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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

DOMINICAN REPUBLIC
PROJECT PAPER
ECONOMIC SUPPORT FUNDS

AID/LAC/P-421

Project Number: 517-0255
Grant Number: 517-K-604

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CLASSIFICATION:

AID 1120-1	AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO.	517-K-604
		2. COUNTRY	Dominican Republic
PAAD	PROGRAM ASSISTANCE APPROVAL DOCUMENT	3. CATEGORY	Cash Transfer
		4. DATE	February 3, 1988
5. TO:		6. OVB CHANGE NO.	
7. FROM:		8. OVB INCREASE	
AA/LAC, Dwight Ink		9. TO BE TAKEN FROM:	Economic Support Funds
LAC/DR, Terrence J. Brown		10. APPROPRIATION -	72-117/81037
9. APPROVAL REQUESTED FOR COMMITMENT OF:			RPC-LES788-35517-KG31
\$ 13,835,000		11. TYPE FUNDING	
		12. LOCAL CURRENCY ARRANGEMENT	
		13. ESTIMATED DELIVERY PERIOD	N/A
		14. TRANSACTION ELIGIBILITY DATE	N/A
		15. COMMODITIES FINANCED	

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: 13,835,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: 13,835,000	Other:

18. SUMMARY DESCRIPTION

The grant will provide dollars 13.835 million for immediate balance-of-payments support to promote the financial stabilization and economic recovery of the country. The assistance will be obligated and disbursed subject to the satisfaction of standard CP's to disbursement (legal opinion, designation of authorized representatives) and, in the case of these ESF resources, the establishment of a separate bank account for the U.S. dollars, and other CP's as may be required by the Mission. The United States dollars provided will be used only to import petroleum and petroleum derivative products under the terms of the San Jose Accord (Mexico or Venezuela). The following covenants will be included in the agreement:

-- Economic program of the GODR. The GODR will covenant that it will carry out the macro-economic program presented to A.I.D. which provides for no increase in domestic banking system net lending to the consolidated public sector during calendar year 1988.

(Continued on next page)

19. CLEARANCES	DATE	20. ACTION
LAC/DP:JEVans	2/10/88	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED
LAC/CAR:LBond	2/19/88	<i>Dwight Ink</i> 3-5-88
LAC/DP:WWheeler	2/19/88	AUTHORIZED SIGNATURE DATE
LAC/GC:CDavidson	2/19/88	Assistant Administrator
PPC/EA:KKauffman	2/19/88	Bureau for Latin America and the Caribbean
PPC/PB:DAadams	2/22/88	TITLE
ARA/BCP:BCleveland		
ARA/CAR:DZweifel		
M/FM/CONT:CChristesen		

CLASSIFICATION:

DAA/LAC:MButler

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151A 2/29/93

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-- Exchange rate policy. The GODR will covenant that it will continue to maintain, throughout calendar year 1988, an exchange rate policy in which all transactions are at unified, market determined rates of exchange between the Dominican peso and the currencies of other countries. The GODR will not impose any additional controls on the purchase or holding of foreign exchange.

-- Special account for local currency counterpart. The GODR will deposit into a special account in the Central Bank of the Dominican Republic the peso equivalent of the U.S. dollar disbursement. The pesos in the special account will be used in support of the investment and development program of the grantee and will be programmed jointly by the GODR and A.I.D.

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OUTGOING
TELEGRAM

PAGE 01 STATE 069832 5222 016472 AID4851
ORIGIN AID-00

ORIGIN OFFICE LACA-03
INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 AMAD-01 PPPB-02
GC-01 PPEA-01 GCLA-03 FM-02 KAY-01 STEY-02 PVC-02 RELO-01
/030 A0

INFO LOG-00 EB-00 ARA-00 TRSE-00 /000 R

DRAFTED BY: AID/LAC/CAR: PBUCKLES: VP: MKROMHOUT: 2502N
APPROVED BY: AID/AA/LAC: DINK
AID/DAA/LAC: MBUTLER AID/PPC/EA: KKAUFFMAN (DRAFT)
AID/LAC/CAR: LBOND (DRAFT) AID/LAC/DP: WWHEELER (DRAFT)
AID/LAC/GC: GDAVIDSON (DRAFT) AID/LAC/DR: JEVANS (DRAFT)
AID/PPC/PB: DADAMS (DRAFT) AID/LAC/DR: TBROWN (DRAFT)
-----153730 060419Z /38

R 051757Z MAR 88
FM SECSTATE WASHDC
TO AMEMBASSY SANTO DOMINGO

UNCLAS STATE 069832

AIDAC

E. O. 12356: 56: N/A

TAGS:

SUBJECT: DOMINICAN REPUBLIC FY 1987 PAAD UPDATE
(FORMERLY 517-0171; NOW 517-0255)

REF: (A) SANTO DOMINGO 01165, (B) STATE 027409,
(C) SANTO DOMINGO 00556, (D) SANTO DOMINGO 12692

1. THE SUBJECT DOCUMENT WAS REVIEWED ON TUESDAY, DECEMBER 15, 1987. AS REQUESTED, THE MISSION IS AUTHORIZED TO PROCEED WITH OBLIGATION OF DOLS 13.8 MILLION IN SUPPORT OF THE GODR BALANCE OF PAYMENT PROGRAM, TAKING INTO ACCOUNT THE FOLLOWING GUIDANCE. PRIOR TO SIGNATURE, MISSION SHOULD ASSURE ITSELF THAT THE COVENANTS RELATING TO THE EXCHANGE RATE REGIME AND ECONOMIC PROGRAM FOR 1988 HAVE BEEN ACCEPTED AT THE HIGHEST LEVELS OF THE GODR.

2: DOLLAR FUNDS MAY BE DISBURSED UNDER THE CONDITIONALITY TERMS INCLUDED IN THE SUBJECT DOCUMENT. HOWEVER, THE MISSION SHOULD NOT PROCEED WITH LOCAL CURRENCY DISBURSEMENT FROM THE SEPARATE ACCOUNT UNTIL A MORE DETAILED DESCRIPTION OF LOCAL CURRENCY MANAGEMENT PROCEDURES AND DOCUMENTATION REQUIREMENTS, PARTICULARLY

WITH RESPECT TO NGO AND PVO ACTIVITIES SUPPORT, IS SUBMITTED FOR INFORMAL REVIEW IN A. I. D. / WASHINGTON. THE DESCRIPTION SHOULD INCORPORATE MODIFICATIONS OF EXISTING PROCEDURES EXPECTED TO BE INTRODUCED IN RESPONSE TO RECENT IG REVIEWS AND AGENCY LOCAL CURRENCY GUIDELINES (STATE 327494).

3: A. I. D. / W CONCURS WITH THE PROGRAMMING OF U. S. DOLLARS PROVIDED UNDER THE AGREEMENT FOR IMPORTS OF PETROLEUM AND PETROLEUM DERIVATIVE PRODUCTS.

4: A. I. D. / W HAS AGREED TO THE MISSION'S REQUEST TO ASSIGN A NEW PROJECT NAME AND NUMBER (REFS C AND D).

5: A COPY OF THE SIGNED AMENDED PAAD FACESHEET WILL BE FAXED TO THE MISSION' SHULTZ

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

19 FEB 1988

MEMORANDUM

TO: AA/LAC, D. Ink
FROM: LAC/DP, W. Wheeler *WJW*
SUBJECT: DR ESF and Exchange Crisis

As we reported in last week's Weekly Report, the Dominican Republic has been experiencing a major crisis with the free market exchange system that was re-established last November at our urging and assurance that ESF would be forthcoming. The exchange rate increased from 3.8 pesos to the dollar in November to 5.7 to the dollar several weeks ago. It has since stabilized at around 5.4 to the dollar and this has reduced domestic pressures to institute exchange controls. However, the threat remains that further instability of the rate would add pressure for exchange controls.

In light of the proposed ESF Agreement covenant committing the GODR to the maintenance of a unified market determined exchange rate throughout CY 1988, the Mission was contacted to determine whether obligation was still feasible. The Mission believes that the ESF will provide needed leverage to ensure that the exchange market remains free. The Mission will seek from the Economic Cabinet assurance that the market will remain free before signing the ESF Agreement. In addition, we have been advised that disbursement of the ESF will be delayed until outstanding auditor issues with earlier ESF are resolved. The obligated but undisbursed ESF would provide further leverage.

Based upon discussions with the Mission Director and our assessment of the situation, we concur in proceeding with the PAAD and authorization cable at this time.

ACTION
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INCOMING
TELEGRAM

PAGE 01
ACTION AID-00

SANTO 01165 051937Z

5355 107884 AID9016

ACTION OFFICE LADR-03
INFO LADP-04 AMAD-01 GC-01 GCLA-03 FM-02 KAY-01 STEY-02
ES-01 RELO-01 LACA-03 /022 A0

INFO LOG-00 ARA-00 /000 W

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P 051936Z FEB 88
FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC PRIORITY 9815

UNCLAS SANTO DOMINGO 01165

AIDAC

FOR P. BUCKLES, LAC/DR

E. O. 12356: N/A

SUBJECT: USAID/DR PAAD UPDATE: PROPOSED FACE SHEET
- LANGUAGE

1. THE FOLLOWING IS PROPOSED LANGUAGE FOR PAAD FACE SHEET:

THE GRANT WILL PROVIDE DOLLARS 13.835 MILLION FOR IMMEDIATE BALANCE-OF-PAYMENTS SUPPORT TO PROMOTE THE FINANCIAL STABILIZATION AND ECONOMIC RECOVERY OF THE COUNTRY. THE ASSISTANCE WILL BE OBLIGATED AND DISBURSED SUBJECT TO THE SATISFACTION OF STANDARD CP'S TO DISBURSEMENT (LEGAL OPINION, DESIGNATION OF AUTHORIZED REPRESENTATIVES) AND, IN THE CASE OF THESE ESF RESOURCES, THE ESTABLISHMENT OF A SEPARATE BANK ACCOUNT FOR THE U. S. DOLLARS, AND OTHER C. P. 'S AS MAY BE REQUIRED BY THE MISSION. THE UNITED STATES DOLLARS PROVIDED WILL BE USED ONLY TO IMPORT PETROLEUM AND PETROLEUM DERIVATIVE PRODUCTS UNDER THE TERMS OF THE SAN JOSE ACCORD (MEXICO OR VENEZUELA). THE FOLLOWING COVENANTS WILL BE INCLUDED IN THE AGREEMENT:

- ECONOMIC PROGRAM OF THE GODR. THE GODR WILL COVENANT THAT IT WILL CARRY OUT THE MACRO-ECONOMIC PROGRAM PRESENTED TO A. I. D. WHICH PROVIDES FOR NO INCREASE IN DOMESTIC BANKING SYSTEM NET LENDING TO THE CONSOLIDATED PUBLIC SECTOR DURING CALENDAR YEAR 1988.

- EXCHANGE RATE POLICY. THE GODR WILL COVENANT THAT IT WILL CONTINUE TO MAINTAIN, THROUGHOUT CALENDAR YEAR 1988, AN EXCHANGE RATE POLICY IN WHICH ALL TRANSACTIONS ARE AT UNIFIED, MARKET DETERMINED RATES OF EXCHANGE BETWEEN THE DOMINICAN PESO AND THE CURRENCIES OF OTHER COUNTRIES. THE GODR WILL NOT IMPDSE ANY ADDITIONAL CONTROLS ON THE PURCHASE OR HOLDING OF FOREIGN EXCHANGE.

- SPECIAL ACCOUNT FOR LOCAL CURRENCY COUNTERPART. THE GODR WILL DEPOSIT INTO A SPECIAL ACCOUNT IN THE CENTRAL BANK OF THE DOMINICAN REPUBLIC THE PESO EQUIVALENT OF THE U. S. DOLLAR DISBURSEMENT. THE PESOS IN THE SPECIAL ACCOUNT WILL BE USED IN SUPPORT OF THE INVESTMENT AND DEVELOPMENT PROGRAM OF THE GRANTEE AND WILL BE PROGRAMMED JOINTLY BY THE GODR AND A. I. D.] KILDAY

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OUTGOING
TELEGRAM

PAGE 01 STATE 027409
ORIGIN AID-00

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ORIGIN OFFICE LADP-04
INFO FPA-02 LADR-03 FCA-01 RELO-01 LACA-03 /014 A4 329

INFO LOG-00 ARA-00 /000 R

DRAFTED BY: AID/LAC/DP: CDWILLIAMS: CDW: 32771

APPROVED BY: AID/LAC/DP: DERBE

AID/LAC/DP: SSHARP

AID/M/FM/PAFD: HTRAN (SUBS)

AID/LAC/CAR: PKOLAR (INFO)

AID/FM/CAD: JHEVESY (INFO)

AID/LAC/DR: PBUCKLES (INFO)

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TO AMEMBASSY SANTO DOMINGO IMMEDIATE

UNCLAS STATE 027409

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E. O. 12356: N/A

TAGS:

SUBJECT: USAID/DR ESF PROGRAM

REF: (A) SANTO DOMINGO 00556 (B) STATE 394553

1. PER REF A, ACTIVITY AND PAAD NUMBERS ISSUED IN REF B
HAVE BEEN CHANGED TO THE FOLLOWING:

FROM ACTIVITY 517-0171 TO 517-0255
FROM PAAD 517K-603A TO 517K-604

2. REVISED BUDGET ALLOWANCE NOT NECESSARY SINCE
ADJUSTMENTS WILL BE MADE BASED ON THIS CABLE. SHULTZ

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Department of State *name* TELEGRAM

PAGE 01 SANTO 00556 221450Z 3267 100096 AID0040

ACTION OFFICE LADR-03
INFO FPA-02 LACO-01 LADP-04 GC-01 GCLA-03 PPR-01 RELO-01
LACA-03 PRE-06 /025 A4 322

INFO LOG-00 EB-00 ARA-00 L-03 /003 W
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P 221450Z JAN 88
FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC PRIORITY 9529

UNCLAS SANTO DOMINGO 00556

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FOR LAC/DR P. BUCKLES
- M/FM/PAFD E. S. OWEN

INFO LAC/DP SALLY SHARP
- LAC/GC C. BROWN
- LAC/CON G. BYLLESBY

E. O. 12356: N/A
SUBJECT: USAID/DR ESF PROGRAM

REF: A. 87 SANTO DOMINGO 14827
B. 87 SANTO DOMINGO 12692
C. 87 STATE 394553

1. USAID/DR REQUESTS THAT PAAD AUTHORIZATION FACESHEET FOR RESIDUAL FY 87 ESF PROGRAM REQUESTED REF B REFLECT A NEW PROJECT NAME AND NUMBER AS DESCRIBED BELOW. USAID, IN TURN, WILL PREPARE A NEW GRANT AGREEMENT RATHER THAN AMEND PREVIOUS AGREEMENT NO. 517-0171.
2. NEW PROJECT NAME: PRIVATE ENTERPRISE SECTOR SUPPORT
NEW PROJECT NUMBER: 517-0255.
3. RATIONALE FOR CHANGE IS TO AVOID HIGHLIGHTING THE DECLINE IN ESF RESOURCES SINCE THE CHANGE IN GODR ADMINISTRATION. U. S. MISSION ALSO BELIEVES THAT THE PAAD AND THE MACRO-ECONOMIC PROGRAM OF THE GCDR, WHICH IS THE BASIS FOR THIS ASSISTANCE, IS IN FACT A NEW AND DISTINCT PROGRAM. THEREFORE, THERE IS NO NEED TO REFER TO THE PREVIOUS AGREEMENT AND ITS AMENDMENTS.
4. ACTION: REQUEST THAT LAC/DR REFLECT THE CHANGE IN PROJECT NAME AND NUMBER IN PAAD AUTHORIZATION.
5. ACTION: REQUEST THAT M/FM/PAFD REISSUE BUDGET ALLOWANCE WITH NEW PROJECT NUMBERS. (FYI: PREVIOUS BUDGET ALLOWANCE WAS ISSUED PER REF. C.) KILDAY

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INCOMING
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PAGE 01 - -SANTO 12692 01 OF 07 0421832 2430 076332 AID0531
ACTION AID-00

SANTO 12692 01 OF 07 0421832 2430 076332 A11

INFO TELE-R: /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PPPD-02
BC-01 BCLA-03 PPEC-01 PPHF-01 GCOH-02 APPC-02 PPR-01
PVC-02 RELO-01 DO-01 PFE-05 /030 A4 305

INFO LOG-00 CIAE-00 EB-00 DODE-00 ARA-00 /000 W

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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 8763

UNCLAS SECTION 01 OF 07 SANTO DOMINGO 12692

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PASS TO ARA/CAR

E.O. 12356: N/A

SUBJECT: USAID/OF FY 1987 ESF PAAD UPDATE

REFS: (A) STATE 141204, (B) SANTO DOMINGO 14827,
(C) STATE 148821

1. SUMMARY

USAID DEFERRED OBLIGATION OF FY 1987 ESF RESOURCES WHEN THE GODR FIRST SUSPENDED THE FREE MARKET FOREIGN EXCHANGE REGIME, AND LATER WAS UNABLE TO COMPLY WITH FISCAL DEFICIT REDUCTION COMMITMENTS THAT UNDERPINNED THE PROGRAM WHICH THE ESF RESOURCES WERE INTENDED TO SUPPORT. THE FREE MARKET FOREIGN EXCHANGE REGIME HAS NOW BEEN SATISFACTORILY RESTORED, AND FISCAL MEASURES ADEQUATE TO ELIMINATE DOMESTICALLY FINANCED FISCAL DEFICITS IN 1988 ARE BEING IMPLEMENTED. THIS PAAD "UPDATE" PROVIDES BACKGROUND ON EVENTS WHICH HAVE OCCURRED SINCE THE ORIGINAL PAAD WAS REVIEWED AND DISCUSSES USAID'S OVERALL PROGRAM STRATEGY, THE NEW FOREIGN EXCHANGE REGIME, BALANCE OF PAYMENTS ISSUES, AND FISCAL AND MONETARY POLICY IMPLEMENTATION. IT PROPOSES REVISED POLICY COVENANTS FOR A CREDIT AGREEMENT UTILIZING THE RESIDUAL \$13.1 MILLION OF FY 1987 ESF RESOURCES. USAID/DR REQUESTS AUTHORIZATION TO PROCEED WITH OBLIGATION ON OR ABOUT DECEMBER 15, 1987 OF \$13.8 MILLION IN SUPPORT OF THIS PROGRAM.

2. BACKGROUND

USAID DEFERRED OBLIGATION OF FY 1987 ESF RESOURCES WHEN, IN JUNE OF THIS YEAR, THE GODR SUSPENDED THE FREE MARKET FOREIGN EXCHANGE REGIME THAT UNDERPINNED THE GODR ECONOMIC PROGRAM WHICH THESE RESOURCES WERE INTENDED TO SUPPORT. AT THAT TIME, THE GOVERNMENT HAD COMMITTED ITSELF TO A PROGRAM DESIGNED TO ACHIEVE MACROECONOMIC STABILIZATION BY IMPLEMENTING FISCAL MEASURES THAT WOULD ELIMINATE FISCAL AND QUASI-FISCAL FINANCING GAPS WITHOUT THE NEED FOR ANY INCREASE IN DOMESTIC BANKING SYSTEM NET CREDIT TO THE CONSOLIDATED PUBLIC SECTOR. MEASURES ADEQUATE TO ACCOMPLISH THESE GOALS WERE EXPECTED TO BE IMPLEMENTED BY AUGUST 1987. HOWEVER, THE PROCESS OF SORTING OUT AN APPROPRIATE FOREIGN EXCHANGE REGIME, CONTROVERSY OVER SUCH ISSUES AS THE MINIMUM WAGE TO BE PAID PUBLIC EMPLOYEES, AND DEVELOPMENT OF THE 1988

CENTRAL GOVERNMENT BUDGET, DELAYED EXPECTED IMPLEMENTATION. THE ISSUES THAT CAUSED THE FY 1987 ESF PROGRAM TO BE DEFERRED ARE NOW LARGELY RESOLVED. THE COUNTRY HAS RETURNED TO A UNIFIED, MARKET-BASED FOREIGN EXCHANGE REGIME, AND MEASURES HAVE BEEN IMPLEMENTED OR FORMALLY SUBMITTED TO CONGRESS THAT SHOULD RESULT IN STABILIZATION OF FINANCIAL STRUCTURES, INCLUDING THE NEAR TERM REDUCTION OF INFLATION AND RELIEF OF PRESSURES ON THE EXCHANGE RATE AND BALANCE OF PAYMENTS.

WE ESTIMATE THAT REAL GDP WILL GROW SOME 5.5 PERCENT THIS YEAR. WITH APPROPRIATE POLICIES AND FINANCING, WE PROJECT GROWTH TO BE ON THE ORDER OF 2.7 PERCENT IN 1988 AND TO AVERAGE 4.0 PERCENT IN 1989 AND 1990.

NEVERTHELESS, THESE GROWTH RATES ARE NOT ASSURED. IN THE ABSENCE OF EXTERNA. FINANCING TO FILL THE PROJECTED RESOURCE GAPS, THE COST OF THE ADJUSTMENT REQUIRED TO ACHIEVE STABILIZATION OF FINANCIAL STRUCTURES IS POTENTIALLY LARGE, AND WILL IMPACT HEAVILY ON NEW PRIVATE INVESTMENT AND THE DOMINICAN ECONOMY'S ABILITY TO REACH A GROWTH PATH ADEQUATE TO ASSURE IMPROVEMENTS IN OVERALL WELFARE OVER THE MEDIUM TERM. WE ESTIMATE THAT REALIZATION OF THE MODEST GROWTH TARGETS SET FOR THE NEXT THREE YEARS WILL REQUIRE TOTAL INVESTMENT AVERAGING SOME 25 PERCENT OF GDP. FOR THIS GROWTH TO BE BALANCED AND SUSTAINABLE, ABOUT 75 PERCENT OF NEW INVESTMENT SHOULD ORIGINATE IN THE PRIVATE SECTOR.

THE "ADJUSTMENT WITH GROWTH" SCENARIO WE HAVE SKETCHED OUT ASSUMES THAT STABILIZATION AND GROWTH OBJECTIVES CAN BE ACHIEVED WITHOUT ACTUAL REDUCTIONS IN AVERAGE CONSUMPTION LEVELS, BUT DOES NOT ALLOW FOR INCREASES IN PER CAPITA CONSUMPTION; THAT IS, ALL IMPROVEMENTS IN PER CAPITA GDP LEVELS ARE ASSUMED TO BE INVESTED. EVEN SO, SIGNIFICANT RESOURCE GAPS AVERAGING \$135 MILLION PER YEAR ARE PROJECTED AND WILL REQUIRE FINANCING. FAILURE

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PAGE 01 SANTO 12692 02 OF 07 0420582 2451 076393 AID0542
ACTION AID-00

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4. FOREIGN EXCHANGE REGIME

INFO TELE-01 /001 A6

ACTION OFFICE LACA-03
INFO FPA-02 AALA-01 LACO-01 LADP-04 LADY-03 FYA-01 PPF-02
GC-01 GCLA-03 PPDC-01 PPF-01 GCCM-02 APPC-02 PPR-01
PVC-02 RELO-01 DO-01 PRE-06 /038 A4 305

INFO L06-00 COPY-01 CIAE-00 EB-00 DODE-00 ARA-00 /021 W
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UNCLAS SECTION 02 OF 07 SANTO DOMINGO 12692

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PAGE TO ARRIVE

E.O. 12356: N/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

TO OBTAIN THIS FINANCING WILL NECESSARILY RESULT IN REDUCED LEVELS OF THE IMPORTS NEEDED TO SUSTAIN THE ECONOMIC RECOVERY, SINCE REDUCTIONS IN ALREADY MEAGER CONSUMPTION LEVELS ARE NOT TENABLE. THE STARTING POINT FOR REALIZING THE POSITIVE EXTERNAL CASH FLOW REQUIRED TO FILL THE PROJECTED RESOURCE GAPS, AS WE INDICATED IN THE PAAD FOR THE DEFERRED FY 1987 PROGRAM, IS SUBSTANTIAL EXTERNAL DEBT RESCHEDULING.

3. PROGRAM STRATEGY

THE MISSION'S STRATEGY IS TO WORK WITH THE GOOR TO DEVELOP A PROGRAM FOCUSED ON STABILIZATION OF FINANCIAL STRUCTURES WITHIN A FRAMEWORK OF BALANCED ECONOMIC RECOVERY LEADING TO SUSTAINED GROWTH OVER THE MEDIUM TERM.

IN PARTICULAR, WE WILL SEEK AN ADJUSTMENT SCENARIO THAT WILL REDUCE INFLATION FROM A PROJECTED 26 PERCENT IN 1987 TO 6 PERCENT BY 1990, STABILIZE THE EXCHANGE RATE, AND RESTORE PER CAPITA INCOME LEVELS AND ANNUAL ECONOMIC GROWTH AS MEASURED BY PER CAPITA GDP TO 1980 LEVELS BY 1988/91. IN 1987 PRICES, PER CAPITA GDP WOULD THEN ONCE AGAIN BE OF THE ORDER OF 1980 AND ANNUAL PER CAPITA GROWTH WOULD AGAIN APPROACH 3 PERCENT. THIS STRATEGY OF ADJUSTMENT WITH GROWTH IS ATTAINABLE, BUT WILL REQUIRE CAREFUL COORDINATION OF GOOR FISCAL AND MONETARY POLICIES, SIGNIFICANT INCREASES IN PRIVATE SECTOR INVESTMENT, AND SUBSTANTIAL EXTERNAL FINANCING OVER THE NEXT THREE YEARS.

FISCAL POLICY WOULD BE PRIMARILY DIRECTED AT STABILIZATION OF FINANCIAL STRUCTURES AND CREATING THE CONDITIONS FOR SUSTAINED GROWTH OVER THE MEDIUM AND LONG TERM RATHER THAN JUST THE MOBILIZATION OF ADDITIONAL RESOURCES FOR AN EXPANDING PUBLIC SECTOR INVESTMENT PROGRAM THAT BY ITSELF IS NOT FULLY ADEQUATE. MONETARY POLICY WOULD SEEK A BALANCE BETWEEN THE OBJECTIVES OF STABILIZATION ON THE ONE HAND AND FINANCING PRODUCTIVE PRIVATE SECTOR INVESTMENT BY PROVISION OF ADEQUATE, BUT NOT EXCESSIVE, CREDIT ON THE OTHER.

THE MONETARY BOARD ISSUED FIVE RESOLUTIONS ON NOVEMBER 12, 1987 THAT: (1) ESTABLISHED AN INTERNATIONAL PAYMENTS SYSTEM BASED ON A UNIFIED, MARKET-DETERMINED EXCHANGE RATE; (2) RAISED THE EXCHANGE COMMISSION ON THE FOB VALUE OF TRANSACTIONS FOR NON-ESSENTIAL PRIVATE IMPORTS FROM 5 PERCENT TO 20 PERCENT, AND THE GOVERNMENT HAS ANNOUNCED THAT THE PROCEEDS OF THIS INCREASE WILL BE USED EXCLUSIVELY FOR EXTERNAL DEBT SERVICE OBLIGATIONS OF THE CONSOLIDATED PUBLIC SECTOR; (3) REESTABLISHED AUTHORIZATION FOR RESIDENTS TO HOLD DOLLAR ACCOUNTS IN DOMESTIC COMMERCIAL BANKS; (4) ABOLISHED THE TWO PERCENT EXCHANGE COMMISSION ON EXPORTS; AND (5) MANDATED AN EXCHANGE DEPOSIT, EQUAL TO 10 PERCENT OF THE LOCAL CURRENCY EQUIVALENT VALUE OF EXPORTS OTHER THAN FROM FREE ZONES, FOR A PERIOD OF 90 DAYS AT 12 PERCENT ANNUAL INTEREST. IN ADDITION, THE EXECUTIVE BRANCH LATER DELETED AN EXCHANGE COMMISSION ON SUGAR AND MINING EXPORTS, EQUIVALENT TO THE DIFFERENCE BETWEEN THE PREVAILING MARKET BASED EXCHANGE RATE AND A RATE OF FOUR PESOS TO ONE DOLLAR.

THE NEW FOREIGN EXCHANGE REGIME CONSISTS BASICALLY OF TWO MARKETS, WITH A SINGLE, UNIFIED, MARKET-DETERMINED EXCHANGE RATE IN TERMS OF ANY OTHER CURRENCY. AS SUCH, THE NEW SYSTEM MANDATES A CLEAN FLOAT. TECHNICALLY, HOWEVER, UNTIL SUCH TIME AS THE EXCHANGE COMMISSIONS ON NON-ESSENTIAL IMPORTS AND EXPORTS OF SUGAR AND MINING ARE ELIMINATED, THE NEW SYSTEM HAS ELEMENTS OF A MULTIPLE EXCHANGE RATE SYSTEM. THE EXCHANGE COMMISSION ON NON-ESSENTIAL IMPORTS, BY ITS NATURE, CAN ALSO BE CHARACTERIZED AS TEMPORARY. THE RATIONALE FOR THE EXCHANGE COMMISSIONS IS TO PROVIDE A MECHANISM FOR MEDIUM-TERM FINANCING OF FISCAL AND QUASI-FISCAL FINANCING GAPS, WITHOUT THE NEED TO IMMEDIATELY SUBMIT TO THE

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TELEGRAM

PAGE 01 SANTO 12692 03 OF 07 042059Z 2455 076334 A100543
ACTION A10-07

SANTO 12692 03 OF 07 042059Z 2455 076334 A101

INCREASE IN THE VOLUME OF PETROLEUM IMPORTS, AND (2) THE IMPORT CONTENT OF PUEL C SECTOR CAPITAL SPENDING WHICH INCREASED 130 PERCENT IN NOMINAL TERMS (82 PERCENT IN REAL TERMS) COMPARED TO 1986.

INFO YLE-01 /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AALA-01 LACC-01 LADP-04 LADR-03 FVA-01 PPPB-02
GC-01 GCLA-03 PPDC-01 PPPF-01 GCGH-02 APPC-02 PPA-01
PVC-02 RELO-01 DO-01 PRE-06 /038 A4 305

WE ANTICIPATE A CURRENT ACCOUNT BALANCE OF PAYMENTS DEFICIT THIS YEAR OF THE ORDER OF 3274 MILLION, EQUIVALENT TO 5 PERCENT OF GDP (INTEREST PAYMENTS BASED ON ACCRUALS, WHETHER OR NOT PAID; PUBLIC TRANSFERS EXCLUDED). THIS COMPARES TO A CURRENT ACCOUNT DEFICIT IN 1986 OF 3218 MILLION, OR LESS THAN 4 PERCENT OF GDP.

INFO LOG-00 COPY-01 CIAE-00 EB-00 BOOE-00 ARA-00 /001 V
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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0770

THE NEW MARKET-BASED FOREIGN EXCHANGE REGIME IS ADEQUATE TO FACILITATE ADJUSTMENT TO SUBSTANTIALLY REDUCE, OR EVEN ELIMINATE, THE CURRENT ACCOUNT DEFICIT BY CHANGING THE RELATIVE PRICE OF TRADEABLES COMPARED TO NON-TRADEABLES, AND SO REDUCING IMPORTS. HOWEVER, SINCE TOTAL EXTERNAL DEBT SERVICE IS ROUGHLY EQUAL TO THE VALUE OF COMMODITY EXPORTS, THE COST OF ULTIMATELY REDUCING IMPORTS COULD EASILY BE TO FORCE THE COUNTRY ONTO AN UNACCEPTABLY LOW, OR EVEN STAGNANT, GROWTH PATH. THIS WOULD OCCUR EVEN WITH SUBSTANTIAL RESPONSE FROM NON-TRADITIONAL EXPORT SECTORS, SINCE THESE SECTORS ARE NOT YET DOMINANT.

UNCLAS SECTION 03 OF 07 SANTO DOMINGO 12692

AIDAC

PASS TO AAA/CAA

E.O. 12336: M/A

SUBJECT: USAID/DR FY 1987 EST PAAD UPDATE

THE PAAD PREPARED LAST YEAR (REF B) INDICATED A BALANCE OF PAYMENTS FINANCING GAP FOR 1987 ON THE ORDER OF \$193 MILLION, AND PREDICTED A BUILD-UP OF EXTERNAL PAYMENTS ARREARS UNTIL RESCHEDULING OF DEBT COULD BE IMPLEMENTED.

LEGISLATURE A LARGE TAX PACKAGE THAT WOULD PERMIT PESO FINANCING TO THE CENTRAL BANK OF EXTERNAL DEBT SERVICE, AND ALLOW SOME FLEXIBILITY IN PETROLEUM PRICING POLICIES. THE EXCHANGE COMMISSION ON SUGAR AND MINING EXPORTS WAS PUBLISHED SIMULTANEOUSLY WITH A NEW DECREE WHICH RAISES THE PUMP PRICE OF GASOLINE BY 20 PERCENT; EVEN SO, PUMP PRICES FOR REGULAR GASOLINE ARE STILL RELATIVELY CHEAP AT THE EQUIVALENT OF U.S. 89 CENTS PER GALLON. THE OFFICIAL MARKET EXCHANGE RATE IS TO BE CALCULATED EACH DAY AS A WEIGHTED AVERAGE OF FREE MARKET SELLING RATES OF THE PREVIOUS DAY. THE OFFICIAL MARKET WILL RECEIVE FOREIGN EXCHANGE FROM EXPORTS OF GOODS AND SPECIFIED SERVICES, AND WILL PROVIDE FOREIGN EXCHANGE FOR EXTERNAL PUBLIC DEBT SERVICE, PETROLEUM IMPORTS, PUBLIC SECTOR IMPORT REQUIREMENTS, SPECIFIED PRIORITY PRIVATE SECTOR IMPORTS AND PENDING OBLIGATIONS INCURRED BY THE CENTRAL BANK UNDER THE SYSTEM OF CONTROLS.

CENTRAL BANK ARREARS ON RESERVE LIABILITIES DECLINED BY \$26 MILLION IN 1986, AND MAY HAVE DECLINED FURTHER THIS YEAR. HOWEVER, PARIS CLUB AND BILATERAL ARREARS INCREASED SOME \$138 MILLION IN 1986. ADJUSTING FOR ADDITIONAL NET REDUCTIONS IN ARREARS ON THE ORDER OF \$22 MILLION, NET BUILD-UP OF EXTERNAL DEBT ARREARS IN 1986 AMOUNTED TO SOME \$82 MILLION. WE ESTIMATE THAT, AS OF THE END OF OCTOBER 1987, ADDITIONAL ARREARAGES ON THE

THE FREE MARKET WILL RETAIN FOREIGN EXCHANGE FROM TOURISM, CASINOS, REMITTANCES AND PRIVATE HOLDINGS, AND PROVIDE FOREIGN EXCHANGE FOR PRIVATE SECTOR IMPORTS OF GOODS AND SERVICES NOT FINANCED BY THE OFFICIAL MARKET, NON-PRIORITY SERVICES OF THE PUBLIC SECTOR, PRIVATE, NON-GUARANTEED EXTERNAL DEBT SERVICE, PROFIT REMITTANCES AND PRIVATE CAPITAL REPATRIATION. IN GENERAL, CENTRAL BANK APPROVAL IS NO LONGER REQUIRED FOR INTERNATIONAL PAYMENTS BY THE PRIVATE SECTOR. EXCEPTIONS ARE PAYMENTS FOR CERTAIN TECHNICAL SERVICES, ROYALTIES, PROFIT REMITTANCES AND CAPITAL REPATRIATION.

5. BALANCE OF PAYMENTS ISSUES

THE AVERAGE VALUE OF THE PESO DURING 1987 IS EXPECTED TO REFLECT DEPRECIATION, IN TERMS OF US DOLLARS, ON THE ORDER OF 25 PERCENT OR MORE, COMPARED TO AVERAGE 1986 LEVELS, LARGELY AS A RESULT OF: (1) THE RAPID GROWTH IN THE MONEY SUPPLY IN 1986 AND CONTINUED GROWTH IN 1987 AS A MEANS OF FACILITATING RAPID ECONOMIC EXPANSION, AND (2) A NOMINAL \$200 MILLION INCREASE IN IMPORTS WITHOUT A COMPENSURATE INCREASE IN EXPORTS. THE RISE IN IMPORTS IS PRIMARILY DUE TO: (1) A 54 PERCENT INCREASE IN THE VALUE OF PETROLEUM IMPORTS RESULTING FROM INCREASED WORLD PRICES FOR PETROLEUM PRODUCTS AND A 23 PERCENT

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TELEGRAM

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ACTION A10-00

SANTO 12692 04 OF 07 042100Z 2438 076335

INFO TELE-01 /001 06

PERCENT EXCHANGE COMMISSION ON NON-ESSENTIAL IMPORTS, ESTIMATED TO YIELD 005710 MILLION DURING 1988, WILL FINANCE MOST INTEREST OBLIGATIONS FOR THE COMING YEAR, SO THIS PROBLEM HAS BEEN "SOLVED" FOR THE NEAR-TERM.

ACTION OFFICE LACA-02

DURING PRESIDENT BALAGUER'S FIRST YEAR IN OFFICE, THE NEW ADMINISTRATION DID, IN FACT, RESOLVE THE FINANCING PROBLEMS OF THE CENTRAL GOVERNMENT, WHICH WAS HIS PERSONAL FOCUS. MOREOVER, DESPITE FAILURE TO ADEQUATELY FOCUS ON THE PROBLEMS OF THE DOMINICAN ELECTRIC COMPANY, WHICH ARE EXPECTED TO BE A SERIOUS DRAIN ON RESOURCES FOR A LONG TIME YET, THE REDUCTION IN THE CONSOLIDATED PUBLIC SECTOR DEFICIT FOR 1987, AT 3.1 PERCENT OF GDP, COMPARED TO 4.5 PERCENT IN 1986, IS A VERY CREDIBLE PERFORMANCE.

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PPPB-02 GC-01 BELA-03 PPG-03 PPHF-01 GCCR-02 APPC-02 PPA-01 PLC-02 BELO-01 DO-01 PRE-06 /038 04 303

INFO LOG-06 COPY-01 CIAE-00 EB-00 BODE-00 ARA-00 /001 V
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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0771

UNCLAS SECTION 04 OF 07 SANTO DOMINGO 12692

A10AC

PASS TO ARA/CAR

E.O. 12356: N/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

IN ADDITION TO THE EXCHANGE COMMISSIONS ALREADY DESCRIBED, THE GOVERNMENT HAS RECENTLY RAISED THE PUMP PRICE OF GASOLINE BY 20 PERCENT; THIS SHOULD YIELD 00500 MILLION TO THE TREASURY DURING 1988, AFTER DISCOUNTS TO SUCH PREFERRED CUSTOMERS AS CCE. THE TAX PACKAGE SUBMITTED TO THE LEGISLATURE, IF APPROVED AS PROPOSED, COULD YIELD UP TO AN ADDITIONAL 005240 MILLION. THIS TAX PACKAGE INCLUDES THE FOLLOWING MEASURES:

ORDER OF 3120 MILLION, INCLUDING 500 MILLION OF INTEREST OBLIGATIONS, ACCRUED. TOTAL OUTSTANDING ARREARS AS OF OCTOBER 31 STOOD AT APPROXIMATELY 3336 MILLION. OUR REVISED ESTIMATE OF THE BALANCE OF PAYMENTS FINANCING GAP FOR 1987 IS 3173 MILLION. THE CUMULATIVE PROJECTED FINANCING GAP THROUGH THE END OF 1988, BASED ON PROJECTED RESOURCE GAPS NEEDED TO ATTAIN TARGETED GDP GROWTH DURING 1988 AND 1989, APPROPRIATE REDUCTION OF ARREARS, AND CONFIRMED DONOR DISBURSEMENTS, IS 3433 MILLION. THIS IS ROUGHLY THE AMOUNT OF NEW FINANCING INCLUDING DEBT RESCHEDULING, THAT WILL BE NECESSARY DURING 1988. WITH THIS FINANCING, THE COUNTRY WILL BE POSITIONED FOR REALIZATION OF POSITIVE AND SUSTAINABLE GROWTH OVER THE MEDIUM TERM, AND THE ADJUSTMENT NEEDED FOR A POTENTIAL ALBEIT SMALL, CURRENT ACCOUNT SURPLUS IN BALANCE OF PAYMENTS FOR 1988 WILL BE ON TRACK.

MEASURE	EXPECTED YIELD, 1988 (MILLIONS OF PESOS)
1) BROADEN COVERAGE OF SALES TAX (ITB)	18
2) ADDITIONAL TAXES ON BEVERAGES AND CIGARETTES	51
3) ADDITIONAL DUTY ON PREVIOUSLY EXEMPERATED IMPORTS	10
4) STRENGTHENED SANCTIONS AGAINST INCOME TAX EVASION	50
5) SPECIAL TAX ON LUXURY HOUSES	10

6. FISCAL AND MONETARY POLICY

ALTHOUGH APPROPRIATE MONETARY AND FISCAL POLICIES HAVE NOT BEEN CONSISTENTLY COORDINATED OVER THE PAST YEAR, SIGNIFICANT PROGRESS IS NOW OCCURRING, AND WE ARE OPTIMISTIC THAT BALAGUER'S RECENT DECISION TO LINK FISCAL AND MONETARY POLICIES, AND HIS DECISION TO BECOME PERSONALLY INVOLVED IN BOTH FORMULATION AND IMPLEMENTATION, WILL HAVE FAVORABLE RESULTS.

THE GOVERNMENT'S FISCAL POLICY IMPLEMENTATION DURING THE FIRST YEAR OF THE NEW ADMINISTRATION, THOUGH INCOMPLETE, WAS NONETHELESS LAUDABLE. ON AN ACCRUAL BASIS, CENTRAL GOVERNMENT RECURRENT SPENDING DECLINED FROM 11.4 PERCENT OF GDP IN 1986 TO A PROJECTED 7.3 PERCENT OF GDP THIS YEAR. MOREOVER, DUE TO BUOYANT REVENUE PERFORMANCE, CENTRAL GOVERNMENT SAVINGS IN 1987 IS NOW EXPECTED TO BE 110 PERCENT HIGHER THAN 1986 SAVINGS IN REAL TERMS. UNFORTUNATELY, THE CENTRAL GOVERNMENT DID NOT PAY SOME 80 PERCENT OF EXTERNAL DEBT INTEREST OBLIGATIONS IN 1986, AND AS OF THE END OF OCTOBER, HAD FAILED TO PAY ANY EXTERNAL DEBT INTEREST OBLIGATIONS FOR 1987. THE CENTRAL BANK HAS, NEVERTHELESS, SELECTIVELY PAID A SIGNIFICANT PORTION OF THESE OBLIGATIONS AND, IN SO DOING, HAS INDIRECTLY FINANCED THEM. THE EARMARKING FOR EXTERNAL DEBT SERVICE OF ALL PROCEEDS FROM THE 20

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TELEGRAM

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ACTION OFFICE LACA-03

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FYA-01 PPPB-02
GC-01 GCLA-03 PPDC-01 PPHF-01 GCCR-02 APFC-02 PPA-01
PVC-02 HELD-01 DO-01 PRE-06 /J38 A4 305

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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0772

UNCLAS SECTION 05 OF 07 SANTO DOMINGO 12692

AIDAC

DATE TO ABA/PAB

E. D. 12356: N/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

0) SPECIAL TAX ON FINANCIAL ACTIVITIES 02

NOT YET ANNOUNCED, BUT EXPECTED EARLY IN 1988, ARE ELECTRICITY TARIFF ADJUSTMENTS AND A RETAIL SALES TAX ON PETROLEUM PRODUCTS.

THE REVENUE MEASURES ALREADY PROPOSED, OR IMPLEMENTED ARE AD HOC IN NATURE AND NOT NECESSARILY CONSISTENT WITH THE SPIRIT OF THE OVERALL REFORM OF THE TAX SYSTEM THAT THE GOVERNMENT HOPES TO IMPLEMENT DURING BALAGUER'S TENURE IN OFFICE. THE PROPOSED REFORMS WOULD INCLUDE POSSIBLY EXTENSIVE STRUCTURAL AND ADMINISTRATIVE REFORMS TO BROADEN THE TAX BASE, RATIONALIZE INCENTIVES, LOWER MARGINAL RATES, AND IMPROVE TAX EQUITY AND OVERALL TAX EFFICIENCY. THE GOVERNMENT HAS DISCUSSED THE NEED FOR COHERENT TAX REFORM WITH USAID, THE WORLD BANK AND THE OAS. USAID IS NOW EXPLORING HOW IT CAN BEST BE OF HELP, BUT WILL COORDINATE ITS EFFORTS WITH THOSE OF THE OAS AND WORLD BANK. WORLD BANK INVOLVEMENT CAN BE EXPECTED IN THE CONTEXT OF A STRUCTURAL ADJUSTMENT LOAN (SAL), SHOULD THE GOVERNMENT AND THE BANK AGREE ON THE POLICY FRAMEWORK SUCH AN UNDERTAKING WOULD ENTAIL.

THE GOVERNMENT'S INTENTION TO ELIMINATE DOMESTICALLY FINANCED FISCAL AND QUASI-FISCAL FINANCING GAPS DURING 1988 CLEARLY HAS PRIORITY OVER COMPREHENSIVE TAX REFORM. IT IS NOW UNDERSTOOD THAT A MAJOR CAUSE OF RECENT INSTABILITY OF FINANCIAL STRUCTURES HAS BEEN INADEQUATE FISCAL BALANCE. THE MEASURES IMPLEMENTED OR PROPOSED IN RECENT WEEKS ARE EXPECTED TO PROVIDE AN ADDITIONAL RD\$66 MILLION OF REVENUES THIS YEAR, AND RD\$1.07 BILLION NEXT YEAR. EVEN IF THE EXCHANGE COMMISSION ON SUGAR AND MINERAL EXPORTS IS SOON RESCINDED, AND PRESSURE IS INTENSIFYING TO DO SO, INCREASED REVENUES FROM THE NEW MEASURES COULD BE SOME RD\$835 MILLION.

THE GOVERNMENT HAS PROJECTED THAT APPLYING ONLY RD\$160 MILLION OF THE POTENTIAL RD\$1.07 BILLION ASSOCIATED WITH THE NEW MEASURES TO CENTRAL GOVERNMENT ACTIVITIES AND SUBSIDIES TO PARASTATALS COULD RESULT IN REDUCING THE CONSOLIDATED PUBLIC SECTOR DEFICIT TO A MERE ONE PERCENT OF GDP IN 1988. SINCE THE GOVERNMENT PROJECTS NET EXTERNAL FINANCING EQUIVALENT TO 1.6 PERCENT OF GDP, THIS WOULD PERMIT A REDUCTION IN DOMESTIC FINANCING OF

THE CONSOLIDATED PUBLIC SECTOR EQUIVALENT TO 1.6 PERCENT OF GDP. WE HAVE EXAMINED THE GOVERNMENT'S PROJECTIONS IN DETAIL, AND HAVE CONCLUDED THAT THEY ARE FEASIBLE. WE EXPECT SOME CHANGES, DEPENDING ON SUCH THINGS AS THE OUTCOME OF THE MEASURES SUBMITTED TO THE LEGISLATURE, BUT WE ARE CONVINCED THAT THE GOVERNMENT IS COMMITTED TO FINDING A WAY OF APPROPRIATELY FINANCING ALL OF ITS ACTIVITIES DURING 1988 SO AS TO COMBINE FISCAL MEASURES WITH MONETARY MEASURES TO STABILIZE FINANCIAL STRUCTURES, EVEN AT THE COST OF POTENTIAL SHORT-FALLS IN NEAR-TERM GROWTH TARGETS.

ON THE MONETARY SIDE, NARROW MONEY, DEFINED AS CURRENCY IN CIRCULATION AND PRIVATE SECTOR DEPOSIT DEPOSITS, ROSE 40 PERCENT IN 1986. BROAD MONEY, WHICH CONSISTS OF NARROW MONEY PLUS SAVINGS AND TIME DEPOSITS, GREW 70 PERCENT IN 1986. WE EXPECT THESE AGGREGATES TO INCREASE SOME 12 PERCENT TO 14 PERCENT IN 1987 AND AGAIN IN A LIKE AMOUNT IN 1988. MONETARY POLICY HAS BEEN GENERALLY ADJUSTED, BUT COMMERCIAL BANKS HAVE HAD DIFFICULTY IN RECENT MONTHS MEETING RESERVE REQUIREMENTS, LARGELY DUE TO THE LINKING OF RESERVE REQUIREMENTS WITH COMPLEX PORTFOLIO COMPOSITION IMPERATIVES. AS OF THE END OF NOVEMBER, WE UNDERSTAND THAT ONLY 2 OF 24 COMMERCIAL BANKS WERE IN COMPLIANCE WITH RESERVE REQUIREMENTS. THE CENTRAL BANK HAS THESE ISSUES UNDER REVIEW AND WE EXPECT A CHANGE IN THE RESERVE/PORTFOLIO COMPOSITION SYSTEM, PERHAPS AS EARLY AS DECEMBER. EXPECTED CHANGES WOULD REDUCE THE COMPLEXITY OF THE SYSTEM, LOWER DIRECTED CREDIT REQUIREMENTS AND LEAD TO RESTORATION OF BANKING SYSTEM RESERVE REQUIREMENTS AS AN INSTRUMENT OF MONETARY POLICY, RATHER THAN BEING USED PRIMARILY AS AN INSTRUMENT FOR RESOURCE ALLOCATION.

7. POLICY COVENANTS

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Department of State

TELEGRAM

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ACTION AID-00

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THIS MECHANISM FROM VENEZUELA AND MEXICO SINCE 1980.

INFO TELLE-01 /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AA.A-01 LACO-01 LADP-01 LADR-01 FVA-01 PPF-02
GC-01 GCLA-01 PPOC-01 PPHF-01 GCM-02 APPC-02 PPA-01
PVC-02 RELG-01 JO-01 PRE-06 /030 A4 305

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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0773

UNCLAS SECTION 05 OF 07 SANTO DOMINGO 12692

AIDAC

PASS TO ARA/CAR

E.O. 12355: N/A

SUBJECT: USAID/DR FY 1987 ESF PAID UPDATE

USAID DR PROPOSES THE FOLLOWING COVENANTS BE INCLUDED IN
THE AGREEMENT:

(1) THE GDR WILL COVENANT THAT IT WILL CONTINUE TO
MAINTAIN THROUGHOUT 1988 AN EXCHANGE RATE POLICY IN
WHICH ALL TRANSACTIONS ARE AT UNIFIED, MARKET-DETERMINED
RATES OF EXCHANGE BETWEEN THE DOMINICAN PECO AND THE
CURRENCIES OF OTHER COUNTRIES. THE GDR WILL NOT IMPOSE
ADDITIONAL CONTROLS ON THE PURCHASE OR HOLDING OF
FOREIGN EXCHANGE.

(2) THE GDR WILL TRANSMIT TO USAID/DR ITS MACROECONOMIC
PROGRAM FOR CALENDAR YEAR 1988. THE PROGRAM WILL
CONTAIN INDICATIVE TARGETS FOR NET DOMESTIC ASSETS OF
THE CENTRAL BANK, BANKING SYSTEM CREDIT TO THE PUBLIC
SECTOR, AND NEW EXTERNA. PUBLIC SECTOR BORROWING. THESE
TARGETS WILL BE CONSISTENT WITH THE OBJECTIVE OF
IMPLEMENTATION OF FISCAL MEASURES THAT WILL RESULT IN
THE ELIMINATION OF A DOMESTICALLY FINANCED PUBLIC SECTOR
DEFICIT DURING CALENDAR YEAR 1988. THE GDR WILL
COVENANT THAT THERE WILL BE NO INCREASE DURING CALENDAR
1988 IN DOMESTIC BANKING SYSTEM NET LENDING TO THE
CONSOLIDATED PUBLIC SECTOR.

LONG-RUN STRUCTURAL POLICIES INTENDED TO BE INCLUDED IN
COVENANTS IN THE FY 1987 ESF AGREEMENT HAVE ALREADY BEEN
SUBSTANTIALLY COMPLIED WITH, AND ARE THEREFORE NOT.
USAID/DR, THEREFORE, PROPOSES THAT THEY BE ELIMINATED
FROM THE AGREEMENT.

8. PLANNED DOLLAR USES AND TRACKING SYSTEM

THE UNITED STATES DOLLARS PROVIDED UNDER THIS ESF
AGREEMENT WILL BE DEPOSITED IN A SEPARATE ACCOUNT IN THE
FEDERAL RESERVE BANK OF NEW YORK AND USED TO IMPORT
PETROLEUM AND PETROLEUM DERIVATIVE PRODUCTS UNDER THE
TERMS OF THE SAN JOSE ACCORD. THE SAN JOSE ACCORD IS A
LONG-STANDING AGREEMENT AMONG LATIN AMERICAN COUNTRIES
IN WHICH THE OIL PRODUCING COUNTRIES PROVIDE LONG-TERM
FINANCING FOR OIL IMPORTS WITH PROVISIONS FOR THE
FINANCING OF ECONOMIC DEVELOPMENT ACTIVITIES. THE
DOMINICAN REPUBLIC HAS BEEN IMPORTING PETROLEUM UNDER

THE OPENING OF THE SEPARATE ACCOUNT IS A CONDITION
PRECEDENT TO DISBURSEMENT. IT MAY BE INTEREST-BEARING
AND THE GDR WILL AGREE TO USE ANY INTEREST FOR THE
AGREED UPON PURPOSES. THE CENTRAL BANK OF THE DOMINICAN
REPUBLIC WILL MAKE DISBURSEMENTS FROM THE ACCOUNT BASED
ON DOCUMENTATION SUPPORTING THE IMPORTATION OF THE
PETROLEUM SUCH AS BILLS OF LADING, PROFORMA INVOICES,
AND OTHER DOCUMENTS ACCEPTABLE TO A.I.D. THE ACTUAL
DISBURSEMENT OF FUNDS WILL BE BY MEANS OF A CODED TELEX
OR BANK DRAFT REQUESTING THE FEDERAL RESERVE BANK OF NEW
YORK TO TRANSFER TO THE CENTRAL BANK OF VENEZUELA OR THE
BANK OF MEXICO, S.A. THE U.S. DOLLAR AMOUNT
CORRESPONDING TO THE VALUE OF THE PETROLEUM IMPORTED.
THESE PROCEDURES ARE THE SAME AS THOSE CURRENTLY
EMPLOYED BY THE DOMINICAN CENTRAL BANK FOR PETROLEUM
IMPORTS.

THE CENTRAL BANK WILL BE REQUIRED TO MAINTAIN BOOKS AND
RECORDS RELATING TO THE USE OF U.S. DOLLARS FOR A PERIOD
OF THREE YEARS. FILES WILL CONTAIN THE ORIGINAL
SUPPORTING IMPORT DOCUMENTATION AND THE CODED TELEXES OF
BANK DRAFTS FOR EACH DISBURSEMENT.
THE CENTRAL BANK WILL BE REQUIRED TO REPORT TO THE
TECHNICAL SECRETARY OF THE PRESIDENCY (WITH A COPY TO
A.I.D.) WITHIN THIRTY DAYS OF EACH TRANSACTION THE: (1)
VALUE OF THE TRANSACTION; (2) THE QUANTITY AND
DESCRIPTION OF THE COMMODITY PROCURED; (3) THE SUPPLIER;
AND (4) THE AMOUNT REMAINING IN THE SEPARATE ACCOUNT.
THE TERMINAL DATE FOR DISBURSEMENT OF THE DOLLAR FUNDS
IS NINE MONTHS FROM THE DATE OF THE INITIAL DEPOSIT INTO
THE SEPARATE ACCOUNT.

THESE PROCEDURES WILL BE FULLY ELABORATED IN A
MEMORANDUM OF UNDERSTANDING (MOU) WHICH WILL BE SIGNED
IN CONJUNCTION WITH THE GRANT AGREEMENT. THE MOU WILL
BE SUBMITTED TO AID/W UPON SIGNATURE. THESE PROCEDURES

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 ACTION AID-00

SANTO 12692 07 OF 07 04210722 2459 076338 A10
 ESTIMATE THE TOTAL AMOUNT OF COUNTERPART TO BE PROVIDED
 UNDER THE GRANT AGREEMENT. RILBAY

INFO TELE-01 /001 AS

ACTION OFFICE LACA-03

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 GC-01 GCLA-03 PPDC-01 PPMF-01 GCGH-02 APPC-02 PPR-01
 PVC-02 RELO-01 DD-01 PRE-05 /033 A4 305

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 FM AMEMBASSY SANTO DOMINGO
 TO SECSTATE WASHDC IMMEDIATE 0774

UNCLAS SECTION 07 OF 07 SANTO DOMINGO 12692

AIDAC

PASS TO ARA/CAR

E.G. 12356: N/A

SUBJECT: USAID/DP FY 1987 ESF PAAD UPDATE

HAVE BEEN REVIEWED AND APPROVED BY THE CONTROLLER'S
 OFFICE.

9. LOCAL CURRENCY PROGRAM

THE LOCAL CURRENCY WILL BE PROGRAMMED PRINCIPALLY FOR
 ACTIVITIES THAT FALL WITHIN THREE OF THE FOUR CATEGORIES
 OF THE USAID STRATEGY: INCREASING INDUSTRIAL
 PRODUCTION, ENHANCING AGRICULTURE DIVERSIFICATION AND
 SUPPORTING PUBLIC INFRASTRUCTURE IMPROVEMENTS. IN THE
 PAST, RESOURCES WERE PROGRAMMED FOR PVO ACTIVITIES THAT
 MET SPECIFIED CRITERIA FOR INCOME AND EMPLOYMENT
 GENERATION AND SELF-SUFFICIENCY. TO MEET A GROWING
 DEMAND FOR ECONOMICALLY VIABLE NGO AND PVO ACTIVITIES, A
 TOTAL OF RDS\$1 MILLION HAS BEEN PROGRAMMED. IN
 ADDITION, FUNDS ARE PROGRAMMED FOR THE USAID'S TRUST
 FUND AND THE TSP COORDINATING UNIT. THE BASIC
 ALLOCATION AGREED TO WITH THE GODR IS AS FOLLOWS:

PROPOSED USE	ESTIMATED AMOUNT RDS MILLION (X)
I. INCREASING INDUSTRIAL PRODUCTION	
- THROUGH PRIVATIZATION AND DEBT	
- EQUITY CONVERSION	25.0
II. ENHANCING AGRICULTURAL DIVERSIFICATION	
- THROUGH AGRIBUSINESS CREDIT	15.0
III. SUPPORTING PUBLIC INFRASTRUCTURE	
- IMPROVEMENTS (ROADS, HIGHWAYS,	
- IRRIGATION)	10.0
IV. OTHER	
- - NGO/PVO PROGRAMS	9.1
- - AID TRUST FUND	2.0
- - COORDINATING UNIT	1.0
- TOTAL	62.1

(X) EXCHANGE RATE OF RDS4.52 TO US\$1.00 WAS USED TO

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