International Monetary Fund

Dominica and the IMF

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December 14, 2006

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

November 27, 2006

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

Roseau, Dominica
November 27, 2006

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

Dear Mr. de Rato:

1. Since the Sixth Review Under the Fund's Poverty Reduction and Growth Facility (PRGF), the Government of the Commonwealth of Dominica has continued to make progress in implementing economic reform. At the time of Dominica's request of an arrangement under the PRGF, the government outlined its policies in the letter of intent and memorandum of economic policies (MEP) of December 10, 2003. These policies were aimed at addressing the serious economic crisis that had emerged and creating 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-June 2006 were met with comfortable margins. The indicative targets for end-September 2006 were also met. We have also made progress in structural reforms including on the structural benchmarks for the seventh review; Parliament recently approved the amendments to the Electricity Supply Act and related legislation; Cabinet approved an action plan to eliminate the unfunded liabilities of DSS; a strategy for dealing with the AID Bank has been completed; and an action plan to restructure the operations of the National Development Corporation (NDC) has been finalised. The approved FY 2006/07 budget was presented within a three-year budgeting framework and contained a primary surplus of 3 percent of GDP consistent with the programme. We are also implementing the approved action plan to further rationalise the wage bill in FY 2006/07. However, approval of the Financial Services Unit (FSU) Act was delayed but the legislation will be submitted to Parliament shortly. Finalisation of the amendments to the Finance Administration Act was also delayed and Parliament's approval is expected for early 2007.

3. We have made significant progress in restructuring of our debt. We will continue with our good-faith efforts to reach collaborative agreements with the remaining nonparticipating creditors, and complete the debt restructuring.

4. Dominica remains committed to the arrangement under the PRGF and the attached supplement to our MEP lays out our policies for the remainder of 2006. These policies are aimed at consolidating the realised gains and implementing structural reforms to bolster the prospects for sustainable private sector-led growth and poverty reduction. On this basis, we request the completion of the seventh review of the programme and the release of the associated disbursement under the arrangement.

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 authorise 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. **Our economic stabilisation strategy has been largely successful, and has begun to yield returns in terms of sustainable growth.** The Government of the Commonwealth of Dominica has implemented reforms over the recent years that have strengthened public finances, addressed the previously unsustainable debt including by its restructuring, and led to a rebound in economic activity following the sharp contraction in 2001 and 2002. Efforts will now focus on consolidating the realised gains and bolstering the prospects for sustainable private sector-led growth and poverty reduction. The government's plans to achieve these objectives are articulated in the recent Growth and Social Protection Strategy (GSPS).

II. PERFORMANCE UNDER THE PROGRAMME

2. **Macroeconomic performance has strengthened further in 2006, with a few areas of weakness.** Data for the first eight months confirm that economic activity has increased and broadened, suggesting an acceleration of growth to around 4 percent in 2006 from 3½ percent in 2005. Indicators of domestic demand remained buoyant; tax revenues point to higher incomes, while credit is growing robustly. Construction has picked up strongly, pointing to a rebound of private sector confidence. Indicators of activity in the financial sector, hotels and restaurants, real estate, and transportation suggest that the recovery is broadening. After contracting in 2005, banana production has rebounded in part due to favorable weather conditions and higher prices. However, nonbanana agricultural exports declined, and manufacturing output has remained weak. Arrival of stayover visitors to July strengthened by about 4 percent over the comparable period in 2005, and tourist receipts are substantially larger as higher expenditure hotel visitors and student enrollment at the offshore schools both rose substantially. Despite the higher value of mineral fuel imports due to the elevated world prices, merchandise imports declined by 2 percent as businesses reacted cautiously ahead of the valued added tax (VAT) regime and delayed resupplying their stocks, and because of some one-off imports in 2005 Accordingly, the external current account is projected to improve. Inflation has remained subdued.

3. **Fiscal performance remained strong throughout FY 2005/06.** Revenue performance was exceptionally strong, due in part to the buoyant economy and some one-off factors—particularly on withholding taxes and property taxes. Noninterest current expenditures were kept at about target, despite higher outlays for utilities and gratuities for retirees; and capital spending was in line with the projection.

4. **All quantitative performance criteria (PCs) for the seventh review were met.** 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. Preliminary data suggest that the indicative targets for end-September 2006 were also met.

5. **We have made progress on the structural benchmarks for the seventh review.** The FY 2006/07 budget has been approved, consistent with the programme and with a 3 percent primary surplus; the FY 2006/07 budget was presented within a three-year budgeting framework; Cabinet approved an implementation plan to further rationalise the wage bill in FY 2006/07; Cabinet approved an action plan to eliminate the unfunded liabilities of the Dominica Social Security (DSS); Parliament recently approved the amendments to the Electricity Supply Act and related legislation; and a strategy for dealing with the AID Bank was recently approved. Additionally, an action plan to restructure the operations of the National Development Corporation (NDC) has been finalised, but some delay has been encountered in preparing a similar action plan for Dominica Export Import Agency (DEXIA)—the completion of strategic reviews and action plans for the operations of DEXIA and NDC with a view to enhance their efficiency, streamline their functions and improve accountability, was an end-September 2006 benchmark. However, some delays have been experienced in a few areas:

- *Parliamentary approval of the Financial Services Unit (FSU) Act granting supervisory responsibility for all nonbank financial institutions (end-September 2006)*: The finalised draft of the new FSU Act has been ready for some time, but there were delays in completing the related amendments to existing legislation and in consulting with stakeholders. This work has now been concluded and all the legislation will be submitted to Parliament for discussion by end-December 2006.

- *Parliamentary approval of amendments to the Finance Administration Act (end-October 2006)*: Personnel constraints and the need to clarify concerns raised during the extensive consultation delayed the finalisation of this legislation. The finalised amendments will be submitted for approval by Parliament, expected in early 2007.

- *Complete strategic review and establish action plan for the operations of DEXIA (end-September 2006):* Difficulties with an earlier strategic review held back the preparation of the action plan. Assistance in preparing the action plan has been sought from USAID/Caribbean Open Trade Support (COTS), and the action plan is expected to be completed in early 2007.

6. **We have made progress in other structural reforms**. In particular:

- The modalities of a one-stop shop for the approval of new businesses have been determined; this will be established as an investment promotion agency in the context of the ongoing restructuring of NDC.

- The government's cash management and budgetary planning are being strengthened, including by the introduction in July 2006 of a new chart of accounts according to international best practices, new expenditure commitment procedures, and improved expenditure classification.

- Information about concessions granted continue to be published on a regular basis in the Official Gazette.

- The audited financial accounts of the NDC for 2003, 2004 and 2005, and DEXIA for 2005, have been submitted to Parliament. Financial accounts for the subsequent years are now in preparation.

III. Macroeconomic Policies and Outlook

7. **Dominica's economic outlook has brightened, providing scope for a quicker reduction of the remaining vulnerabilities and the bolstering of the prospects for sustainable growth and poverty reduction.** Economic growth in 2006 appears to be broad-based and is now expected to surpass the 3 percent target in the GSPS; world petroleum prices have fallen; and private sector confidence appears to be strengthening. The favorable outlook should facilitate the implementation of our medium-term strategy for growth and poverty reduction, as presented in the GSPS. The government underscores its commitment to implement the macroeconomic policies and structural reforms that are envisaged over the medium term.

A. Debt and Fiscal Policies

8. **We are firmly committed to engaging in good-faith negotiations with the creditors that have not confirmed their participation in our debt restructuring**. We remain confident that we will reach collaborative agreements with the remaining nonparticipating creditors. As an indication of our commitment, we continue to make efforts to contact them on a regular basis, and also make payments into an escrow account on their behalf on the restructured terms. Our commitment to this strategy has yielded some recent progress; agreements were reached with a few of the smaller creditors. We also recently listed on the Eastern Caribbean Securities Exchange (ECSE) the debentures that were issued to participating creditors, allowing them to be traded on this exchange.

9. **The strong implementation of the FY 2006/07 budget and subsequent budgets is a crucial part of our policies in the period ahead.** This would allow a further strengthening of the structure of the budget and attainment of the primary surplus target of 3 percent of

GDP. To this end, revenues and expenditures will be monitored closely; a particular focus will be the execution of the public sector investment programme (PSIP) to ensure a more even spending during the year and the minimisation of implementation constraints. If revenues are stronger than projected, this could allow a partial accommodation of shortfalls in grant receipts, and allow further debt reduction to more sustainable levels over the medium term. We will use budget-support grants in excess of programmed amounts to further reduce our debt and build up bank balances. Looking ahead, we are committed to a primary surplus target of 3 percent of GDP in the future fiscal budgets, so as to reduce public sector debt to more sustainable levels.

10. **We are committed to advancing fiscal reforms, which are essential in strengthening the budget over the medium term.** These reforms include:

- **Implementing an effective VAT and advancing revenue reforms.** We continue to carefully monitor the implementation of the VAT and are cautiously optimistic based on the very early experience to date. We reiterate our commitment to protect the VAT from any weakening, including by: providing the resources needed to strengthen VAT administration; implementing good audit and risk management programmes and mechanisms to detect stopfilers; and making timely VAT refunds. We intend to conduct a comprehensive review of the experience under the VAT, by September 2007, including ascertaining the scope for other revenue reforms. In the interim, background work has been initiated to guide the forthcoming revenue reforms, such as on income tax. We have requested technical assistance from FAD and CARTAC to support this work.

- **Streamlining of public sector employment**. We are implementing the approved action plan to reduce the wage bill in FY 2006/07. Accordingly, several services were outsourced from October 1, 2006 affecting a total of 104 workers. However, delays were encountered in finalising the legislation for the merger of the air and sea ports authorities; this legislation was recently approved by Parliament, allowing the merger to take place in early 2007. Legislative changes to allow the commercialisation of the Public Works Garage and the Electrical Division were also approved recently, clearing the way for their implementation from January 1, 2007. A draft of the legislation to allow the commercialisation of the Government Printery has been prepared, and is expected to be brought to a subsequent sitting of Parliament. However, delays in securing the needed assistance from the CDB to develop a new management structure for the National Parks Services will postpone its implementation. Work is continuing on the reorganisation of government units with a view to greater efficiency and cost-effectiveness, but the government has not yet been successful in securing external assistance for the streamlining of the Police, Fire and Prisons departments. We remain committed to reducing the wage bill to 12¼ percent of GDP by 2008/09.

- **Strengthening public expenditure management.** We expect that the finalised amendments to the Finance Administration Act and the related legislation will be considered by Parliament in early 2007. Line ministries will be asked to make complete submissions of their three-year budget from FY 2007/08, to fully implement a medium-term budgeting framework. Finally, as experience is gathered with the changes in expenditure control that were introduced in July 2006, it is expected that additional improvements will be introduced to strengthen the budget monitoring and cash management.

B. Financial Sector Policies

11. **We expect to strengthen significantly the supervision and regulatory framework of the financial sector.** The new FSU Act is expected to be discussed by Parliament by end-December 2006, and when implemented should improve the regulatory regime for nonbank financial institutions that include the AID Bank and credit unions. Extensive amendments to the Cooperative Societies Act will also be approved, intended to address the most serious weaknesses in the existing legislation. Additional measures include:

- **Reforming AID Bank.** We will seek to implement the recently approved action plan, which will address the serious weaknesses that have already been identified.

- **Encourage onsite inspections of the commercial banks.** The recent reduction in the sector's nonperforming loans is welcome. However, in light of the recent rapid increase in lending, and some sizeable changes in the banks' balance sheets, a close monitoring of developments is needed including through onsite inspections of the four commercial banks.

C. Other Structural Reforms and Other Issues

12. **We are committed to reforming the Dominica Social Security (DSS) scheme to strengthen its financial position.** The approved action plan has been widely discussed with all stakeholders and aims at eliminating the unfunded liabilities of the DSS, while ensuring that pensions remain relevant. The action plan presents a combination of policies, with specific measures over the next 15 years detailed in the plan, the earliest of which will be implemented on January 1, 2007. Regular actuarial reviews of the implementation of the action plan will help ensure that this reform remains on track, recommending additional measures as needed. On this basis the sustainability of DSS will be assured, and the risk to public finances and debt sustainability minimised.

13. **We intend to restructure DEXIA and the NDC, and establish a one-stop shop for investors.** USAID/COTS, with additional assistance from the World Bank, is already

working on the restructuring of NDC into a tourism authority and an investment promotion agency. The mission of the investment promotion agency will include providing the one-stop shop services to investors. Parliamentary approval of the new legislation is expected by end-December 2006. We also intend to finalise the action plan for restructuring DEXIA by early 2007, with a view to enhancing its efficiency, streamlining its functions and improving accountability.

14. **A reform of the customs department is underway, aimed at improving efficiency, modernising the operations, and reducing the processing time.** USAID/COTS is providing the needed assistance with the support of the World Bank, UNDP and other donors. In light of the breadth of this reform, it will require careful monitoring and coordination of its elements.

15. **Other areas include**:

- **Reducing tax concessions.** We remain committed to reducing tax concessions and statutory exemptions. This could be achieved through tax reforms that reduce the marginal tax burden and do not allow for exemptions, and through a regional approach to dealing with tax exemptions and fiscal incentives. In the meantime, we will continue to publish each month in the Official Gazette, information on concessions granted.

- **PetroCaribe agreement.** The operational details of the agreement are being finalized, with a view to maximise the potential benefits and minimise any possible risks. The relevant transactions would be recorded aptly; in particular all external obligations under the long-term financing arrangement, would be recorded as central government debt.