

International Monetary Fund

[Dominican Republic](#)
and the IMF

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

Press Release:
[Press Release: IMF Executive Board Completes Fifth and Sixth Reviews under Stand-By Arrangement with the Dominican Republic and Approves US\\$57.5 Million Disbursement and Extension of Arrangement](#)
February 15, 2007

January 31, 2007

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Santo Domingo, January 31, 2007

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

Dear Mr. de Rato:

1. The Dominican economy has continued to develop favorably, growing faster than envisaged and with inflation under control. While we met the monetary targets for 2006 by wide margins, we encountered difficulties with the program's fiscal objectives because of some tax revenue weakness and the need to carry out priority expenditures, especially in infrastructure. There have been delays in implementing structural reforms, but the congressional majority we gained in the May 2006 elections has helped us to make significant progress in recent months. As evidence of this, congress approved a series of laws designed to strengthen the institutional framework for fiscal management and control. Moreover, we have taken the necessary steps to consolidate the 2007 fiscal position, including approval of a corrective tax package and implementation of a new comprehensive plan for the electricity sector. In view of our efforts, we request that the pertinent waivers be granted, and that the Executive Board complete the fifth and sixth reviews of the program.

2. With a view toward consolidating the achievements under the Stand-By Arrangement, we ask for the arrangement to be extended until January 2008 and for the outstanding disbursements to be rephased evenly over the remaining period. The program will be monitored by semiannual reviews, and quarterly quantitative performance criteria have been set through end-2007. New structural performance criteria and benchmarks have been established to continue strengthening the country's economic institutions. The seventh review, to be completed by end-June 2007, will focus on assessing fulfillment of the quantitative performance criteria at end-March 2007, progress in improving public sector performance, and implementation of the structural agenda. An eighth review will be completed by December 2007.

Macroeconomic projections

3. After two years of rapid economic recovery, reflected in real GDP growth of about 10 percent a year, we anticipate solid but more moderate real growth of about 6 percent in 2007. Moreover, we have managed to reduce the 12-month inflation rate from a high of 65 percent a year in 2004 to 5 percent in 2006, at the lower bound of the target range of 5–7 percent. For 2007 we envisage a further reduction in annual inflation, subject to DR-CAFTA becoming effective shortly, to which end we will continue pursuing a prudent monetary policy. The current account of the balance of payments performed slightly better than anticipated in 2006, and based on preliminary data we estimate that the year ended with a deficit between 2–2½ percent of GDP, partly reflecting greater buoyancy in exports and a lower-than-projected oil import bill. For 2007 a small improvement in the current account is anticipated as a result of the recent decline in oil prices, though non-oil imports are expected to rise (especially capital goods) to support the continuing growth of the economy.

Main Macroeconomic Indicators

	2005	2006		2007
	Prel.	Prog.	Est.	Proj.
Real GDP growth (in percent)	9.3	5.5	10.4	6.0
CPI inflation (in percent)	7.4	5–7	5.0	4–6
Current account balance (in percent of GDP)	-0.3	-2.4	-(2.1– 2.6)	-(1.8– 2.3)
Net international reserves (in US\$ million, program definition)	855	750	1,128	1,275

Monetary policy

4. The 2006 monetary objectives were met by comfortable margins, consistent with the program's inflation target. Base money was maintained below target, and accompanied by a strong accumulation of net international reserves that far exceeded program targets, while avoiding a nominal appreciation of the peso. This was possible because the issuance of central bank certificates allowed appropriate domestic liquidity management while keeping net domestic assets of the central bank below program ceilings.

5. The 2007 monetary program is compatible with an inflation rate of 4–6 percent and an increase in the net international reserves of about US\$150 million. Our objective is to manage the liquidity of the system through interest rates on central bank instruments. In particular, we will continue the policy of closing the gap between the rates on central bank lending operations (Lombard rate) and borrowing operations (overnight) to reinforce the signaling of policy intentions. In the first half of 2007, we expect to begin publication of a more detailed semi-annual report on monetary policy and a monthly index of core inflation.

6. The central bank remains committed to exchange rate flexibility, but reserves the right to intervene in the market to prevent abrupt exchange rate movements. To strengthen the integrity of the foreign exchange market, the Monetary Board approved general regulations for foreign exchange trading and operating guidelines that will consolidate the functioning of the private electronic foreign-exchange trading platform.

7. We continue making advances in carrying out our comprehensive plan to resolve the quasi-fiscal deficit of the central bank, which includes the bank's recapitalization, the sale of assets acquired in the recent bank resolution process, and the lengthening of the maturity profile of peso-denominated BCRD certificates.

- In July 2006 we formulated a plan to recapitalize the central bank over a 10-year period, and we have defined the financing strategy for the plan that is compatible with the sustainability of public sector debt (*prior action*). The plan was developed with the benefit of drawing on the successful experiences of various Latin American countries. An inter-institutional team from the Secretariat of Finance and the BCRD is preparing a draft Framework Law on Recapitalization. At the same time, the BCRD and Superintendency of Banks are finalizing amendments to the Monetary and Financial Law (keeping the main elements mentioned in previous letters), with a view to presenting these draft laws to Congress by end-March 2007. We expect congressional approval of the Framework Law on Recapitalization by end-May 2007 and the Monetary and Financial Law by end-September 2007 (*both structural performance criteria*).

- In 2006, the Assets Recovery Commission (COPRA) held six auctions of assets acquired during the bank resolution process (with a face value of about US\$440 million). Together with other mechanisms for asset realization, US\$91.1 million in receipts and receivables were recovered in 2006. The auctions were strengthened by technical recommendations of external consultants and experts in the sale and management of assets. On the basis of those recommendations, we will continue advancing in completing an updated inventory of existing assets and will adopt internal procedures and policies to improve asset management, scheduling, and the rate of return from the sale process. At the same time, we are preparing an action plan summarizing COPRA's strategy, establishing short- and medium-term goals and actions, and we have published the 2007 auction schedule. We expect to offer for sale assets worth about US\$300 million in 2007.
- The central bank has been improving the maturity structure of its certificates. The average maturity of central bank certificates has increased from 13 months in December 2005 to 16 months in December 2006, and the proportion of certificates redeemable-on-demand has fallen from one half to one third over the same period. The Monetary Board has authorized the issuance of various long-term instruments, which include inflation-indexed certificates with the limited aim of continuing to extend the maturity of the certificates. These certificates will be issued at opportune moments, in line with the established strategy for the central bank's recapitalization and public debt management.

Fiscal policy

8. Despite the strong macroeconomic performance, the fiscal outturn fell short of the program's objectives in 2006. For the year, the nonfinancial public sector deficit is estimated at about 1 percent of GDP, compared with balance in the program.

- Tax revenue yields were lower-than-projected, especially from the transitory foreign exchange commission and the tax reform adopted at end-2005, the latter owing to changes in consumption patterns toward lower-excise-taxed substitutes and to difficulties in increasing fuel taxes in the context of rising oil prices throughout most of the year. Also, in 2006 we began to recognize (against firms' tax liabilities) losses associated with the financial crisis.
- To support the strong growth outlook and improve infrastructure that had deteriorated during the crisis, the government undertook and accelerated spending on important capital projects. At the same time, the change in the structure of consumption that decreased tax collections also affected spending on subsidies for liquid gas that rose in line with the unforeseen consumption. Also, the electricity sector deficit was higher than programmed (US\$530 million, compared with an original projection of US\$480 million), mainly attributable to the insufficient improvement in the performance of distributors' cash recovery indices (CRI) in the first half of the year and to increased generating costs brought about by higher oil prices. Arrears to electricity generating companies accumulated through December 2006 as a result of the sector's financial difficulties were recently eliminated (*prior action*).
- With regard to the contracting of external debt for project financing, the ceiling for end-2006 was met despite the greater gross contracting compared with the indicative target in the program, as this was compensated by larger than expected cancellations. For 2007, we will stay within the limits in the program that have been established with the aim of stabilizing

annual debt-contracting flows at similar levels consistent with the foreign-financed public investment expected over the medium term.

Public Sector Balance
(in percent of GDP)

	2004	2005 Prel.	2006		2007 Prog.
			Prog.	Est.	
a. NFPS Overall balance (b-c)	-3.6	-0.2	0.0	-1.0	0.5
b. NFPS Primary balance	-1.4	1.5	1.8	0.5	2.1
c. NFPS interest expenditure	2.1	1.6	1.8	1.6	1.6
d. Central bank quasi-fiscal balance	-4.0	-2.9	-2.8	-2.5	-2.3
e. Consolidated public sector balance (a+d)	-7.6	-3.1	-2.8	-3.5	-1.7
f. Consolidated primary balance	-1.4	1.6	1.8	0.4	2.3
g. Consolidated interest expenditure	6.2	4.7	4.6	3.9	4.0

9. With the aim of reinvigorating the process of fiscal consolidation, the 2007 program targets a primary surplus of 2.3 percent of GDP at the consolidated level. To meet this objective, Congress approved the 2007 budget consistent with a primary surplus of 2.1 percent of GDP at the consolidated public sector level (*prior action*), with the remaining 0.25 percent of GDP coming from the net savings from extraordinary revenues secured from a capital gains case (0.5 percent of GDP), as half of the receipts will be saved. The government is committed to maintaining a consolidated primary surplus of at least 2 percent of GDP in the coming years to bring the consolidated public debt below 30 percent of GDP by the end of the next decade. In this regard, we expect that Congress will approve the 2008 budget with a primary surplus consistent with this commitment by end-2007 (*structural performance criterion*). To achieve this primary surplus in 2007, a fiscal effort of about 2.5 percent of GDP has been necessary, in part reflecting the loss of revenue associated with the entry into the DR-CAFTA free-trade treaty. This adjustment is being carried out through tax and expenditure-reduction measures:

- On the revenue side, in December Congress approved a corrective tax package that we estimate will yield around 1.5 percent of GDP in 2007 (*prior action*). The package includes measures to: (i) include the excise tax in the VAT base, in line with best international practices; (ii) rationalize excise taxes to minimize distortions and increase excise rates for alcoholic beverages, cigarettes, and some fuels; (iii) raise car registration fees and increase income taxes on gambling establishments; and (iv) maintain the financial transaction tax at current low levels. The package also contains important measures to improve tax administration, including increased sanctions for noncompliance and strengthened regulation of transfer pricing mechanisms.
- On the expenditure side, the budget envisages: (i) limiting transfers to the electricity sector to US\$400 million (1 percent of GDP) and subsidies for liquid gas to RD\$2.4 billion (0.2 percent of GDP); (ii) lowering transfers (in real terms) to municipalities and autonomous branches of government; and (iii) cutting non-priority administrative expenditure. These savings will allow for increased spending for recapitalizing the central bank and for health and education (as shares of GDP). The latter is in line with our social protection reform program, being supported by the Inter-American Development Bank, that aims at achieving the Millennium Development Goals by improving the quality and effectiveness of social spending through a gradual elimination of social programs with low redistributive impacts and reassignment of resources to priority programs.

Institutional reforms in fiscal management

10. We have taken a number of important steps to strengthen the institutional framework for public financial management. The main objective of the reforms is to ensure that responsibility for all aspects of budget and debt management is centralized in a single State Secretariat, and that any spending above the established budget caps is approved by Congress by means of a supplementary budget, thereby abolishing the procedure for administrative approval of expenditure through the budget surplus mechanism.

Institutional reform

- Following the earlier adoption of Laws on Public Credit, Procurement, and Treasury, Congress passed in November 2006–January 2007 another six laws (the Organic Law on the Budget, Establishment Laws on the Finance Secretariat and the Economy, Planning and Development Secretariat, and Laws on Financial Administration, Public Planning and Investment, and Internal Controls) that strengthen fiscal management in line with best international practices. These new laws came into force in January 2007 (*prior action*).
- In addition, we have issued the regulations for implementing the Treasury Law and the Law on Public Credit (*prior action*), and we expect to issue the regulations for implementing the remaining laws by end-July 2007 (*structural performance criterion*).
- We will continue to work on consolidating the institutional reorganization of fiscal management during the first half of 2007, including by defining in more detail organizational charts, job descriptions, and staff needs. We intend to ask the IMF Fiscal Affairs Department for technical assistance to help us in preparing the fiscal regulations and establishing a single treasury account (see *reform of financial management* section below).

Reform of expenditure policy

- The government is assessing the system of transfers to municipalities and autonomous branches of government to ensure that the transfer of resources is consistent with expenditure responsibility and financing needs. To this end, we expect to finalize a proposal on reform of the transfer system by June 2007 (*structural benchmark*) so that it can be included in the 2008 budget. At the same time, in January 2007 the new Economy, Planning and Development Secretariat, in coordination with the Finance Secretariat, will start monitoring the investment spending of municipalities, as provided for by law.

Reform of financial management

- We have made progress toward the establishment of a single treasury account. To this end, we prepared an inventory of all the bank accounts held by central government, autonomous agencies, and decentralized bodies, and we ordered the closure of all inactive accounts (about one-third of the total). We are carrying out a review of the remaining accounts with the aim of closing unnecessary accounts and incorporating those that are necessary into the integrated financial management system (SIGEF) by May 2007. This will lead to improved tracking of the expenditure of nonfinancial public institutions. We hope to include in the treasury single account a first group of central government units (Secretariats of Foreign Affairs, Tourism, Women, Culture, Youth, and Sports) by end-June 2007 (*structural performance criterion*) and will extend the scope of the treasury single account to include all central government entities

by end-2007, followed by the autonomous and nonfinancial decentralized institutions in 2008.

- To strengthen expenditure management and progress in the implementation of legislative reforms, the 2007 budget includes provisions to: (i) eliminate the *budget surplus* mechanism; (ii) execute the 2007 budget on the basis of expenditure commitments and payment quotas at an aggregated level, abolishing the practice of expenditure approval on an item-by-item basis (this provision will be phased in gradually, to include all central government institutions by April 2007); and (iii) prohibit the indiscriminate use of advances, limiting them to cases provided for in the legislation (*prior action*).

Reform of revenue management

- The tax rectification package will be supported by efforts to strengthen tax and customs management. To this end, during the first half of 2007 we will issue regulations for implementing the laws granting greater autonomy to the Internal Revenue and Customs Directorates that, among other things, will strengthen control mechanisms and accountability. We also resent to Congress legislation to criminalize tax evasion, which we expect Congress to approve by March 2007.
- Lastly, we will begin technical preparation of the study on the cost of tax incentives so that it can be finalized in the first half of 2007. The study will make a complete survey of tax incentives and exemptions with a view to preparing a tax expenditure budget that makes explicit their cost and identifies their beneficiaries. It will be sent to Congress along with the fiscal budget every year, starting with the 2008 budget (*structural performance criterion related to the 2008 budget*). The ultimate purpose of these efforts is to: (i) consolidate all tax benefits under a new section in the Tax Code; (ii) establish that only tax benefits included in the Code are applicable, validating only those that are of the highest importance for the national interest and eliminating the rest; (iii) rule out the possibility of granting tax incentives or exemptions outside of the Code; and (iv) establish the criteria that tax exemptions or incentives must meet to be considered priority.

Electricity sector

11. To effect a sustainable reduction in government transfers to the electricity sector and improve the quality of service, in September 2006 we launched a new comprehensive reform plan for the sector. During 2007–08, the plan will focus on improving the performance of the electricity distribution companies through measures to reduce losses, especially those resulting from fraud, and on reducing the price of electricity generation through voluntary renegotiation of existing contracts with generation companies (including with signatories under the Madrid Agreements and private companies Cogentrix and Smith & Enron). From 2008, the plan envisages an expansion of electricity transmission and generation capacity, with higher levels of efficiency. The plan includes improvements in the legal, regulatory, managerial, supervisory, and control areas, while redefining the tariff structure and its social component.

- *Regulatory and legal framework.* Congress is expected to approve amendments to the General Law on Electricity by end-March 2007 (*structural performance criterion*), including: (i) the identification of criminal acts related to the electricity sector; (ii) the legal obligation of non-contractual users to regularize their financial situation with the distribution companies; (iii) the strengthening of institutions that regulate and supervise the electricity

sector; and (iv) the equitable application of sanctions against all who commit illegal acts in the electricity sector. In addition, by end-March 2007, we will modify the regulatory framework to eliminate the administrative obstacles to our efforts to inspect suspected cases of electricity theft, as well as those that hinder good management practices in distribution companies (*structural performance criterion*).

- *Management of distributors.* The performance of the distribution companies has improved considerably since May 2006 as a result of a vigorous monitoring of users of electricity service with the assistance of the Program for Eliminating Electricity Theft (PAEF), a police force which is assigned exclusively to this task. In December 2006, the CRI in non-PRA (Program to Reduce Blackouts) areas reached 56 percent and is expected to reach 66 percent by end-2007. To ensure that targets are met, the electricity distribution companies will invest US\$72 million in 2007, mainly to install meters and other technologies.
- *Supervision and control.* We have recently set up a high-level Electricity Monitoring Committee (*prior action*), which has the task of monitoring the implementation of the comprehensive plan and recommending corrective actions in the event of slippages. To ensure that distribution companies report their results accurately, we expect to publish the shortly the external audits of the CRI of distribution companies for the period July 2005–June 2006 (*prior action*). These audits are being conducted in accordance with the terms of reference agreed with the World Bank. Moreover, the external audits of the 2005 financial statements of the electricity distribution companies and the CDEEE were recently published.
- *Tariff policy.* We intend, in principle, to allow electricity prices to fluctuate in line with international oil prices and the exchange rate (according to a resolution from the Superintendency of Electricity). However, in the case that electricity prices are temporarily lower than the reference prices, we will cover any additional transfers to the electricity sector by reducing non-priority spending. In addition, we expect to complete a review of the pricing structure by June 2007, aimed at reducing incentives to commit electricity fraud and at channeling subsidies to low-income households. We plan to open an escrow account to manage resources of the Tariff Stabilization Fund shortly.
- *Social support.* We intend to finalize before end-April 2007 a plan to improve the focus and efficiency of subsidies to the sector, particularly those related to the PRA areas (*structural benchmark*) and to begin its implementation to ensure a significant reduction of government support during 2007. In addition, investments will be made to improve the distribution network in rural and poorer semi-urban areas.

Reform of the financial sector

12. We remain committed to taking all necessary measures to prevent fraud and improve corporate governance practices in the financial sector. To do so, we understand that the law must be strictly applied to those involved in the recent financial crises, which was so damaging to the country. We also understand the need to strengthen management practices in financial intermediation institutions through appropriate regulation. To this end, the Superintendency of Banks issued a circular requiring external auditors to carry out special reviews of risk management and internal control practices and systems and of the proper functioning of corporate governance. In addition, recently, the Superintendency of Banks submitted to the Monetary Board for public consultation, a regulation spelling out the internal control and corporate governance requirements for financial institutions.

13. To improve the supervision and global risk management of the financial sector, we are working to implement effective consolidated supervision. For this purpose, by end-February 2007, the regulatory bodies of financial intermediaries, insurance companies, pension funds, and securities companies will sign a Memorandum of Understanding (MOU) providing for the sharing of information and the coordination of responsibilities (*structural benchmark*). By end-June 2007 we expect to finalize an action plan to implement the MOU and ensure effective coordination, as well as a plan to strengthen the regulation and supervision of the securities market and integrate into the payments system the recording of all transactions involving securities (*structural performance criterion*), for which we are counting on financial support from the World Bank.

14. In the Superintendency of Banks we have been implementing our institution building plan. In July we published the self-assessment of compliance with the Basel Committee's *Core Principles for Effective Banking Supervision*, and we recently developed an action plan to improve banking supervision and will publish it soon. One of the priority areas for development that was identified is risk-based supervision, which we have begun implementing. The new supervision process will be supported by a new institutional structure as well as new internal procedures, including integrated inspection and analysis manuals.

15. To strengthen the banking sector, we have concluded inspection of the quality of banking assets, and the findings have been used in preparing the relevant financial statements. Moreover, the Superintendency of Banks has signed memoranda of understanding with financial institutions with weaknesses in their business plans, internal control, and corporate governance. We are also working on strengthening other financial intermediaries, completing inspections of savings and loan associations, with financial support from the IDB. We expect to formalize a plan shortly to strengthen all nonbank financial intermediaries, with implementation starting in about a month. Moreover, the Superintendency of Banks is concluding a diagnostic of *Banco Agrícola* to determine its current situation and will prepare a draft law to transform this bank into an agency for agricultural development.

Financing guarantees for the program

16. We believe that the fiscal program for 2007 is adequately financed. Congress has ratified all bilateral agreements on the restructuring of external debt corresponding to the 2005 Paris Club (minor arrears with Paris Club creditors were recently cleared). We will continue to keep the level of external debt under control and will remain current on our debt service obligations. Also, we have eliminated all technical arrears, save one, on which we are continuing to negotiate in good faith (to resolve outstanding arrears of an amount totaling less than US\$20 million). To comply strictly with the Law on Public Credit as regards the contracting of new public debt, we will persevere with the policy that any new public debt contracted must be consistent with the priorities set by the government, which will be reflected in the multi-year public investment program to be included in the central government budget for 2008 in accordance with the newly approved Public Investment Law.

17. In 2007 the government intends to access international capital market only to improve the structure of public debt, either by reducing arrears or by lengthening the existing debt maturity profile. In view of the large amount of contracted public debt that has not been disbursed for investment programs, the contracting of new debt for financing projects will be limited to ensure compliance with the ceilings established in the Technical Memorandum (attached). Should gross

external debt contracting for projects exceed these ceilings, we will cancel a similar amount of debt contracted to finance investment projects but not yet disbursed.

Final remarks

18. In view of the progress achieved under the program, the measures we have recently adopted, and our policy commitments, we request completion of the fifth and sixth reviews of the current Stand-By Arrangement and for the Arrangement to be extended until January 30, 2008. As we implement the program, we will continue to consult closely on policy issues with the Fund and the rest of the international community.

Very truly yours,

/s/

Héctor Valdez Albizu
Governor
Central Bank

/s/

Temístocles Montás
Secretary of Economy,
Planning, and Development

/s/

Vicente Bengoa
Secretary of Finance

Attachments:

Tables (prior actions, and structural performance criteria and structural benchmarks).
Technical Memorandum of Understanding.

Table 1. Dominican Republic- Prior Actions for Fifth and Sixth Reviews under the SBA

Fiscal Policy

1. Approval by congress of a package of laws to reform fiscal management practices. Package includes: (i) Organic Budget Law; (ii) Establishment Laws for the new Secretariat of Finance and the new Economy, Planning and Development Secretariat; (iii) Public Investment Law; (iv) Internal Controls Law; and (v) Financial Administration Law.
2. Congressional approval of a tax package yielding about 1.5 percent of GDP. Issuance of DGII regulation abolishing the VAT exemptions on tourism packages.
3. Congressional approval of a 2007 budget consistent with a consolidated primary surplus of 2.1 percent of GDP, including central bank transfers equivalent to 0.5 percent of GDP. In addition, the budget should include provisions that: (i) eliminate the budget surplus mechanism; (ii) ensure the execution of the budget through periodic quotas set at the aggregate level (eliminate the practice of approving expenditures on an item-by-item basis); (iii) prohibit the use of budget advances, except as allowed in the regulations.
4. Issuance of regulations implementing the Public Credit Law.

Banking sector

5. Completion of an agreed plan to recapitalize the central bank and address the quasi-fiscal deficit problem, including an evaluation of the financing alternatives.
6. Completion of corrective actions for a mid-size bank and its exit from the regularization process.

Electricity sector

7. Creation of a High Level Monitoring Committee in charge of monitoring the implementation of the Comprehensive Plan for the Electricity Sector.
 8. Clear arrears with electricity generators accumulated through end-December 2006.
 9. Publish CRI audits that were done in accordance with the terms of reference agreed upon with the World Bank.
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Table 2. Dominican Republic: Proposed Structural Performance Criteria and Structural Benchmarks 2007

	Date
Structural Performance Criteria	
Fiscal policy	
Issuance of regulations implementing the: (i) Organic Budget Law; (ii) Public Investment Law; (iii) Establishment Laws of the new Secretariat of Finance and the new Secretariat of Economy, Planning and Development; and (iv) Internal Controls Law.	End-Jul. 2007
Establishment of a Single Treasury Account for a first group of central government institutions consistent with paragraph 10 of the January 2007 LOI.	End-Jun. 2007
Approval by congress of a budget for 2008 consistent with a consolidated primary surplus of at least 2 percent of GDP (consistent with paragraph 9 of the January 2007 LOI) and publication of a list of tax expenditures as required under the Organic Budget Law (consistent with paragraph 10 of the January 2007 LOI).	End-Dec. 2007
Banking sector	
Congressional approval the Framework Law for the Central Bank Recapitalization Law, consistent with the elements outlined paragraph 7 of the January 2007 LOI.	End-May 2007
Finalize an action plan to (i) strengthen securities markets and nonbank intermediaries' regulation and supervision; and (ii) improve coordination among the central bank and financial sector superintendencies (consistent with paragraph 13 of the January 2007 LOI and paragraph 8 of the January 2007 TMU).	End-Jun. 2007
Congressional approval of amendments to the Monetary and Financial Law (MFL), consistent with the elements outlined in paragraph 17 of the April 2006 LOI and the Central Bank Recapitalization Law.	End-Sep. 2007
Electricity sector	
Congressional approval of modifications to the General Electricity Law, to include, inter-alia, provisions to criminalizing electricity fraud and theft (as specified in paragraph 11 of the January 2007 LOI).	End-Mar. 2007
Modify regulations to eliminate administrative obstacles that hinder inspections of suspected cases of electricity theft and good management practices in distribution companies.	End-Mar. 2007
Structural Benchmarks	
Fiscal policy	
Completion of proposal to reform the system of transfers to municipalities and autonomous agencies.	End-Jun. 2007
Banking sector	
Agreement on a Memorandum of Understanding to strengthen cooperation among financial sector supervisors (Superintendency of Banks, Securities, Insurance and Pensions) and the Central Bank.	End-Feb. 2007
Issuance of regulations implementing the systemic risk and regularization of financial intermediaries provisions in the new MFL.	End-Sep. 2007
Electricity sector	
Completion of study to improve the targeting of the electricity subsidy program (Programa para la Reduccion de Apagones, PRA) and timetable for implementation.	End-Apr. 2007

**TECHNICAL MEMORANDUM OF UNDERSTANDING
JANUARY 31, 2007**

All aspects of the Technical Memorandum of Understanding (EBS/05/9, Supplement 1, Attachment II), issued on January 31, 2005, remain in effect, except for the revisions incorporated in the annexes to the letters of intent of September 29, 2005 and April 24, 2006, and those indicated below.

19. **Quantitative performance criteria for end-March, end-June, end-September, and end-December 2007** (see Table 1, annexed hereto) are established 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; (iv) arrears with private external creditors; (v) net contracting of external debt in connection with investment projects; (vi) accumulation of arrears on current electricity invoices to the electricity-generating companies; and (vii) budgetary transfers to the central bank (BCRD). Cumulative flow variables will be measured from December 31, 2006. The following clarifications/changes are provided:

- The cumulative floor on the nonfinancial public sector is measured from below the line (as defined in section I.A. of the Technical Memorandum of Understanding of January 2005) and will include the change in central government deposits held abroad.
- Budgetary transfers to the central bank (BCRD) represent the transfers included in the 2007 Budget Law (RD\$5,800 million), which will be disbursed on a quarterly basis in equal installments of RD\$1,450 million.
- Arrears to private energy generating companies have been redefined as the balance of current invoices for energy sales to electricity distribution companies (EdeNorte, EdeSur and EdeEste) for which no payment has been made within 45 days following the contractual due date.

20. **Indicative targets for end-March, end-June, end-September, and end-December 2007** (see Table 1, annexed hereto) are established for the: (i) change in net credit to the nonfinancial public sector from the domestic banking system; (ii) gross contracting of external debt in connection with investment projects; (iii) gross contracting of external debt for budget support purposes; and (iv) monetary base. In addition, an indicative target for end-December 2007 is established for the consolidated public sector primary balance, expressed in relation to GDP.

21. **Indicative targets are added for end-March, end-June, end-September, and end-December 2007 on primary expenditure of the central government (cumulative ceiling).** Central government primary expenditure, will be measured on an accrual basis as the overall central government balance (as defined in section I.A. of the Technical Memorandum of Understanding of January 2005) less overall revenues and grants, and less interest.

22. **Adjustor on the indicative target on central government primary expenditures.** In the event that the central government revenues and grants are higher-than-programmed on a cumulative basis, the cumulative ceiling on the primary expenditure of the central government will be adjusted upward by the amount of additional revenues up to a maximum of DR\$4 billion. The central government revenue projections for 2007 are as follows: (i) January–March: DR\$ 56.4 billion; (ii) January–June: DR\$110.4 billion; (iii) January–September: DR\$164.8 billion; and (iv) January–December: DR\$221.1 billion. These projections include DR\$5.9 billion of capital gains revenues from Verizon from the first quarter onward.

23. Indicative targets are added for the average Cash Recovery Index (CRI) for electricity distributing companies in the non-PRA (Blackout Reduction Program) areas for end-March, end-June, end-September, and end-December 2007.

- The CRI is equivalent to the ratio between the invoice rate and the collection rate (TC), where the invoice rate is difference between one and the loss rate (TP) [$CRI = (1-TP) / (TC)$]. Both the loss rate and the collection rate are defined in the January 2005 Technical Memorandum of Understanding.
- The quarterly CRI target will be compared with the weighted average CRI of the three electricity distribution companies (EdeNorte, EdeSur, and EdeEste), as defined by the CDEEE, estimated on the basis of the average for the quarter.
- The CDEEE will transmit the monthly report on the performance of the distributing companies, including the CRI (and its components), to the IMF no later than 21 days following the end of each month. Should there be slippage against the program, the report will indicate the reason for that slippage and will present an action plan to correct it.

24. Data requirements for the electricity sector. In order to monitor the sector's performance effectively, the CDEEE will continue to provide the information detailed in para. 8 of the Technical Memorandum of Understanding of April 2006. Additional data requirements include:

- The CDEEE will provide on a monthly basis (with a 21-day lag) information on the arrears the generation companies accumulate with the CDEEE on energy purchases and transmission fees.
- The high level Electricity Monitoring Committee will transmit to the IMF a report evaluating the performance under the electricity sector plan on a quarterly basis (and 45 days following the end of each quarter).

25. Timetable for abolishing the practice of expenditure approval on an item-by-item basis. Starting in January 2007 this practice was abolished for a first set of central government units, including the Secretariats of Foreign Affairs, Finance, Tourism, Women, Culture, Youth, and Sports, as well as some obligations of the Public Debt (Chapter 998) and Treasury (Chapter 999) Administration. This policy will be expanded to the rest of the central government by April 2007.

26. The action plan to strengthen the regulation and supervision of the securities market and improve coordination between financial sector supervisors and regulators requires: (i) the Superintendency of Banks, in coordination with the other regulators, to specify the data requirements for ongoing and on-site supervision of financial groups; (ii) the Superintendency of Securities to draw up a detailed timetable for issuing regulations, improving supervisory practices, and beginning the work with securities market participants on self-regulation to improve market behavior; and (iii) the regulators (including the BCRD) to present a detailed timetable for improving custody, including integration of the recording of all securities transactions in the payments system.

27. The government will present the IMF with the draft Central Bank Recapitalization Law and amendments to the Monetary and Financial Law, at least 15 days prior to their submission to Congress.

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

	2005	Jun-06		Sep-06		Dec-06		2007 Prog.			
		Prog.	Prel.	Prog.	Prel.	Prog.	Est.	Mar.	Jun.	Sep.	Dec.
I. Quantitative Performance Criteria											
	<i>(In billions of Dominican Republic pesos)</i>										
A. Nonfinancial public sector (NFPS) balance (cumulative floor)	-1.6	0.3	-3.6	0.2	-8.9	0.0	-10.8	5.3	7.6	8.2	5.6
B. Central bank transfers (cumulative floor)	...	1.7	1.8	2.6	1.9	3.4	3.4	1.5	2.9	4.4	5.8
C. Central Bank net domestic assets (ceiling) 3/	8.3	8.0	-0.1	8.0	0.9	14.0	3.8	7.2	6.3	3.4	11.0
	<i>(In millions of U.S. dollars)</i>										
D. Central Bank NIR, excluding bank's foreign currency deposits (floor)	853	750	973	750	1,004	750	1,125	900	900	900	1,000
E. Gross accumulation of public sector external arrears (continuous ceiling) 4/	0	0	0	0	0	0	0	0	0	0	0
F. Gross accumulation of arrears with electricity generators (ceiling)	...	0	0	0	39	0	42	0	0	0	0
G. <i>Net</i> contracting of <i>project-related</i> external debt by the public sector (cumulative ceiling) 5/	...	200	68	150	252	150	72	540	540	410	410
II. Indicative Targets											
	<i>(In billions of Dominican Republic pesos)</i>										
A. Change in NFPS net credit from the domestic banking system (cumulative ceiling) 6/	-9.9	7.0	0.7	5.0	-2.0	3.0	-2.9	2.5	1.0	0.0	-2.0
B. Central government primary expenditure (ceiling) 7/	...	...	...	...	...	...	...	45.5	93.0	141.6	196.3
C. Monetary base, excluding reserves on foreign currency deposits (ceiling) 8/	104.7	107.0	94.5	109.0	98.1	122.0	111.4	113.0	116.0	115.0	127.0
	<i>(In millions of U.S. dollars)</i>										
D. <i>Gross</i> contracting of <i>project-related</i> external debt by the public sector (cumulative ceiling)	...	400	68	400	432	400	432	540	540	540	540
E. <i>Gross</i> contracting of <i>budget-support</i> external debt by the public sector (cumulative ceiling) 9/	...	250	185	345	240	475	294	540	540	540	540
	<i>(In percent of GDP)</i>										
F. Consolidated public sector primary balance (floor) 10/	1.6	...	...	...	...	...	0.4	...	...	...	2.3
	<i>(in percent)</i>										
G. Cash Recovery Index (floor) 11/	...	...	...	...	...	...	56.0	60.1	61.1	64.9	66.0

1/ As defined in the Technical Memorandum of Understanding and Annexes.

2/ Cumulative from the beginning of the year. In the case of monetary variables, figures reflect the average stock over the past 10 working days.

3/ Defined as currency in circulation less NIR (program definition) valued at the accounting exchange rate.

4/ Arrears for about US\$6 million were accumulated with Paris Club creditors in January 2007, and cleared shortly after.

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/ Starting in 2007, the floor will be adjusted upward should central government revenues exceed program projections.

8/ Includes reserve requirements in the form of investment certificates. The numbers for December 2005 and June 2006 on these certificates have been revised.

9/ In case that program-related disbursement exceeds the ceiling, the excess financing will be used for central bank recapitalization and repayment of domestic arrears.

10/ Consolidated balance includes NFPS and quasi-fiscal losses of the central bank. Primary balance is defined as overall balance less interest expenditures (registered on an accruals basis).

11/ Cash recovery index is the average for the quarter.