Dominican Republic
and the IMF

Press Release:
Press Release: IMF Executive Board Completes Third and Fourth Reviews and Financing Assurances Review Under the Stand-By Arrangement for the Dominican Republic
May 10, 2006

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Dominican Republic: Letter of Intent and Annex to the Technical Memorandum of Understanding

April 24, 2006

Santo Domingo, April 24, 2006

Mr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. de Rato:

1. The Dominican economy has continued to develop favorably and the quantitative performance criteria established in the Stand-By Arrangement for end-September and end-December 2005 had been met with comfortable margins. Progress has also been made in the area of structural reforms, as draft laws to improve the country's institutional framework have been submitted and, in some cases, approved by congress. We remain committed to the objectives and policies set out in our letters of January 14 and September 29, 2005, as amended by the present letter and annex to the Technical Memorandum of Understanding.

2. Understandings have been reached on quantitative performance criteria for end-June, end-September, and December 2006, and on new structural performance criteria and benchmarks, including specific items relating to the performance of the electricity sector. The fifth review, scheduled for completion by end-September 2006, will focus on assessing fiscal and electricity sector developments, as well as progress in the reform of fiscal institutions. The sixth and seventh reviews will assess overall performance under the program and observance of associated performance criteria and benchmarks.

Macroeconomic Projections

3. Real GDP growth in 2005 was considerably higher than anticipated, at 9.3 percent. Inflation for the year reached 7.4 percent, in line with the target of keeping inflation to single-digit levels. We estimate that the Dominican economy will grow at a rate of 5.5 percent in 2006 and that annual inflation will fall to the 5–7 percent range, depending on the volatility of world oil prices. The external current account deficit is expected to widen from 0.5 percent of GDP in 2005 to about 2.4 percent in 2006. Among the factors contributing to this result will be the impact on imports of the oil bill, which is forecast to increase by about 1.5 percent of GDP.

Fiscal Policy

4. The fiscal objectives set for 2005 were met with margins, despite the increased financial deficit of the electricity sector. We estimate that the nonfinancial public sector closed 2005 with a deficit of 0.4 percent of GDP, less than the 0.7 percent established under the program. The central bank reduced its quasi-fiscal deficit from 4 percent of GDP in 2004 to 2.9 percent in 2005, below the program target of 3.2 percent of GDP. This implied a total consolidated public sector deficit equivalent to 3.3 percent of GDP.

5. To achieve the 2006 macroeconomic objectives and prevent an undesirable reduction in primary spending, the fiscal target was relaxed on account of the impact of the oil shock on government transfers to the electricity sector (para. 19). In this regard, we are aiming to achieve an overall balance in the nonfinancial public sector, which when combined with quasi-fiscal losses by the central bank will imply an overall consolidated public sector deficit of about 2.8 percent of GDP. We will continue the fiscal consolidation process during 2007 by reducing the overall consolidated public sector deficit to about 2 percent of GDP (implying a primary surplus in excess of 2 percent of GDP) to decisively reduce the debt-to-GDP ratio.

6. Congress approved the 2006 proposed budget that specifies a zero deficit in the nonfinancial public sector. The budget provides for a series of measures, including keeping nominal wages unchanged for most central government employees (except in the case of agreements reached with doctors and teachers), containing administrative expenses, reducing the liquid gas subsidy to RD$2.6 billion, and limiting electricity sector transfers to US$500 million. These measures will offset unavoidable increases in spending, including larger transfers to municipalities and autonomous government agencies and a significant increase in social spending to achieve the Millennium Development Goals. Given the likelihood that expenditures in certain items could exceed the budgeted amounts, we have identified spending cuts and have instructed the National Budget Office (ONAPRES) to prepare an expenditure program consistent with the fiscal target for the year (prior action).

7. The approved budget also calls for a major reform of the budget surplus mechanism (*excedente presupuestario*), requiring legislative approval of the increased spending associated with the surplus revenue. Nevertheless, any changes to the budget will be submitted to congress after June 2006 reflecting fiscal developments to date and revenue and expenditure projections for the remainder of the year to achieve the fiscal objective (*continuous structural performance criterion*). For 2007, as expressed in the letters of January and September of 2005, any mechanism that allows for increased spending without a proper assessment of the fiscal position to date and projections for the remainder of the year will be eliminated in the context of the new Organic Budget Law and the 2007 Budget Law.

8. In December 2005 Congress approved a tax reform that broadens the base of the value-added tax, increases the income tax, and raises the excise taxes on fuel, alcoholic beverages, and other goods. The revenues generated by this reform, about 2½ percent of GDP, will partially compensate the losses associated with entering into DR-CAFTA. In order to ensure revenue neutrality during 2006, the government will maintain some import taxes until mid-year, when it is anticipated that the Dominican Republic will accede to the free trade treaty. The government also undertakes to identify by July 2006 (*structural benchmark*) measures that will ensure the continuation of the fiscal consolidation process in 2007 and subsequent years, following a fiscal reform performance evaluation in the first six months.

9. To support the reforms of the tax system, we will renew our efforts to improve revenue administration. In this regard, we plan to resubmit to Congress by end-May 2006 draft legislation to strengthen the tax and customs administration, including proposals to

criminalize tax evasion, grant budgetary autonomy to the collecting agencies and streamline the tax system.

10. We will continue to move forward with the reform of fiscal agencies to ensure that the reorganization of fiscal policy goes into effect on January 1, 2007:

- Two working groups will be set up (one for the Finance Secretariat and the other for the Planning Secretariat) to manage the transition to the new institutional structure, along with a supervisory committee (*prior action*). By end-June, these teams will prepare an implementation plan including organization charts, job descriptions, and staffing needs (*structural benchmark*).

- The new laws on Public Credit and Treasury were approved in January 2006 and we are in the process of preparing implementing regulations for these laws. The laws on Procurement and Internal Controls will be reintroduced in Congress for consideration (*prior action*) and are expected to be approved by end-September 2006 (*structural performance criterion*).

- The Organic Budget Law, the Financial Administration Law, the Planning and Public Investment Law and the laws establishing a new Finance Secretariat and Planning Secretariat will also be reintroduced in Congress for consideration without substantial changes from the drafts submitted to Congress in 2005 (*prior action*) and are expected to be approved by end-June 2006 (*structural performance criterion*).

- In making progress toward establishing a Single Treasury Account, the Finance Secretariat will prepare an inventory of all the deposit accounts held by the central government, autonomous agencies, and decentralized agencies by end-June 2006. This inventory will include the balance for each account as at end-December 2005 and the volume and number of transactions during 2005. We will use the results of this inventory to select a first subset of unused or unnecessary accounts, which will be closed by end-September 2006 (*structural benchmark*).

11. We have made progress on designing a plan to regularize existing arrears and prevent further arrears from occurring:

- The verification of arrears accrued through end-2004 on public works projects has been postponed until end-June 2006. In order to ensure the cooperation of all public agencies in this process, a communication will be sent requesting the agencies to provide the requisite documentation to the Ministry of Finance within 60 days (*prior action*). In the case of arrears on expropriations, implementing regulations will be issued to expedite the audits. We have also designed a plan to pay the verified debt owed to suppliers, including through debt bonds, by end-2006. A separate plan to deal with any arrears incurred in 2005 will be prepared after such arrears have been verified and not later than September 2006.

- In order to monitor and prevent further domestic arrears from accruing, a pilot program has been established whereby the key agencies of the central government will implement the procurement system starting in June 2006. Implementation will consist of recording all procurement requests and purchase orders, or of signing contracts in order to formalize the commitments made, in line with the definitions in the draft Organic Budget Law (*structural benchmark*). The reports will be validated by the Finance Secretariat, and noncompliance by these agencies will be penalized.

Monetary Policy

12. The monetary objectives for 2005 were met by comfortable margins and base money was in line with the indicative program targets. The improvement in the capital account allowed international reserves to accumulate to a level considerably higher than forecast. The issuance of central bank certificates to sterilize foreign exchange purchases also ensured that net domestic assets remained substantially below the program ceiling.

13. The monetary program for 2006 is compatible with an inflation rate in the range of 5–7 percent and a slight increase in international reserves. To this end, we have established quantitative performance criteria for net domestic assets and net international reserves. The first half-yearly report on monetary policy will be published within the next few weeks as part of the efforts to improve communication regarding monetary policy.

14. Progress has been made on the strategy to reduce the quasi-fiscal deficit and the risks relating to central bank certificate renewals:

- In January 2006, the Assets Recovery Commission (COPRA) published a bidding timetable for 2006 and prepared a budget for the assets to be tendered. On the same date we announced the third auction of assets relating to the bank rescue for a sum of approximately US$200 million; the auction will be held in April 2006. These processes will be strengthened relative to the previous ones by incorporating the recommendations of external consultants. In that regard, the Monetary Board will ratify the measures established by COPRA to avoid situations of comparative advantage among the bidders. Moreover, information on the debtors portfolio administered directly or indirectly by COPRA will be made available to the credit risk bureau of the Superintendency of Banks by end-June 2006.

- The commission appointed to formulate a plan to recapitalize the central bank expects to complete the design of this plan by July 2006 (*structural performance criterion*). This represents a delay with respect to the original March date in order to incorporate the recommendations of international experts. The government's fiscal plan for 2006 also envisages recapitalizing the central bank by about RD$3.5 billion.

Strengthening Financial Sector Institutions

15. We remain committed to strengthening the supervisory capacity of the Superintendency of Banks (SB) to ensure the implementation of the new regulatory framework. The following actions are being taken in that context:

- In December 2005 the first evaluation of the business plans of banking institutions was carried out. On the basis of that evaluation, we plan to sign memoranda of understanding with banks identified by the Superintendent of Banks as having significant weaknesses in their business plans in order to strengthen the quality of their portfolios, their internal controls, and their corporate governance (*prior action*). It is expected that by August 2006 the banks will deliver the updated version of the business plans based on the financial statements as of end- June 30, 2006, and that by September the SB will have evaluated the plans and signed new memoranda of understanding with the financial institutions that require it (*structural benchmark*).

- In February 2006 we began an inspection of the asset quality of the commercial banks; we expect to complete the inspection of all institutions by end-May 2006 (*structural performance criterion*). It will be mandatory for the financial statements as at June 30, 2006 to be prepared on the basis of the results of these inspections.

- The new on-site and off-site inspection and analysis manuals will be integrated and fully in use by end-September 2006.

- To improve the transparency of financial data, an evaluation of the financial system's current data requirements will be completed by September 2006, with a view to streamlining the data and ensuring that all financial institutions publish their consolidated financial statements in accordance with the reporting schedule required by the regulations in force (unaudited on a quarterly basis and audited on a half-yearly basis).

- The SB will publish, by end-July 2006 (*structural benchmark*), its self-assessment of its level of compliance with the Basel Core Principles for Effective Banking Supervision, which it is preparing with the assistance of a leading international supervisory institution. Any actions needed to correct existing deficiencies will be published on that same date and incorporated in its institutional strengthening plan.

- The revision of the chart of accounts for financial intermediaries has been completed, and the first of their financial statements prepared as at June 30, 2006 on the basis of the revised version will be published in July 2006.

- To ensure the adoption of effective consolidated supervision, a plan is being developed to: (i) strengthen regulation and oversight of the securities, pensions, and insurance markets; and (ii) improve coordination between the central bank, the Superintendency of Banks, the Superintendency of Insurance, the Superintendency of Pensions, and the Superintendency of Securities. This plan, which will be prepared with the assistance of international experts, will be completed in September 2006 (*structural benchmark*) and implemented in June 2007.

16. To promote improvements in the internal controls, risk management, and corporate governance of financial institutions:

- The SB will publish, by end-May 2006, a directive aimed at preventing the risk ratings of a single commercial debtor in the financial system from diverging too widely (by more than one grade).
- The SB will issue a circular by end-May 2006 (*structural benchmark*) requiring external auditors to conduct starting end-June a special review of the risk management, internal controls and governance practices and systems of financial institutions and of the functioning of their corporate governance structures. We also expect to issue by end-September 2006 a regulation aimed at strengthening the internal controls and corporate governance of financial institutions.

17. With a view to strengthening the independence of monetary and banking supervision institutions, amendments to the Monetary and Financial Law were sent to Congress for consideration in November 2005, and are expected to be approved by end-December 2006 (*structural benchmark*). The main objectives of the proposed amendments are as follows: (i) to lengthen the term of office for which the Governor of the central bank, the Superintendent of Banks, and other members of the Monetary Board are appointed from two years to four; (ii) to provide that state-owned banks will be subject to the same regulations and degree of supervision as private banks; (iii) to improve the definition of supervision with reference to economic and financial groups; and (iv) to establish the illegality of regularly taking funds from the public without first possessing the necessary authorization issued by the appropriate authority. Nevertheless, legal and constitutional restrictions in the Dominican Republic prevented the observance of the original performance criteria requiring that the Senate ratify the appointment or removal of the members of the Monetary Board, and that the term of office of the board members coincide with the term of office of the executive authority.

18. Progress is being made in implementing the plan for strengthening nonbank financial intermediaries. The inspection and analysis stage will be completed by end-October 2006, and for that purpose the SB will subcontract the services of professionals having experience in bank supervision or local audit firms. The implementation stage will be completed by December 2006. In the case of the Banco Agrícola, we expect to complete an analysis and prepare a draft law by end-December 2006 with a view to transforming the bank into an agricultural development agency (that does not collect deposits from the general pubic).

Electricity Sector

19. The deficit for the electricity sector for 2005 reached US$620 million, up substantially from the initial projection of US$350 million mainly because of poor performance of the cash-recovery index (CRI), an increase in the supply of electricity, and higher fuel prices. With the assistance of private managers, the distribution companies have put forward plans for raising the CRI for non-PRA (Blackout Reduction Program) areas to approximately 63 percent for 2006, with an investment budget consistent with that objective. The following measures will be taken to improve the financial position of the sector: (i) government transfers to the sector that are intended to finance investment in support of the projected increase in the CRI will be monitored; (ii) first quarter CRI audits will be published by end-August 2006 in accordance with the terms of reference agreed upon with the World Bank (*structural performance criterion*); second quarter audits will be made public by end-September 2006, while subsequent quarterly CRI audits will be published with a two-month lag; (iii) external audits will be completed of the 2005 financial statements of the electricity distribution companies and of the Dominican power utility CDEEE and the findings of those audits will be published by end-August 2006 (*structural benchmark*). While we intend for the electricity tariff to fluctuate with oil prices and the exchange rate (in accordance with the regulation published by the Superintendency of Electricity), if the tariff is temporarily below the calculated tariff, the resulting higher transfers to the electricity sector will be offset by lower spending in non-priority areas.

20. We have recently signed a General Electricity Sector Agreement for 2006 in which: (i) the distribution companies agreed to pay in full and on time the monthly invoices to electricity generators; (ii) the government agreed to remain current in paying its electric bills; and (iii) the debts and credits owed between the different electricity sector firms were reconciled as at end-2005. In addition, efforts will be made to restructure the debts owed to the electricity generators in the context of renegotiating the contracts with those companies.

21. Given the sector's fragile financial position, we will evaluate its performance on a monthly basis and implement the measures needed to offset the fiscal impact of any deviation, so that the nonfinancial public sector balance will not be affected.

Program Financing Assurances

22. Agreements were concluded successfully in October 2005 with commercial banks and with the Paris Club, and Congress recently approved all the external debt rescheduling agreements. Arrears with commercial banks were cleared following the external debt restructurings.

23. We believe that the fiscal program for 2006 is adequately financed and that consequently, in the expected circumstances, a further rescheduling with Paris Club creditors will not be necessary. The government will go to international capital markets only to finance debt restructuring operations or to improve the existing debt maturity profile. The limits on

the contracting of debt associated with the financing of public investment projects are established in the Technical Memorandum of Understanding (see attached).

Final Remarks

24. In view of the progress achieved under the program and our policy commitments, the government of the Dominican Republic requests completion of the third and fourth reviews of the Stand-By Arrangement, including the granting of corresponding waivers (see Table 3 attached). In addition, we request the rescheduling of the purchase associated with the objectives established for March 2006, such that it is evenly spread among the remaining purchases under the Stand-By Arrangement, starting with the purchase that should become available in September 2006. As we implement the program, we will continue to confer closely on policy issues with the Fund and the rest of the international community.

Very truly yours,

/s/	/s/	/s/
Héctor VALDEZ ALBÍZU	Temístocles MONTÁS	Vicente BENGOA
Governor	Technical Secretary	Secretary of Finance
Central Bank		

Attachments:
Tables (prior actions, structural conditionality, request for waivers)
Technical Memorandum of Understanding

Table 1. Dominican Republic- Prior Actions for Third and Fourth Reviews under the SBA

	Status
Fiscal sector	
Issue instructions to Budget office (Onapres) to prepare quarterly budget execution quotas consistent with the identified expenditure cuts (LOI ¶6).	Pending
Create working groups in charge of implementing and supervising the establishment of the new Finance and Planning Secretariats (LOI ¶10).	Pending
Resubmit to congress, without substantive changes, the following draft laws: Procurement Law, Internal Controls Law, Organic Budget Law, Planning and Public Investment Law, Financial Administration Law, and Laws establishing the new Finance and Planning Secretariats (LOI ¶10).	Pending
Issuance of a communique requesting public agencies to send the documentation related to the stock of outstanding arrears as of end-2004 to the Secretary of Finance within 60 days (LOI ¶11).	Pending
Banking Sector	
The Superintendent of Banks will identify banks with significant weaknesses in their business plans, communicate the list of such banks to Fund staff in writing, and sign memoranda of understanding with those banks (LOI ¶15).	Pending
Electricity Sector	
Clear all arrears with electricity generators through the first quarter of 2006.	Done (being verified)

Table 2. Dominican Republic: Structural Performance Criteria and Structural Benchmarks

	Date
A. Structural performance criteria	
Fiscal policy	
1. Any supplementary budget will be presented to congress after June 2006 in a manner consistent with the program's fiscal targets (LOI ¶7).	Continuous
2. Approval by congress of laws (Ley Orgánica del Presupuesto, Ley Orgánica de la Secretaria de Hacienda, Ley Orgánica de la Secretaria de Planificación y Desarrollo, Ley de Administración Financiera, Ley de Inversión Publica) centralizing fiscal management and eliminating the *excedente presupuestario* mechanism.	End-Jun. 2006
3. Approval by congress of agreed amendments to the Procurement and Internal Controls Laws (LOI ¶10).	End-Sep. 2006
4. Full implementation of the reorganization of fiscal management, as defined in ¶12 of the September 2005 LOI.	January 1, 2007
Banking sector	
5. Design plan to recapitalize the central bank and address the quasi-fiscal deficit problem (LOI ¶14). Key features of the plan are defined in ¶9 of the September 2005 LOI.	End-Jul. 2006
6. Finalize evaluation of banks' asset quality (LOI ¶15).	End-May 2006
Electricity sector	
7. Publish first quarter 2006 CRI audits in accordance with the terms of reference agreed upon with the World Bank (LOI ¶19).	End-Aug. 2006
B. Structural Benchmarks	
Fiscal policy	
1. Presentation of a detailed institutional restructuring plan for the new secretaries of Planning and Finance, including functional descriptions, organograms and staffing levels (LOI ¶10).	End-Jun. 2006
2. Initiate implementation of a pilot program requiring key government agencies to report expenditures at different stages: commitment, accrual, and payment (LOI ¶11).	End-Jun. 2006
3. Identify measures to offset the revenue losses associated with the tax reform for 2007 and beyond (LOI ¶10).	End-Jul. 2006
4. Closing down of a first tier of unused and unnecessary deposit accounts (LOI ¶10).	End-Sep. 2006
Banking sector	
5. Issue circular requiring external auditors to conduct a special review of the bank's internal control and corporate governance practices (LOI ¶16).	End-May 2006
6. Publication of report on describing the Superintendency's compliance with Basle principles for effective bank supervision (LOI ¶15).	End-Jun. 2006
7. Complete second evaluation of the banks' business plans, and finalize negotiation on memoranda of understanding with banks, as required (LOI ¶15).	End-Sep. 2006
8. Finalize an action plan to improve the regulation and supervision of the securities market and improve coordination among financial supervision agencies (banks, insurance, pension funds, and securities) (LOI ¶15).	End-Sep. 2006
9. Approval of draft Monetary and Financial Law (LOI ¶17).	End-Dec. 2006
Electricity sector	
10. Publish external audits of the 2005 financial statements of the electricity distribution companies and of the Dominican power utility CDEEE (LOI ¶19).	End-Aug. 2006

Table 3. Dominican Republic- Request for Waivers for the Third and Fourth Reivews under the SBA

	Date	Status
Fiscal policy		
Approval by congress of budget for 2006 consistent with a NFPS overall surplus of 0.7 percent of GDP and the elimination of the *excedente presupuestario* for 2006.	Dec. 2005	Budget approved in Feb. 2006, *modified ad-referendum to a zero balance*. A form of the *excedente* was preserved.
Tax reform to become effective in tandem with the implementation of DR-CAFTA.	Continuous	Tax reform approved in Dec. 2005 was not revenue neutral.
Approval by congress of proposed amendments to the Public Credit, Treasury, Procurement and Internal Controls Laws.	Jan. 2006	Procurement and Internal Controls draft Laws were not approved.
Validate domestic arrears incurred prior to December 31, 2004.	Mar. 2006	Verification of public works arrears is pending.
Banking sector		
Submit to congress draft legislation aimed at increasing the independence and accountability of the central bank and bank superintendency. The draft law will also ensure that state-owned banks are subject to the same regulatory requirements as private banks.	Nov. 2005	Submitted to congress in Nov. 2005. Excludes provision requiring Senate ratification of Board members.
Complete evaluation of the banks' business plans, and finalize negotiation of memoranda of understanding with banks, as required.	Dec. 2005	Delays in finalizing memoranda of understanding with a few banks.
Design plan to recapitalize the central bank and address the quasi-fiscal deficit problem.	Mar. 2006	*Postponed until end-July 2006* to allow for full incorporation of MFD TA.

ANNEX TO THE TECHNICAL MEMORANDUM OF UNDERSTANDING
APRIL 24, 2006

All aspects of the Technical Memoranda of Understanding (EBS/05/9, Supplement 1, Attachment II), issued on January 31, 2005, remain in effect, except for the revisions incorporated in the Annex to the Letter of Intent of September 29, 2005, and those indicated below.

1. Quantitative performance criteria for end-June, end-September, and end-December 2006 (see Table 1, annexed hereto) are being added for: (i) the cumulative balance of the nonfinancial public sector; (ii) net domestic assets of the central bank; (iii) net international reserves of the central bank; and (iv) arrears with private external creditors. Indicative targets are also being established for end-2007. Cumulative flow variables will be measured from December 31, 2005.

2. The quantitative performance criterion related to the limit on the *total* contracting of external debt is being eliminated, and three new quantitative performance criteria are being established for end-June, end-September, and end-December 2006; their flow will be measured from end-2005. Indicative targets are also being established for end-2007. The new quantitative performance criteria include:

(a) Limit on the *net* contracting of external debt related to investment projects

- *External debt related to investment projects* is defined as comprising obligations that, as defined in section I.D of the Technical Memorandum of Understanding of January 2005, are dedicated exclusively to financing specific public works and expenses. *Net contracting* is defined as the difference between the amount of new debt contracted and the amount of existing debt cancelled by end-December 2005. Cancellations do not include debt amortization.

(b) Limit on the accumulation of arrears in the payment of current electricity invoices to the energy generating companies

- Arrears to the energy generating companies are defined as the balance of current invoices for energy sales that have been received as from January 1, 2006, by a distribution company (EdeNorte, EdeSur and EdeEste), or by the Dominican power utility CDEEE, for which no payment has been made within the contractually agreed grace period or, in the absence of a grace period, within 30 days following the contractual due date. Any invoice having a due date within the current month is considered a current invoice.

- The Ministry of Finance will receive from the CDEEE a monthly report on energy invoices and payments made to the generating companies in each month. This report will also clear up any discrepancies in the invoicing and payment data submitted by the distribution companies, the CDEEE, and the generating companies.

- If the payments made do not cover the total amount of the invoices, the Ministry of Finance will effect the payments needed to avoid the accumulation of arrears. We expect Congress to approve a Supplementary Budget to ensure that there are sufficient budgeted funds to avoid an accumulation of arrears with the electricity generation companies.

(c) Floor on budgetary transfers to the BCRD

- Budgetary transfers to the central bank (BCRD) represent the transfers included in the 2006 Budget Law (RD$3.44 billion). They will be disbursed on a quarterly basis in equal installments of RD$860 million.

3. The following indicative targets are being added for end-June, end-September, and end-December 2006:

- **Limit on the gross contracting of external debt related to *budgetary aid***. *External debt related to budgetary support* is defined as comprising obligations that, as defined in section I.D of the Technical Memorandum of Understanding of January 2005[1], are not tied to specific expenses or investment projects, and therefore, can be freely used for the payment of general expenditures and the amortization of debt. If the contracting of such debt exceeds the established ceiling, the government deposits in the central bank need to increase in line with the higher amount of disbursements, to ensure that the target of a balance for the nonfinancial public sector is achieved.

- **Limit on the gross contracting of external debt related to investment projects.** The limit is equivalent to the additional debt contracting needed to execute the externally-financed investment projects included in the 2006 Budget Law.

4. The following indicative targets are being added for end-December 2006 and end-December 2007:

- **Floor on the *overall* balance of the *consolidated* public sector.** The overall balance of the consolidated public sector is equivalent to the overall balance of the nonfinancial public sector (as defined in section I.A of the Technical Memorandum of Understanding of January 2005) plus the quasi-fiscal balance of the central bank. This floor is defined in relation to GDP.

- **Floor on the *primary* balance of the *consolidated* public sector.** The primary balance of the consolidated public sector is equivalent to the overall balance (defined above) less interest payments on the consolidated public sector debt. As defined in section I.A of the

[1] For the purposes of the program, such debt will be considered to have been contracted as of the date when both: (1) an agreement to provide such a lending facility or *guarantee* has been concluded and signed; and (2) the proposed borrowing or *guarantee* has been approved by Congress."

Technical Memorandum of Understanding of January 2005, interest payments will be registered on a due basis. This floor is defined in relation to GDP.

5. Floor on the overall balance of the nonfinancial public sector. Item (b) of the third paragraph of section I.A of the of the Technical Memorandum of Understanding of January 2005 will be modified to state "external and domestic bank borrowing and deposits, including deposits in the central bank *and financing guarantees of any type that the nonfinancial public sector may offer to the private sector*"

6. Monitoring Public Sector Arrears. The pilot program will involve the following central government agencies: the Public Works Secretariat, the Superintendency of Government Projects, the Armed Forces, and the National Police.

7. **Quarterly audits of the basic data needed to calculate the cash-recovery index (CRI).** External audits should follow the criteria set out in the terms of reference agreed with the World Bank for that purpose. Audits will include an opinion on the accuracy and reliability of the data provided by the energy distribution companies (EdeNorte, EdeSur, and EdeEste) with regard to:

- Energy supplied in the PRA (Blackout Reduction Program) areas and non-PRA areas (GWh).
- The amounts invoiced monthly by each Ede in PRA and non-PRA areas, in terms of energy (GWh) and value (RD$).
- The amounts collected monthly by each Ede in PRA and non-PRA areas, in terms of value (RD$).

The Committee for the Recovery of the Electricity Sector will transmit the final audit report to the International Monetary Fund. First quarter 2006 CRI audits will be made public by end-August 2006, while second quarter 2006 audits will be published by end-September 2006. Subsequently, all quarterly audits will be published no later than 60 days following the last day of each quarter.

8. Data requirements for the electricity sector. The 2006 objectives for the electricity sector are shown in Table 2, annexed hereto. To monitor the sector's performance effectively, the authorities will provide the following:

- A monthly report on the performance of the electricity sector, no later than 21 days following the last day of the month. The report will include data on: (i) the energy supply in PRA and non-PRA areas; (ii) the loss rate and collection rate in PRA and non-PRA areas; (iii) the CRI in PRA and non-PRA areas; (iv) the charges applied and indexed; (v) the marginal costs (generation, power, and connection) and energy purchase costs for the distribution companies; (vi) government transfers to the distribution companies and the CDEEE; (vii) the operational expenditure and capital expenditure of the distribution companies and the CDEEE; and (viii) debt service payments to the generating companies.

- Monthly cash flows of the distribution companies and the CDEEE, no later than 21 days following the last day of the month.

9. Additional informational requirements for the nonfinancial public sector. To monitor more effectively the public finances, the monthly data reporting requirements (as specified in section VI of the Technical Memorandum of Understanding of January 2005) will be expanded to include: (i) taxes paid in advance during the current year falling due in subsequent years; (ii) taxes falling due during the current month whose payment has been deferred; and (iii) the new calendar for receiving the differed taxes mentioned in the previous point. This information will be provided by the Finance Secretariat no later than 30 days following the last day of the month.

Table 1. Dominican Republic: Quantitative Performance Criteria and Indicative Targets for 2005–07 1/ 2/

	2004	Sep-05 Prog.	Sep-05 Prel.	Dec-05 Prog.	Dec-05 Prel.	Mar-06 Est.	Performance Criteria Jun-06	Performance Criteria Sep-06	Performance Criteria Dec-06	Proj. Dec-07
I. Quantitative Performance Criteria										
(In billions of Dominican Republic pesos)										
A. Nonfinancial public sector (NFPS) balance (cumulative floor)	-3.6	-7.3	8.8	-6.4	-3.4	1.0	0.3	0.2	0.0	9.0
B. Central bank transfers (cumulative floor)	...	...	...	...	...	0.9	1.7	2.6	3.4	...
C. Central Bank net domestic assets (ceiling) 3/	25.1	22.5	4.7	26.5	8.3	1.8	8.0	8.0	14.0	15.0
(In millions of U.S. dollars)										
D. Central Bank NIR, excluding bank's foreign currency deposits (floor)	201	225	661	350	853	880	750	750	750	1,100
E. Gross accumulation of public sector external arrears (continuous ceiling)	0	0	0	0	0	0	0	0	0	0
F. Gross accumulation of arrears with electricity generators (ceiling)	...	...	...	...	...	0	0	0	0	0
G. *Gross* contracting of external debt by the public sector (cumulative ceiling) 4/	0	855	426	1,105	596	...	...	...	...	...
H. *Net* contracting of *project-related* external debt by the public sector (cumulative ceiling) 5/	...	...	...	...	...	400	200	150	150	...
II. Indicative Targets										
(In billions of Dominican Republic pesos)										
A. Change in NFPS net credit from the domestic banking system (cumulative ceiling) 6/	9.4	3.0	-10.8	1.0	-9.9	8.0	7.0	5.0	3.0	...
B. *Gross* contracting of *project-related* external debt by the public sector (cumulative ceiling)	...	...	...	...	...	400	400	400	400	...
C. *Gross* contracting of *budget-support* external debt by the public sector (cumulative ceiling) 4/ 7/	...	...	...	...	...	135	250	345	475	450
D. Monetary base, excluding reserves on foreign currency deposits (ceiling) 8/	91.1	93.0	89.8	104.0	104.6	95.5	107.0	109.0	122.0	131.0
(In percent of GDP)										
E. Consolidated puiblic sector overall balance (floor) 9/	-7.6	...	...	...	-3.3	...	...	...	-2.8	-2.0
F. Consolidated public sector primary balance (floor) 9/ 10/	-1.4	...	...	...	1.4	...	...	...	1.9	2.3

1/ As defined in the Technical Memorandum of Understanding and Annexes. Performance criteria are proposed for June, September and December 2006.
2/ For September 2005, cumulative from end-September 2004. For December 2005, and for 2006, cumulative from the beginning of the year.
3/ Defined as currency in circulation less NIR (program definition) valued at the accounting exchange rate of DR$35 per US$.
4/ Ceiling excludes any new debt instruments issued as part of the process of debt restructuring and rescheduling. Performance criteria is eliminated starting in 2006.
5/ Defined as new debt contracting less cancellations of already contracted but undisbursed debt.
6/ Credit is defined on a net (of deposits) basis, and includes the central bank.
7/ In case that program-related disbursment exceeds the ceiling, the excess financing will be used for central bank recapitalization and repayment of domestic arrears.
8/ Includes reserve requirements in the form of investment certificates.
9/ Consolidated public sector balance include quasi-fiscal loses of the central.
10/ Primary balance is defined as overall balance less interest expenditures (registered on a accruals basis).

TMU Table 2. Electricity Sector Indicators

	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	2006
Electricity supply (GWh)													
PRA areas	95	87	101	99	104	103	104	108	101	109	103	108	1,222
Non-PRA areas	632	577	668	663	710	702	711	748	695	728	677	719	8,228
Total	727	664	769	762	815	805	815	856	796	837	780	827	9,450
Loss rate (non-PRA areas, percent)													
EdeNorte	41.0	39.2	38.2	36.4	35.1	33.5	32.1	31.2	29.9	29.0	27.6	27.6	33.4
EdeSur	32.1	31.2	30.9	30.1	29.6	28.8	28.0	27.7	26.6	26.2	24.8	24.7	28.4
EdeEste	31.3	24.0	37.6	30.3	35.3	31.0	25.9	23.6	21.9	25.5	21.5	26.2	27.8
Total	34.9	31.9	35.3	32.3	33.1	31.1	29.0	27.9	26.5	27.0	24.8	25.9	30.0
Collection rate (non-PRA areas, percent)													
EdeNorte	83.2	83.3	84.0	84.3	84.9	85.3	85.8	86.3	86.4	86.8	86.9	87.4	85.4
EdeSur	92.8	93.2	93.5	93.9	94.3	94.7	95.1	95.5	95.9	96.3	96.6	97.0	94.9
EdeEste	92.9	92.8	94.8	92.1	93.3	90.4	89.1	89.6	92.8	91.6	92.3	93.6	92.1
Total	90.1	90.3	91.2	90.6	91.1	90.4	90.1	90.6	91.9	91.7	92.2	92.9	91.1
Cash Recovery Index (non-PRA areas, percent)													
EdeNorte	49.1	50.7	51.9	53.6	55.1	56.7	58.3	59.4	60.6	61.6	62.9	63.3	56.9
EdeSur	63.0	64.1	64.6	65.7	66.4	67.4	68.5	69.0	70.4	71.0	72.7	73.1	68.0
EdeEste	63.8	70.5	59.2	64.2	60.4	62.4	66.0	68.5	72.5	68.2	72.5	69.1	66.5
Total	58.7	61.5	59.0	61.3	60.9	62.3	64.0	65.3	67.5	66.9	69.3	68.8	63.8
Operational expenditure													
EdeNorte	2.5	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	29.3
EdeSur	3.8	3.6	3.4	3.3	3.3	3.3	3.2	3.2	3.2	3.2	3.1	3.1	39.6
EdeEste	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	69.0
CDEEE													
Total	10.2	9.9	9.7	9.6	9.5	9.5	9.5	9.5	9.4	9.4	9.3	9.3	108.6
Capital expenditure													
EdeNorte	3.0	3.0	3.0	3.0	3.2	3.2	3.2	3.2	0.7	0.7	0.7	0.7	27.2
EdeSur	2.0	2.0	1.9	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	23.0
EdeEste	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	24.0
CDEEE													
Total	6.9	6.9	6.9	6.9	7.1	7.1	7.1	7.1	4.6	4.6	4.6	4.5	74.2
Central government transfers (US$ millions) 1/	50	50	45	47	44	46	42	39	38	33	35	31	500

1/ Includes Union Fenosa.