PD-ABD-167 73106

CLASSIFICATION

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

	1. PAAD Number 538-K-604E Amendment No.4
	2. Country Dominica
	3. Category Cash Transfer
	4. Date September, 1990
5. To Aaron S. Williams, Director	6. OYB Change Number
7. From Henson Carter, PRM/ECON	8. OYB Increase To be taken from: Economic Support Funds
9. Approval Requested for Commitment of $	10. Appropriation Budget Plan Code 72-110/11037 LESO-90-35538-IG31

11. Type Funding	12. Local Currency Arrangement	13. Estimated Delivery Period	14. Transaction Eligibility Date
☐ Loan ☒ Grant	☐ Informal ☒ Formal ☐ None	9/90 to 9/92	Date of Agreement

15. Commodities Financed

16. Permitted Source	17. Estimated Source
U.S. only	U.S. $557,000
Limited F.W.	Industrialized Countries
Free World	Local
Cash $557,000	Other

18. Summary Description

The grant will be used to support the Government of the Commonwealth of Dominica (GOCD) in maintaining sound fiscal management. In the long term, Dominica is working to implement policies that will improve the climate for private investment, and that will restrain growth of the public sector. Conditionality in this grant includes targets for restraint in the growth of the central government wage bill, and for achievement of a sufficient level of central government current savings to assist in the financing of Dominica's Public Sector Investment Program.

Under the amended program, ESF dollars will continue to be used to finance imports from the United States, while local currencies will be provided as budget support to the GOCD's development programs.

- Per STATE 286011 dated August 25, 1990, funds are available upon signature of the AA/LAC or his designee for a total amount not to exceed US$557,000.

James B. Sanford 9/14/90
James Sanford
Acting Controller
Date

19. Clearances	Date
PRM/ECON: MCOtt	mco 9/12/90
C/PRM/ECON: PLerner	9/12/90
A/C/PDO: RPosner	9/14/90
D/DIR: LArmstrong	9/14/90

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: A. S. Williams
Date: 9/14/90

Title: Aaron S. Williams, Director

AID 1120-1 (5-82)

CLASSIFICATION

AMENDMENT NUMBER FOUR
PROGRAM ASSISTANCE APPROVAL DOCUMENT

DOMINICA - STRUCTURAL ADJUSTMENT SUPPORT

THE REGIONAL DEVELOPMENT OFFICE/
CARIBBEAN

SEPTEMBER 12, 1990

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DOMINICA - STRUCTURAL ADJUSTMENT SUPPORT PROGRAM
FOURTH AMENDMENT TO
PROGRAM ASSISTANCE APPROVAL DOCUMENT
September 1990

(Program No. 538-0141.05)
Grant No. 538-604E)

I. Recommendation:

That the RDO/C Mission Director approve the fourth amendment to the Program Assistance Approval Document (PAAD) for the Dominica Structural Adjustment Support Program and thereby authorize an additional $557,000 in Economic Support Funds for the Government of the Commonwealth of Dominica.

This amendment revises the conditionality presented in the original (September 1987) PAAD and adds $557,000 in Economic Support Funds for the Government of the Commonwealth of Dominica, for a program total of $5,099,900. The funds will be obligated in September of 1990, and will be provided as a cash transfer grant, to be disbursed in one tranche, as soon as the conditions precedent are met. The assistance, however, will not be disbursed prior to January 1, 1991 (halfway through Dominica's fiscal year), thereby allowing plausible full-year projections for the fiscal performance conditions precedent to disbursement. The ESF dollars will be used for imports from the United States. Local currencies associated with the grant will be programmed as general budget support. The Grantee will be the Government of the Commonwealth of Dominica (GOCD), as represented by the Ministry of Finance.

II. Background and Rationale:

A. Introduction:

This fourth and final amendment to the Dominica PAAD is needed to execute the following changes:

1. To increase the authorized level of funding under the program by $557,000 to $5,099,900;

2. To establish conditionality for the fourth tranche of the multi-year series of contributions to the structural adjustment program; and

3. To update information provided in the original PAAD, and prior amendments, in particular, the narrative on economic performance.

A chronology is detailed on the following page which shows the dates of previous PAAD amendments, and disbursements of funds under the Dominica Structural Adjustment Support Program.

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TABLE 1
DOMINICA
STRUCTURAL ADJUSTMENT SUPPORT PROGRAM
CHRONOLOGY

		Authorized	Disbursed
1.	Program Authorization Approval Document (proposed level was $4.5 million, but only $1.5 million was available	September 1987	January 6, 1988 "first tranche"
2.	PAAD Amendment No. 1 (increased authorized level by $1,042,900, to a total of $2,542,900, and revised conditionality)	September 1988	July 18, 1989 "second tranche"
3.	PAAD Amendment No. 2 (increased authorized level by $600,000, to a total of $3,142,900)	June 1989	July 18, 1989 "second tranche"
4.	PAAD Amendment No. 3 (increased authorized level by $1,400,000, to a total of $4,542,900, and revised conditionality)	August 1989	August 28, 1990 "third tranche"
5.	PAAD Amendment No. 4 (increases authorized level by $557,000, to a grand total of $5,099,900, and revises conditionality)	September 1990	1/ "fourth tranche"

1/ Upon fulfillment of conditions precedent to disbursement.

This PAAD amendment supplies information that supplements the original PAAD and its prior amendments. Much of Dominica's economic data (particularly balance of payments and monetary account) are prepared for the country by the IMF staff. The next formal revision of their accounts will take place in October, hence the data tables from the PAAD amendment have not been updated in this amendment. The additional text below is keyed to the relevant sections of the original PAAD.

B. Background:

The Dominica Structural Adjustment Support Program was initiated in 1987 as the vehicle for providing the U.S. contribution to a multidonor effort to assist the country in strengthening its public finances and improve the climate for private investment. Dominica had agreed to embark upon a serious policy reform program in July of 1986 with the assurances that, under the "Tight Consultative Group" auspices, additional inflows from bilateral donors could supplement monies available from IFI sources and ease any burdens of the adjustment process.

The formal TCG-supported program ended in late 1989. Nonetheless, given the original allocation of no ESF for the Eastern Caribbean for FY 1990, the U.S. was unable to provide the last installment of our $5,100,000 in pledged support to Dominica, amounting to $557,000. With the passage by Congress of a Supplemental Appropriations bill in May of 1990, funds for the Dominica program were restored. Due to the delay in allocating the full amount of the U.S. pledge, we will be obligating the final tranche nearly one year after the TCG program ended, and will disburse approximately six months after obligation. One proposal for use of the supplemental ESF was to tack it onto the amount obligated in FY 1989 and disbursed in FY 1990, adding no conditionality. This approach was rejected due to the Mission's belief that the additional amount, although small, should be used to encourage Dominica to maintain and consolidate the gains that were hard-won under the TCG program. Hence, the $557,000 grant will be disbursed based on evidence that Dominica is holding fast to the fiscal improvements implemented during the past three years.

The TCG-supported structural adjustment program for Dominica has been widely viewed as a success. The following sections of this amendment detail the most recent developments in the Dominican economy, and outline the policy actions this grant will support that will assure strong fiscal performance in the year to come.

C. Economic Performance under the TCG Adjustment Program

As described in more detail in the previous PAAD amendments, Dominica's TCG structural adjustment program more than met its objectives. The goal of 4 percent real GDP growth for the period 1986-1988 was surpassed, with growth averaging 6.4 percent a year. The Central Government deficit was reduced by nearly half, to seven percent by 1988.

While part of Dominica's strong growth can be attributed to the favorable banana prices observed over the period, the policy reforms adopted also played an important role in reactivating the economy. Dominica reduced the level of direct taxation, restrained the growth of wage and salary payments in the public sector and improved infrastructure. Increased public sector savings made it possible for the Government of Dominica to reduce its indebtedness to the domestic banking system.

The only area where the adjustment program had less than its desired impact was in broadening the national productive base. While the measures adopted resulted in a more positive climate for investment, this did not in turn foster a wider diversification of economic activities. Dominica's economy remains highly dependent on bananas. The IMF reported that over the period of the TCG program, the average increase in the production of crops other than bananas was less than five percent annually, and minimal new investment in manufacturing was made. Part of the problem, as described in detail in the World Bank report "The Long-Term Prospects of the OECS Countries," is that banana prices were so favorable over the period that resources were not attracted into other sectors.

D. Economic Performance in 1989 and Outlook for 1990

National Income and Prices - The most significant event of the past year for the Dominican economy was Hurricane Hugo, which caused extensive damage to the island in September of 1989. The country lost about seventy percent of its banana crop, and sustained damage to its infrastructure, particularly roads and seawalls. As a result, estimated real growth was slightly negative (about -0.5 percent) due to the loss in income in the banana and other productive sectors. Inflation rose from 2.0 percent during 1988 to 6.3 percent recorded through the end of December of 1989. While part of the adverse economic impact of the Hurricane was mitigated by STABEX and WINBAN insurance payments, and by additional donor assistance (including a USAID disaster assistance grant to the Government of Dominica and the Dominica banana marketing board), economic performance in 1990 continues to suffer.

Economic growth for 1990 is now projected to reach about 3 percent in real terms, a bit higher if banana production recovers to pre-hurricane levels relatively quickly. Also expected to be important in growth this year is construction related to investment activity. An ambitious public sector investment program combined with commercial banks more actively pursuing local private investment has led to spot labor shortages in some sectors. Inflation has moderated in the first months of 1990 - price index figures for the first quarter show a reduction of one percent in the overall index, and a five percent reduction for food prices.

Public Finance - On the fiscal side, the hurricane resulted in a revenue loss related to the export tax on bananas. As an incentive to recovery of the banana sector, the Government suspended the tax for most of the fiscal year. In addition, the STABEX payments were both less than and later than anticipated. Nonetheless, Dominica still met the fiscal targets for the 1989/90 fiscal year contained in last year's ESF program. These targets and actual figures are contained in Table 2.

As noted in last year's PAAD, the 1989/1990 budget contained provisions for a tax reform whose intent was two-fold: to stimulate private investment and to reduce the tax burden on low income households. Examples of measures in the former category were rate reductions in the hotel occupancy tax and the corporation tax. In the latter category, the tax reform increased the personal income tax threshold. The tax reform was implemented on January 1, 1990, and implies a revenue loss of roughly 1.6 percent of GDP. Part of this tax revenue loss may be recovered when the higher rates of the CARICOM Common External Tariff come into effect, possibly as early as 1991.

On the expenditure side, Dominica continued to exercise restraint. Public sector wage policy was relaxed a bit when the Government returned to the policy of automatic wage increases for all public sector workers, which had been abolished in 1986. This step was justified as an interim measure while the new civil service reform law was negotiated through the political and legislative process. The law, which will allow merit increases to be restricted to a small fraction of public employees, will be an early agenda item for Parliament this fiscal year. Even with the reinstatement of the automatic merit wage increases, the wage bill for the Central Government increased by an estimated six percent over the previous fiscal year, within the target of three percent in real terms established in the ESF agreement.

<u>Balance of Payments</u> - Last year's PAAD amendment for the Dominica program predicted a pessimistic outlook for bananas, even without envisioning a hurricane. Banana tonnage in the early months of 1989 was sharply lower than in previous years, and prices were not favorable. The PAAD amendment noted that a stronger U.S. dollar against the British pound also lowered the profitability of Dominican bananas, as the E.C dollar is pegged to the U.S. currency.

Much of the above has been overtaken by events. Banana tonnage is recovering, as government and donor support in the aftermath of the hurricane created incentives to replant. At the same time, the dollar has weakened substantially against the pound, and this trend may continue. While all of these developments are seemingly good news, if one takes the longer view, with the spectre of a drastically lower price for Windward Island bananas after 1992, renewed incentives for investment in the banana sector are not what Dominica needs most at this point. As mentioned earlier, the country's longer-term diversification efforts are being thwarted by the market signals sent from the near-term profitability of bananas. It may be the case that serious diversification cannot begin until the banana price actually falls as 1992 approaches.

Because of the hurricane, the current account balance was quite a bit more negative than originally projected for 1989. The PAAD

DOMINICA
FISCAL OPERATIONS OF THE CENTRAL GOVERNMENT
(millions of E.C. dollars)

	1989/90	1990/1991
REVENUE	148.8	183.7
Current Revenue	119.9	130.8
Tax Revenue	107.4	111.9
Nontax Revenue	12.5	18.9
Capital Revenue	0.3	6.2
Foreign Grants	28.3	46.7
CURRENT EXPENDITURE	107.0	122.5
Wages and Salaries	60.2	66.3
Goods and Services	21.6	29.0
Other	25.2	25.5
CAPITAL EXPENDITURE	50.4	76.1

ESF Quantitative Targets

	1989/90 Target	1989/90 Projection*	1989/90 Target	1989/90 Budget
Wage/Revenue	.50	.50	.49	.51
Wage/Expenditure	.57	.56	.54	.54
Surplus/Revenue	.12	.11**	.07	.06
Real Increase Wage Bill	.03	about .02-.03***	n.a.	n.a.

* Using the IMF February 1990 figures given in the table above. For disbursement purposes, the targets were examined using the GOCD actual data for the first six months of the fiscal year, and the May 1990 projection for the full fiscal year. In both cases, Dominica met or exceeded all targets.

** This target was met or exceeded, as described in note (*) above.

*** Inflation figures are not yet available through June 1990, the end of the fiscal year. The target was evaluated using half-year data and full year projections, and was met.

SOURCES: 1989/90 fiscal year - IMF projections 2/90
1990/91 fiscal year - GOCD Ministry of Finance

amendment projected a deficit on current account of US$27.9 million, while the current estimate is US$43.4 million, according to the IMF. For 1990, the deficit will be lower at a projected US$34.9 million. In 1990, the IMF projects the trade deficit to be slightly reduced, from US$59.2 million in 1989 to US$53.4 million.

The previous PAAD document projected that imports would show moderate growth. The impact of the hurricane, however, caused increased import requirements (especially of capital goods) leading to much higher than originally projected import levels for both 1989 and 1990. Nevertheless, the level of exports, external grants and foreign investment is projected to be sufficient in both years to produce a modest overall balance of payments surplus - US$ 3.4 million in 1989 and US$ 2.9 million in 1990.

Financial Markets - Hurricane Hugo caused a reduction in loanable funds available from commercial banks in late 1989 and early 1990, as savings dropped from households whose livelihood was affected. The commercial banks report that credit availability has since increased, and lending operations have normalized.

Investment Policy - In addition to the tax reform already mentioned, Dominica is implementing an agenda of policy measures aimed at improving the attractiveness of the island to investors. In 1989, the privatization of the Water Authority was completed. (This action formed part of the conditionality of the FY 1989 ESF Agreement.) The Government is also pursuing the necessary legal changes to remove restrictions in the Alien Landholding Act on equity ownership and holding of directorships in local firms by foreign investors. In the interim until the law is changed, the new policy is being applied to firms on a case-by-case basis. The Government of Dominica is also initiating steps to establish a venture capital fund for enabling new firms better access to credit.

III. Program Description:

A. Conditions and Covenants:

RDO/C has negotiated the following measures to be included in the Grant Agreement as conditions precedent to disbursement of the $557,000 in ESF assistance authorized under this PAAD amendment. These measures reflect Dominica's commitment to maintain its sound fiscal management during the 1990/1991 fiscal year and to continue to control the growth of wage and salary expenditures by the Central Government. The specific conditions are:

Using actual data for the first semester of the 1990/1991 fiscal year and projections for the full 1990/1991 fiscal year, the Grantee will demonstrate best effort progress toward the following fiscal targets:

(A) Restraining growth in central government civil service wage and salary payments so that they do not exceed forty-nine percent of current revenue and fifty-four percent of current expenditure, and

(B) Achieving a central government current account surplus equal to at least seven percent of current revenue.

RDO/C defines best effort progress to mean that, should Dominica not meet the targets, the GOCD must demonstrate the cause of any shortfall, and indicate a plan of action for correcting the problem. In that case, depending on the magnitude of the shortfall, the Mission may decide to withhold disbursement until corrective actions are in place and showing results. Realistically, however, the GOCD has always approached its fiscal targets with great seriousness in the past, and we expect this seriousness of intent to continue with the current year program.

In addition to the quantified performance targets that will serve as conditions precedent to disbursement, RDO/C will also include covenants in the Agreement which relate to Dominica's progress in two qualitative areas: public sector management reform and the investment climate. These covenants are:

1. The Grantee covenants to continue making progress in implementing the cost-containment measures based on the Grantee's response to the findings and recommendations of the Organization, Methods and Manpower technical assistance team. The Grantee will provide a letter to AID, no later than January 31, 1991, describing the additional progress already achieved or planned for the 1990/1991 fiscal year.

This covenant refers to progress in two areas. First, the GOCD has developed a new civil service law, one of whose beneficial impacts will be to limit meritorious wage increases to a small fraction of public sector employees whose performance has been exceptional, rather than routinely awarding increases to all public employees. The new law has been approved by Cabinet and is working its way through the legislative process.

In addition, under the TCG program, Dominica committed itself to undertake the lengthy process of reviewing all public sector positions with regard to need for the position, grade, and required qualifications. This covenant will be used to maintain discussions with the Government that it continues making progress in this area.

A second covenant relates to the investment climate:

2. The Grantee covenants to continue its progress in identifying and removing barriers and disincentives to private investment in Dominica. The Grantee will provide a letter to AID prior to January 31, 1991, describing measures planned or taken during the 1990/1991 fiscal year to remove fiscal, regulatory or other disincentives to private investment in Dominica.

The measures on Dominica's agenda in this area are discussed on page 7 of this amendment. In addition, the covenant formalizes the dialogue between the U.S. Country Team and the Government of Dominica on investment climate issues, in the sense that provision of the Grant is linked through the covenant to this area where both parties share a concern that further progress is needed.

The ESF program agreement will also include the standard conditions and covenants relating to specimen signatures, opinion of counsel, the separate dollar account, the separate local currency account, program record-keeping, accounting and reporting, and so on.

B. <u>Program Elements:</u>

THe uses of ESF dollars and associated local currencies will follow the scheme described in the original PAAD. Consistent with the Buy America policy, the cash transfer U.S. dollars will be used for imports from the United States. The reader is referred to the original PAAD document for the details. The same justifications for grant funding and for providing the assistance as a cash transfer are still valid. The same reporting requirements will be retained for the additional assistance. All tracking, reporting and auditing requirements have been reviewed for consistency with recent Agency policy guidance on financial management issues.

The amount of the additional grant is still well below Dominica's annual import requirement from the United States. Therefore, the country is not expected to have difficulty in importing at least $557,000 in commodities from the U.S. under the fourth tranche of the program. Under the financial monitoring system in place, U.S. dollars can be directly tracked from the separate account to individual import transactions, and there is a redeposit clause in the Agreement in case U.S. dollars are found to have been withdrawn for ineligible uses.