public finances.** Reflecting population aging, the number of pensioners per contributor is expected to increase sharply from 0.23 in 2004 to 0.32 in 2020 and 0.78 by 2050. The net present value (NPV) of the unfunded liabilities of DSS are estimated at more than 150 percent of GDP. The restructuring of the government's debt has also had the effect of further weakening the financial position of DSS. Therefore, in the absence of corrective measures, cash flows will turn negative in 2014 and DSS will deplete its reserves by 2025. The transfers that the central government would need to make to fill the gap between DSS's income and spending would mean that public finances would return to an unsustainable path.

15. **The government recognizes that reforms to address the financial problems in DSS are unavoidable.** Ultimately, the choice is not between reform and no reform, but between gradual, moderate, and equitable reform now or abrupt, drastic, and inequitable reforms later when the pension system's finances are exhausted. Accordingly, we will prepare an action plan (by end-December 2005) to eliminate the unfunded liabilities of DSS that will identify specific steps and a time line for implementation, and we will subsequently have this plan approved by Cabinet (by end-March 2006). Putting the finances of the DSS on a sustainable footing will require adjustments to: the replacement rate, the contribution rate, the number of years over which average earnings are calculated, and the retirement age. The reform strategy will consider the appropriate balance between these options. Another important reform objective is international diversification of DSS's portfolio, which we will be undertaken in a gradual manner. In the interim, we have regularized the financial relations between the government and DSS, including by finalizing the debt restructuring agreement in September 2005.

16. **The overriding objective for the public sector is for our country to have a relatively smaller, more efficient, and better paid public service—consistent with our vision of the private sector playing the dominant role in the economy.** To that end, we intend to reduce the role of the government, with particular attention to the share of the wage bill in GDP.

- For 2005/06, the government has adopted a number of measures to initiate the process of focusing the civil service on the core activities that the government needs to provide. These measures include outsourcing of janitorial and government building protection services and streamlining the airport and ports authorities. Government is hopeful that the initial (redundancy) costs of this exercise will be grant-financed from the EU's Framework of Mutual Obligations. Steps are also being taken to reduce overtime pay at Customs. These initiatives will ensure that the allocation for the wage bill will be adhered to.
- Second, as outlined in the budget, in addition to the foregoing measures, the government will keep under review the scope for streamlining, commercializing or privatizing other services. The government has already identified possible additional

measures. The overall objective of these initiatives is to reduce the wage bill further by 1–1½ percent of GDP from its current level of 13¾ percent of GDP over the next three years. With this in mind, the on-going review by the Establishment, Personnel and Training Division on public service reform will continue, with a view to streamlining the structure and functioning of government ministries and departments. This review, which will be completed by end-February, will *inter alia* seek to address unfilled positions, with a view to identifying and eliminating those that are no longer necessary.

- Third, future wage and salary increases will be consistent with progress in reaching the objectives of reducing the wage bill. The government recognizes the need to improve emoluments of deserving civil servants, and expects that further rationalization of public sector employment will contribute to this.

17. Further reforms are also being put in place to strengthen the framework governing public finances. Based on the outcome of the public and Cabinet discussions of the proposed revisions to the Finance Administration Act (FAA), we plan to obtain Cabinet approval of the amendments to the FAA by end-November 2005 and parliamentary approval in early 2006. These amendments to the FAA will improve the credibility of fiscal policy, provide an anchor for public expectations regarding the public finances over the medium term, as well as improve the transparency and accountability of the management of public finances. Specifically:

- The revised legislation will outline as an important objective the reduction of public debt to prudent levels. It will further note that the government will target a primary surplus consistent with reducing public debt annually while the debt stock remains above 60 percent of GDP—the benchmark recommended by the ECCB. Where such a primary surplus is not being targeted, the government, in its annual budget document, will need to provide a comprehensive explanation of the reasons for the deviation from the target and outline its policies for getting back on target within the shortest possible timeframe.
- Moreover, these amendments will be buttressed by a public commitment by the government to aim for a 3 percent of GDP primary surplus in the budget. Again, where a primary surplus of at least 3 percent is not being targeted, the government, will provide a comprehensive explanation of the reasons for the deviation from the target and outline its policies for getting back on target within the shortest possible timeframe.

18. Further reforms are planned to improve the consistency of budget and debt management. With the help of CARTAC, we intend to introduce medium-term budgeting practices for line ministries to minimize ad hoc shifts in the fiscal stance and instill a greater measure of expenditure controls. To ensure debt remains sustainable and off-budget entities do not accrue excessive liabilities, we have adopted guidelines under which the government is willing to extend guarantees.

19. Preparations for the introduction of a VAT on March 1, 2006 continue apace.

The draft VAT and Excise Tax Laws are expected to be approved by Parliament in August (prior action), with implementing regulations finalized soon after. The VAT will have two rates (a standard 15 percent rate and a 10 percent rate for hotel accommodation), and zero rating and exemptions have been kept to a minimum. To ensure the VAT will be introduced on time, organizational and staffing issues have been resolved and IT infrastructure will be tested and put in place by end-October 2005. All necessary steps will be taken to ensure that the introduction of VAT refunds can be made on a timely basis.

20. The government also intends to undertake a comprehensive review of statutory tax exemptions. The review will by end-December consider the justification for statutory and nonstatutory concessions, and repeal those that are found to be unnecessary.

21. The government will continue to closely monitor the projects that are included in the Public Sector Investment Programme (PSIP) for their consistency with our growth and poverty reduction strategy. The PSIP for the 2005/06 budget is broadly in line with the our poverty reduction strategy document—the Growth and Social Protection Strategy (GSPS) paper. To ensure full consistency with the GSPS, government will seek to ensure an appropriate balance between investments in the economic sectors and economic and social infrastructure. The government will strictly limit nongrant financed capital spending to a level that is consistent with agreed macroeconomic parameters. Consistent with our implementation capacity, we will also limit the overall PSIP to around 10 percent of GDP.

Table 1. Dominica: Quantitative Performance Criteria and Indicative Targets
Under the PRGF, September 2005–June 2006 1/

	2005		2006	
	Sept. 30	Dec. 31	Mar. 31	June 30
	Program 2/	Program 2/	Program 2/	Program 2/
I. Performance Criteria (PC)				
(In millions of Eastern Caribbean dollars)				
Central government primary balance	2.9	7.6	16.2	23.7
Central government wage bill	27.6	55.7	81.4	106.5
Banking system net credit to central government	3.0	-0.1	-6.4	-13.6
Net changes in central government arrears to private domestic parties	4.0	8.0	8.0	8.0
(In millions of U.S. dollars)				
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year	1.9	4.4	6.9	9.0
Net changes in the outstanding stock of short-term external debt contracted or guaranteed by the central government (with maturity of less than one year) 3/	0.0	0.0	0.0	0.0
Nonaccumulation of central government and central government guaranteed external payments arrears 3/ 4/	0.0	0.0	0.0	0.0
II. Indicative Targets (IT)				
(In millions of Eastern Caribbean dollars)				
Central government overall balance	-10.5	-14.0	-18.7	-19.3
Central government revenues	52.9	111.1	171.9	230.8
Central government primary savings	5.5	14.0	27.3	38.9

Sources: Dominican authorities; 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, 2005. Targets for September 31, 2005 and March 31, 2006 are all indicative targets.

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

4/ Waiver requested for the external arrears known at the time of the Executive Board discussion on October 14, 2005.

Table 2. Structural Conditionality

(Structural benchmarks, unless otherwise indicated)

Prior Actions for the Fifth Review

- Passage by Parliament and enactment into law of a VAT Act with an effective date of March 1, 2006.
- Approval by Cabinet of an implementation plan to rationalize the wage bill.

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-December, 2005).
- Complete strategic review and establish action plans for the operations of Aid Bank, DEXIA and NDC, with a view to enhancing their efficiency, streamlining their functions and improving accountability (end-December, 2005).
- Parliamentary approval of amendments to the Electricity Supply Act and related legislation (end-December 2005).
- Complete review by end-February 2006 the streamlining of the structure and functioning of government ministries and departments, with a view to further reducing wage bill over the following three years.
- Implementation of VAT starting March, 1 2006 (**structural performance criterion**).

Seventh Review

- Cabinet approval of action plan to eliminate the unfunded liabilities of DSS (end-March 2006).
- Parliamentary approval of amendments to the Finance Administration Act as described in paragraph 17 (end-May, 2006).
- Line ministries to submit rolling three-year expenditure plans (end-May, 2006).

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 September 8, 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.

I. FISCAL TARGETS

A. 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 authorities¹ and commercial banks, including special tranches from the ECCB and excluding net changes in (a) "double signature accounts"² 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

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

² The "double signature accounts" include the accounts 115002797, 115002976, 115002220, 115001912, 115003051, 115001911, 115003025, 115001471, 115001523, 115003053, 115001710, and 100038724 held in the National Bank of Dominica (NBD), and any new account in which grant receipts are deposited and which requires a signature of an external party for the release of its funds. It is expected that the forthcoming grants from the European Union in late 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.³

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)				
Cumulative flows (from June 30, 2005)				
End-September 2005	8.3	3.2	5.1	0.9
End-December 2005	11.5	13.2	10.1	1.7
End-March 2006	19.7	16.1	15.2	2.9
End-June 2006	22.8	20.4	20.2	3.5

³ 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.

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)
Cumulative balance (from June 30, 2005)	
End-September 2005 (indicative target)	-10.5
End-December 2005 (indicative target)	-14.0
End-March 2006 (indicative target)	-18.7
End-June 2006 (indicative target)	-19.3

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

- (i) Upward⁴ 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 programmed budgetary grants for fiscal year 2005/06 amount to: EC\$2.6 million by end-September 2005; EC\$3.8 million by end-December 2005; EC\$5.0 million by end-March 2006; and EC\$6.2 million by end-June 2006.⁵
- (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) Upward by the amount received from Security Bond forfeitures.

B. Performance Criterion on the Central Government Primary Balance

9. **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.

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

⁴ Upward adjustment means lower deficit.

⁵ The program assumes that EC\$4.8 million will be received from EU STABEX 1998/99/00 to cover severance payments and other already identified projects.

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

(In millions of Eastern Caribbean dollars)	
Cumulative balance (from June 30, 2005)	
End-September 2005 (indicative target)	2.9
End-December 2005 (performance criterion)	7.6
End-March 2006 (indicative target)	16.2
End-June 2006 (performance criterion)	23.7

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

Performance Criterion on the Central Government Wage Bill

12. The **central government wage bill** will be measured as the total expenditure of the central government on wages and salaries of central government employees net of wage refunds, including acting allowances, special duty allowances, responsibility allowances, subsistence allowances, the employer contribution to Dominica Social Security, 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.

13. 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)	
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	27.6
End-December 2005 (performance criterion)	55.7
End-March 2006 (indicative target)	81.4
End-June 2006 (performance criterion)	106.5

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

14. **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.

15. 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)	
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	4.0
End-December 2005 (performance criterion)	8.0
End-March 2006 (indicative target)	8.0
End-June 2006 (performance criterion)	8.0

D. Indicative Targets on Revenues of the Central Government

16. **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. Capital revenues are excluded.

17. 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)
Cumulative flows (from June 30, 2005)		
End-September 2005 (indicative target)		52.9
End-December 2005 (indicative target)		111.1
End-March 2006 (indicative target)		171.9
End-June 2006 (indicative target)		230.8

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

18. **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.

19. 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)
Cumulative flows (from June 30, 2005)		
End-September 2005 (indicative target)		5.5
End-December 2005 (indicative target)		14.0
End-March 2006 (indicative target)		27.3
End-June 2006 (indicative target)		38.9

Monitoring discretionary tax exemptions

20. **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).

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

II. MONETARY TARGETS

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

22. **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)
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	3.0
End-December 2005 (performance criterion)	-0.1
End-March 2006 (indicative target)	-6.4
End-June 2006 (performance criterion)	-13.6

23. 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)			
Cumulative flows (from June 30, 2005)			
End-September 2005	5.0	2.7	2.3
End-December 2005	8.8	4.5	4.3
End-March 2006	13.9	7.2	6.6
End-June 2006	17.8	9.1	8.7

III. EXTERNAL SECTOR TARGETS

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

24. 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.

25. 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)	
Cumulative flows (from June 30, 2005)	
End-September 2005 (indicative target)	2.6
End-December 2005 (performance criterion)	6.7
End-March 2006 (indicative target)	8.3
End-June 2006 (performance criterion)	10.0

26. 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.”

27. **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.⁶ The limit excludes the disbursements of short-term import-related debts, the use of Fund resources, and refinancing operations.

B. 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

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

⁶ 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 August 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.

29. 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.

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

30. **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, 2005 (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.

31. 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.

IV. STRUCTURAL CONDITIONALITY

(Structural benchmarks unless otherwise indicated)

Prior Actions for the Fifth Review

- Passage by Parliament and enactment into law of a VAT Act with an effective date of March 1, 2006.
- Approval by Cabinet of an implementation plan to rationalize the wage bill.

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-December, 2005).
- Complete strategic review and establish action plans for the operations of Aid Bank, DEXIA and NDC, with a view to enhancing their efficiency, streamlining their functions and improving accountability (end-December, 2005).
- Parliamentary approval of amendments to the Electricity Supply Act and related legislation (end-December 2005).
- Complete review by end-February 2006 the streamlining of the structure and functioning of government ministries and departments, with a view to further reducing wage bill over the following three years.
- Implementation of VAT starting March, 1 2006 (**structural performance criterion**). This is understood to mean that the first tax period for which the VAT law would apply starts on March 1, 2006 or earlier.

Seventh Review

- Cabinet approval of action plan to eliminate the unfunded liabilities of DSS (end-March 2006).
- Parliamentary approval of amendments to the Finance Administration Act as described in paragraph 17 of the SMEP (end-May, 2006).
- Line ministries to submit rolling three-year expenditure plans (end-May, 2006).

V. PERIODIC REPORTING

32. **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.

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

➤ External and real sectors

(xviii) GDP and its components.

(xix) Balance of payments accounts.

34. Other reporting will include:

➤ Reports of legislative changes pertaining to economic matters.