International Monetary Fund

Dominica and the IMF

Press Release:
IMF Executive Board Completes Sixth Review of Dominica's PRGF Arrangement
July 31, 2006

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

July 12, 2006

Roseau, Dominica
July 12, 2006

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 two and a half years since Dominica requested an arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF). At that time, the government outlined in the letter of intent and memorandum of economic policies (MEP) of December 10, 2003, its policies to address the serious economic crisis that had emerged and to create the basis for sustainable growth. We have subsequently refined these policies in the context of the past programme reviews.

2. Performance under the programme remains satisfactory. All quantitative performance criteria for end-December 2005 were met with comfortable margins. The indicative targets for end-September 2005 and end-December 2005 were also met. The value added tax (VAT) was implemented on March 1, 2006 (a structural performance criterion), and an important step in our revenue reforms. On other structural reforms, an onsite inspection of the Agricultural and Industrial Development (AID) Bank was conducted; several government services were outsourced in January, March and June 2006 as we implemented our Action Plan to reduce the wage bill; a review of the streamlining of government units was also completed; and the preparation of an Action Plan to reform the Dominica Social Security (DSS) is well underway. However, preparation of the amendments to the Electricity Supply Act and related legislation was delayed and has only recently been finalized. Additionally, capacity and technical difficulties thwarted the planned review of statutory exemptions, and delayed the strategic reviews of key public sector institutions.

3. We have maintained our efforts to complete the restructuring of our debt. We will continue with our good-faith efforts to reach collaborative agreements with the remaining non-participating creditors.

4. Dominica remains committed to the arrangement under the PRGF and the attached supplement to our MEP presents our policies for the remainder of 2006. These policies are aimed primarily at implementing structural reforms that will establish the basis for sustainable growth and poverty reduction, as reflected in our recent *Growth and Social Protection Strategy* (GSPS). The proposed indicative targets and structural benchmarks for the remainder of the programme are indicated in Tables 1 and 2 of the MEP. On this basis,

we request the completion of the sixth review of the programme and the release of the associated disbursement under the arrangement. We expect that the seventh review will be completed by October 31, 2006.

5. The Government of Dominica will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies, and achieving the objectives of the programme. The government believes that the policies set out in the attached MEP are adequate to achieve the objectives of the programme, but it will take further measures that may become necessary for this purpose. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEP, in accordance with the Fund's policies on such consultation.

6. We authorize the Fund to publish this letter and the attached supplement to our MEP to facilitate a wider access to our policies and signal the seriousness of our commitment to the programme to civil society and the international community.

Sincerely,

/s/

Honourable Roosevelt Skerrit
Prime Minister and Minister of Finance and Planning

Attachment

Supplementary Memorandum of Economic Policies of the Government of Dominica

I. Background

1. **Much of our strategy for re-establishing the basis for sustainable growth, after the economic crisis a few years ago, has been successfully implemented.** Due in part to the sustained and comprehensive economic reforms that the Government of the Commonwealth of Dominica has pursued in recent years, public finances have strengthened, the debt restructuring process is addressing the previously unsustainable debt, and economic activity recovered in 2004 and 2005, following the sharp contraction in 2001 and 2002.

2. **The objectives of the reforms are safeguarding the gains from adjustment and bolstering the prospects for sustainable private sector-led growth and poverty reduction.** The government's comprehensive plans for achieving these objectives are articulated in the Growth and Social Protection Strategy (GSPS). These plans envisage structural reforms, including enhancing the efficiency of the public service, removing structural and institutional bottlenecks, improving the private sector investment climate, and prioritizing public sector investments. The government remains fully committed to implementing all these reform measures.

II. Performance under the Programme

3. **Macroeconomic performance remained strong in 2005 and to April 2006, despite some areas of weakness.** Economic activity expanded robustly in 2005, with real GDP growing at about 3½ percent to yield the second straight year of higher-than-average growth. Indicators of domestic demand were strong; consumer imports, tax revenues, and credit all grew robustly. Financial services, retail trade and electricity production grew strongly. But weakness in the export sectors emerged; both banana and nonbanana agricultural exports declined, tourist arrivals weakened, but the value of manufactured exports expanded. Inflation remained subdued, despite the sharp increases in energy prices. However, the external current account worsened due to the high fuel prices, the robust growth of nonfuel imports on account of the economic recovery, and some one-off imports, and weaker tourism earnings. Indicators through April 2006 show a strengthening of tourist arrivals and a moderation of imports. However, exports have remained weak.

4. **A strong fiscal performance has been sustained in FY 2005/06**. Revenue collection has been strong in part due to the vibrant economy and transitory factors (e.g., exceptional payments of withholding tax); noninterest components of current expenditures were kept at about target despite an acceleration of gratuities to retirees and higher than expected payments for utilities; and capital spending has been lower than projected, in part due to delays in disbursing donors' funds.

5. **All quantitative performance criteria (PCs) for the sixth review were met, and the structural performance criterion was observed**. Reflecting the strong fiscal performance, the PC on the primary balance and the indicative targets on the budget were met with wide margins. The performance criterion on the wage bill was met, and our effort to reduce pending claims allowed us to observe, with a wide margin, the performance criterion on arrears to domestic parties. A value-added tax (VAT) was implemented on March 1, 2006 as targeted (a structural performance criterion), along with excise tax legislation. The indicative targets for end-March 2006 were also met.

6. **We have made progress on the structural benchmarks for the sixth review.** However, acute personnel constraints have hampered this work and delayed completion beyond the target dates:

- *Review to streamline the structure and functions of government units (end-February 2006)*: Resource constraints have forced us to examine only those ministries that earlier work had suggested to be in greatest need of streamlining. On this basis we have completed reviews of the ministries of Agriculture, Health, Education, and Community Development. Cabinet has examined these reviews, and approved the recommendations to streamline their structure and functions, and improve their efficiency. We are exploring ways to review, with external assistance, the police, fire and prisons departments.

- *Parliamentary approval of amendments to the Electricity Supply Act and related legislation (end-December 2005)*: Drafts of the new pieces of legislation are being discussed thoroughly with stakeholders. Following Cabinet's approval, the legislation will be submitted to Parliament for discussion at the first sitting subsequent to the FY 2006/07 presentation.

- *Approval of legislation providing the Financial Services Unit (FSU) with regulatory responsibility over all nonbank financial institutions (end-December 2005)*: Limited legal support impeded the drafting of the new FSU Act. We expect that this work would be completed shortly and the law presented to Parliament by end-August 2006.

- *Complete strategic review and establish action plans for the operations of AID Bank, DEXIA and NDC (end-December, 2005)*: The review of the AID Bank was initiated recently, having been delayed partly to allow the completion of an onsite inspection (see below). After initial delays in identifying external assistance to review the NDC, an affiliate of the USAID (Caribbean Open Trade Support (COTS)) has now started work on an action plan and the World Bank has agreed to provide additional assistance. A review of DEXIA has been completed but has not yielded operationally useful recommendations; further work is needed.

7. **We are also making progress in other structural reforms**. In particular:

- The revised Banking Act regulating commercial banks was approved by Parliament in December 2005.

- An onsite inspection of the AID Bank was completed in February 2006.

- A draft Action Plan for the elimination of the unfunded liabilities of the Dominica Social Security (DSS) was prepared and has been approved by Cabinet for wider consultation with stakeholders, ahead of its final approval (benchmark, end-March 2006).

- Following Cabinet's approval and public consultation on the proposal to amend the Finance Administration Act, amendments are being drafted but the pace of this work has suffered from the limited availability of legal expertise. In light of these delays, it is now unlikely that the amendments will be completed in time for Parliamentary approval and implementation in the FY 2006/07 budget.

- Information about concessions granted is being published each month in the Official Gazette. However, a review of statutory exemptions, expected by end-December 2005, has not been completed.

- Following a clean-up of the government accounts, the opening balances of the general ledger were adjusted. Considerable progress has also been made in addressing weaknesses in cash management and budgetary planning; this includes the finalization of a new chart of accounts according to international best practices, new expenditure commitment procedures, and improved expenditure classification.

- The audited financial accounts of the AID Bank (accounts for 2004 and 2005), DOWASCO (for 2004), DEXIA (for 2004), DSS (for 2004), and NDC (2000, 2001 and 2002) were submitted to Parliament. Audits of the accounts of the NDC for the subsequent years are underway, and will be submitted to Parliament when finalized.

III. Macroeconomic Policies and Outlook

8. **The government's policies over the medium term are articulated in the recently finalized Growth and Social Protection Strategy (GSPS) paper.** In particular, it reaffirms our commitment to reducing poverty, and presents our medium-term strategy for growth and poverty reduction for the five-year period 2005/06 to 2009/10; the close connection between poverty reduction and economic growth provides the basis for our strategy. The strategy seeks to advance the private sector as the engine of economic growth, with the government playing a facilitating role. It also aims to better target the existing social programmes so that the benefits from growth can reach the under-privileged in society. In the short term, a key challenge is making growth more broad-based for its sustainability to be assured. The government acknowledges the challenges that its citizens face; it underscores the pressing concern about raising economic growth and reiterates its commitment to implement macroeconomic policies that would facilitate a speedy achievement of these objectives.

A. Debt and Fiscal Policies

9. **We remain committed to engage in good faith negotiations with the remaining creditors that have not indicated their participation in our debt restructuring**. As an indication of our commitment, we continue to make payments into an escrow account on their behalf on the restructured terms, and make efforts to contact them on a regular basis. We recently passed legislation allowing the debentures that were issued to the creditors participating in the restructuring to be traded on the Eastern Caribbean Securities Exchange (ECSE), and plans are underway to have them listed by end-July 2006.

10. **The primary surplus target for FY 2005/06 of 3 percent of GDP appears achievable, which should allow further debt consolidation.** The higher revenues will accommodate the higher spending on utilities, retirement benefits, and allow further debt reduction. However, the low implementation rate of planned capital spending remains a key concern; we will examine how the key constraints could be relieved but without jeopardy to efficiency.

11. **We are fully committed to implementing an effective VAT**. This is the first step in our reform of the tax system, and following the implementation of the VAT and the excise tax legislation on March 1, we expect substantial benefits to accrue from the widened tax base and the greater economic efficiency of the tax. While the VAT was expected to be revenue-neutral (recouping the revenues from the taxes that have been repealed) we realize that actual collection in the early stages is uncertain and we have been carefully monitoring collections and other operational aspects. We also intend to undertake a comprehensive review of the experience under the VAT, including ascertaining the scope for other aspects of the revenue reforms, by September 2007.

12. **Some amendments to the initial VAT and excise tax legislation were introduced in early May 2006.** During the first days of the VAT regime some inaccuracies in the initial legislation became evident and it was necessary to amend the laws without delay; this was done on May 10, 2006. At that time, the government made additional amendments that altered the VAT and excise tax regime. These include: (i) granting VAT exemption on construction services for homes; (ii) applying the reduced rate for hotels to the dive sector; (iii) giving VAT exemption for capital goods imported by new entrants under the Hotel Aid Act or the Fiscal Incentives Act; (iv) transfer of agricultural inputs from being zero rated to exempt, and expanding the list; and (v) introducing excise tax exemptions on trucks imported by farmers, and motor vehicles, tobacco and alcohol imported by diplomats. The main objective was to provide temporary support to the nascent dive sector and the agricultural sector and thus help support growth. However, given the experiences in other countries and cognizant of the budgetary implications, the distortionary effects across sectors, and the risk for weakening VAT administration, these amendments will be reviewed in the context of the comprehensive review of the VAT.

13. **We intend to protect the VAT from any further weakening.** In particular, (i) we shall not introduce any additional amendments that will increase the scope for the reduced

rate, zero rating or exemptions in the VAT and excise tax regime, at least until the conclusion of the comprehensive review of the VAT; (ii) we will provide the needed resources to strengthen VAT administration, including by implementing good audit and risk management programs and mechanisms to detect stopfilers; and (iii) as noted above, we will examine the recent VAT amendments in the context of the envisaged comprehensive review. We have also taken necessary steps to ensure that VAT refunds are made on a timely basis.

14. **The ongoing public sector reforms are essential for the strengthening of the budget and national economic management.** These reforms include:

- **Streamlining of public sector employment**. We continue to implement the Action Plan that we announced with the FY 2005/06 budget, aimed at reducing the government's wage bill. The first phase comprised the outsourcing of security and janitorial services—137 persons have so far been affected by this programme—and positive results regarding the process and outcomes have been very encouraging. Plans to merge the air and sea port authorities were delayed due to unexpected difficulties, but this is expected to be effected by October 2006. The protracted delay in disbursing the European Union grant funds that were expected to cover the severance payments for this exercise has also created unnecessary uncertainties. We expect to accelerate in FY 2006/07 the implementation of the already identified measures, including those identified in the recent reviews of the streamlining of government units. Additionally, we will conduct a review, with external assistance, on the streamlining of the Police, Fire and Prisons departments. This review will be initiated by end-September 2006. We reiterate our commitment to reduce the wage bill from 13¾ percent in 2004/05 to 12¼ percent of GDP by 2008/09 and underscore that this process should move in tandem with a reorganization of government units with a view to greater efficiency and cost-effectiveness.

- **Strengthening public expenditure management.** Following initial delays, we have concluded with technical assistance from CARTAC/FAD our plans to implement a medium-term budgeting framework. However, given the current insufficient capacity to support this work in the line ministries, we will proceed in two steps: for the FY 2006/07 budget the Ministry of Finance has prepared the budgets for the two outer years based on ministries' submissions for FY 2006/07; and line ministries will be expected to make complete submissions of their three-year budget from FY 2007/08. Further progress in cash management is expected from July 1, 2006, with the introduction of new commitment procedures that include the electronic recording of expenditure commitments, the improved chart of accounts, and improved classification of capital expenditure. These changes will facilitate further automation of cash management. However, given the amount of work that remains to implement the proposed amendments to the Finance Administration Act and the related legislation, and in light of our resource constraints, we consider it prudent to delay the implementation of these amendments to FY 2007/08. The government remains fully committed to strengthening of budgetary planning with these amendments to the Act, which will be finalized and approved as foreseen by end-October 2006.

15. **The FY 2006/07 budget will advance the ongoing strengthening of fiscal operations, and include a primary surplus target of 3 percent of GDP.** We will approve a government budget for FY 2006/07 that is consistent with the programme (structural benchmark, end-July 2006), so as to further improve the structure of the budget and allow further debt reduction to sustainable levels over the medium term. Revenues will be estimated cautiously, measures to offset the revenue shortfall from the recent amendments to the VAT legislation will be included, and the public sector investment programme (PSIP) will be kept in line with our implementation capacity and the prioritization in the GSPS. We will use budget-support grants in excess of programmed amounts to further reduce our debt and build up bank balances.

16. **We will advance fiscal reforms in FY 2006/07 in several respects.** These include:

- Approving an implementation plan to further rationalize the wage bill in FY 2006/07, reducing it to a maximum of 13.1 percent of GDP, by end-June 2006.

- Presenting the FY 2006/07 budget within a three-year budgeting framework, prepared by the Ministry of Finance based on ministries' submissions for the FY 2006/07. This will be completed by end-July 2006.

- Initiate a reform of the customs department to improve the efficiency of the operations and reduce the processing time, including by improved information technology. This reform will benefit from the already completed diagnostic studies and is expected to be undertaken with the support of the World Bank and USAID/COTS.

B. Financial Sector Policies

17. **We are committed to strengthening supervision and the regulatory framework in the financial sector.** A key element in improving the regulatory regime for nonbank financial institutions is the Financial Services Unit (FSU) Act. Preparation of this legislation will be completed shortly and submitted to Parliament by end-September 2006. A draft model law for the insurance sector in the Eastern Caribbean Currency Union is currently under discussion within the region. We also plan to revise the credit union legislation, which will improve the regulatory framework for that industry.

18. **We are addressing the weaknesses identified by the onsite inspection of the AID Bank.** The inspection uncovered serious weaknesses, including a high ratio of nonperforming loans and weak management practices. We are expecting a technical assistance mission from the Fund at end-June 2006, which will prepare a strategy and recommendations based on accepted best practices to deal with the situation. In the meantime, the AID Bank has ceased accepting deposits from the public.

C. Other Structural Reforms and Other Issues

19. **We are committed to reforming the Dominica Social Security (DSS) scheme to strengthen its financial position.** The draft Action Plan approved by Cabinet for wider consultation proposes a package of measures based on the recommendations of the recent IMF/World Bank technical assistance and from the 2002 Actuarial Review. The draft Action Plan aims to eliminate all unfunded liabilities of the DSS. It proposes reform measures to be implemented gradually but steadily, distributing the burden of reform across generations and minimizing potential disruptions to the economy. Discussions with stakeholders of the reform measures are proceeding well, and we expect to finalize the Action Plan for Cabinet approval by end-July 2006. We will review regularly, consistent with the legal requirements, the strength of the DSS and the implementation of these measures, making any adjustments as needed. On this basis the risk to public finances and debt sustainability will be minimized.

20. **We are committed to reducing tax concessions and statutory exemptions.** However, a comprehensive review of statutory tax exemptions, expected by December 2005, has not been conducted. In light of the inherent difficulties of performing a robust cost-benefit analysis, we have decided to forego this review. Rather, we see greater scope for reducing the exemptions by introducing tax reforms that reduce the marginal tax burden and do not allow for exemptions. However, we would welcome a regional approach to dealing with tax exemptions and fiscal incentives. We will continue to publish each month in the Official Gazette, information on concessions granted.

21. **We intend to realign DEXIA, NDC, and AID Bank more towards the requirements of private sector-led growth.** We will finalize a strategic review of DEXIA, which would allow us to establish by end-September 2006, an action plan for its operations with a view to enhancing its efficiency, streamlining its functions and improving accountability. In an effort to accelerate the process and given the clarity of the available options for transforming the NDC, we have decided to forgo a strategic review of NDC and concentrate on the output of the ongoing work by USAID/COTS and the World Bank. An objective of this work is to recommend how to set up a one-stop shop that streamlines the process for establishing businesses, and it is expected to be completed by end-September 2006.

22. Considering that the PetroCaribe agreement has potential for significant benefits, we are conferring with other parties to clarify the operational aspects of the agreement. The agreement provides concessional financing for a fraction of the value of oil imports, which would yield benefits only gradually to the extent that more expensive debt is replaced, in addition to the direct benefits that would arise if the landed price of oil imports was lower. We will monitor these savings and ensure that they are used in a manner consistent with our overall debt strategy. We will continue our policy of allowing world oil prices to pass through to retail prices.

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

	2006	
	June 30 Program 2/	Sept. 30 Program 3/
I. Performance Criteria (PC)		
(In millions of Eastern Caribbean dollars)		
Central government primary balance	23.7	8.6
Central government wage bill	106.5	27.8
Banking system net credit to central government	-13.6	3.0
Net changes in central government arrears to private domestic parties	8.0	4.0
(In millions of U.S. dollars)		
Disbursement of central government or central government guaranteed external nonconcessional debt with maturity of at least one year	9.0	2.0
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) 4/	0.0	0.0
Nonaccumulation of central government and central government guaranteed external payments arrears 4/ 5/	0.0	0.0
II. Indicative Targets (IT)		
(In millions of Eastern Caribbean dollars)		
Central government overall balance	-19.3	-1.0
Central government revenues	230.8	54.9
Central government primary savings	38.9	5.7

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.

3/ Cumulative amounts from June 30, 2006. Targets for September 30, 2006 are all indicative targets.

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

5/ External arrears that were known at the time of the Executive Board meeting of October 14, 2005 were waived.

TABLE 2. STRUCTURAL CONDITIONALITY

(Structural benchmarks, unless otherwise indicated)

Seventh Review

- Approval of the FY 2006/07 budget, containing a primary surplus of 3 percent of GDP consistent with the programme (end-July 2006).
- Approval of an implementation plan to further rationalize the wage bill in FY 2006/07 (end-June 2006).
- Cabinet approval of action plan to eliminate the unfunded liabilities of DSS (end-July 2006).
- Parliamentary approval of amendments to the Finance Administration Act as described in paragraph 17 of the MEP of September 8, 2005 (end-October, 2006).
- Parliamentary approval of the Financial Services Unit (FSU) Act, providing legislative basis to supervise nonbank financial institutions, including the AID Bank and credit unions (end-September 2006).
- Complete strategic review and establish action plans for the operations of DEXIA and NDC, with a view to enhancing their efficiency, streamlining their functions and improving accountability (end-September 2006).
- Prepare strategy for dealing with AID Bank (end-June 2006)
- Parliamentary approval of amendments to the Electricity Supply Act and related legislation (end-August 2006).
- Presenting the FY 2006/07 budget within a three-year budgeting framework (end-July 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 July 12, 2006, 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 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

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 authorities[1] 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 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

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[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 will be released through a "double signature account."

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
Cumulative flows (from June 30, 2006)				
End-September 2006	6.4	8.4	3.2	0.5

[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 (actual)	-1.0
End-December 2005 (actual)	1.1
End-March 2006 (actual)	10.6
End-June 2006 (indicative target)	-19.3
Cumulative balance (from June 30, 2006)	
End-September 2006 (indicative target)	-1.0

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

(i) Upward[4] to the extent that **budgetary grants** exceed programmed amounts. Budgetary grants are defined as grant receipts that are not earmarked for capital outlays or loan repayment, 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] The programmed budgetary grants for fiscal year 2006/07 amount to EC$2.7 million by end-September 2006.

(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

[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.

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.

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 (actual)	12.3
End-December 2005 (actual)	22.7
End-March 2006 (actual)	45.4
End-June 2006 (performance criterion)	23.7
Cumulative balance (from June 30, 2006)	
End-September 2006 (indicative target)	8.6

11. The same adjustors described in paragraph 8 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 (actual)	25.6
End-December 2005 (actual)	52.7
End-March 2006 (actual)	78.8
End-June 2006 (performance criterion)	106.5
Cumulative flows (from June 30, 2006)	
End-September 2006 (indicative target)	27.8

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 (actual)	-1.4
End-December 2005 (actual)	-3.1
End-March 2006 (actual)	-2.8
End-June 2006 (performance criterion)	8.0
Cumulative flows (from June 30, 2006)	
End-September 2006 (indicative target)	4.0

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 (actual)	63.7
End-December 2005 (actual)	127.1
End-March 2006 (actual)	190.9
End-June 2006 (indicative target)	230.8
Cumulative flows (from June 30, 2006)	
End-September 2006 (indicative target)	54.9

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 8 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 (actual)	18.3
End-December 2005 (actual)	34.9
End-March 2006 (actual)	49.2
End-June 2006 (indicative target)	38.9
Cumulative flows (from June 30, 2006)	
End-September 2006 (indicative target)	5.7

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.

V. 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 (actual)	-6.5
End-December 2005 (actual)	-2.6
End-March 2006 (actual)	-14.0
End-June 2006 (performance criterion)	-13.6
Cumulative flows (from June 30, 2006)	
End-September 2006 (indicative target)	3.0

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 (actual)	5.0	2.1	1.9
End-December 2005 (actual)	7.6	3.5	4.1
End-March 2006 (actual)	16.6	10.2	6.4
End-June 2006	17.8	9.1	8.7
Cumulative flows (from June 30, 2006)			
End-September 2006	5.6	3.2	2.5

VI. 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 (actual)	0.9
End-December 2005 (actual)	1.7
End-March 2006 (actual)	2.4
End-June 2006 (performance criterion)	9.0
Cumulative flows (from June 30, 2006)	
End-September 2005 (indicative target)	2.0

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.

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.

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[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 June 2006 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.

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.

VII. Structural Conditionality

(Structural benchmarks unless otherwise indicated)

Seventh Review

- Approval of the FY 2006/07 budget, containing a primary surplus of 3 percent of GDP consistent with the programme (end-July 2006).
- Approval of an implementation plan to further rationalize the wage bill in FY 2006/07 (end-June 2006).
- Cabinet approval of action plan to eliminate the unfunded liabilities of DSS (end-July 2006).
- Parliamentary approval of amendments to the Finance Administration Act as described in paragraph 17 of the MEP of September 8, 2005 (end-October, 2006).
- Parliamentary approval of the Financial Services Unit (FSU) Act, providing legislative basis to supervise nonbank financial institutions, including the AID Bank and credit unions (end-September 2006).
- Complete strategic review and establish action plans for the operations of DEXIA and NDC, with a view to enhancing their efficiency, streamlining their functions and improving accountability (end-September 2006).
- Prepare strategy for dealing with AID Bank (end-June 2006)
- Parliamentary approval of amendments to the Electricity Supply Act and related legislation (end-August 2006).
- Presenting the FY 2006/07 budget within a three-year budgeting framework (end-July 2006).

VIII. 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.