AID 1120-1

**PAAD**

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: 517-0263

2. COUNTRY: DOMINICAN REPUBLIC

3. CATEGORY: CASH TRANSFER

4. DATE: September 9, 1991

5. TO: James H. Michel, AA/LAC

6. OYB CHANGE NO.:

7. FROM: LAC/DR

8. OYB INCREASE: $10,000,000

TO BE TAKEN FROM: ECONOMIC SUPPORT FUNDS

9. APPROVAL REQUESTED FOR COMMITMENT OF: $40,000,000

10. APPROPRIATION - BUDGET PLAN CODE

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☐ INFORMAL ☐ FORMAL ☒ NONE

13. ESTIMATED DELIVERY PERIOD:

14. TRANSACTION ELIGIBILITY DATE:

15. COMMODITIES FINANCED:

| 16. PERMITTED SOURCE | 17. ESTIMATED SOURCE |
|---|---|
| U.S. only: | U.S.: |
| Limited F.W.: | Industrialized Countries: |
| Free World: | Local: |
| Cash: $40,000,000 | Other: |

18. SUMMARY DESCRIPTION

The purpose of this program is to support the Government of the Dominican Republic's (GODR) comprehensive economic reform program, which includes the recently initiated 19 month stand-by arrangement with the IMF. Upon GODR compliance with conditionalities, the ESF will be disbursed in three tranches into a separate non-commingled account for repayment of GODR debt to the IMF, IBRD, IDB and USG (payments for final uses will be made directly from the separate account). The only local currency generated under the program will be up to 10% of the ESF amounts obligated, for the operating expense trust fund.

Conditionalities to first disbursement of ESF program resources comprise: evidence satisfactory to A.I.D. that the GODR has sustained implementation of the principal elements of is economic program, including compliance with the fiscal and monetary targets of the stand-by arrangement, and maintenance of a unified market-determined exchange rate and market-determined financial systems interest rate. Conditionalities for the second and third tranches would focus on policies to support structural reforms designed to attract investments needed to restore growth to the Dominican economy, and continued compliance with sustained implementation of the economic reform program and IMF stand-by.

| 19. CLEARANCES | DATE |
|---|---|
| REG/DP | |
| REG/GC | |
| AA/PPC | |
| M/FM | |
| M/SER/COM | |
| AA/PRE | |

20. ACTION

☐ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE

TITLE

CLASSIFICATION:

BEST AVAILABLE COPY

FY 1991-1992 PAAD

for

INVESTMENT AND TRADE EXPANSION PROGRAM

(517-0263)

September, 1991

# Index

# I. SUMMARY AND RECOMMENDATIONS

## A. Overview

The US Mission to the Dominican Republic proposes to support the Dominican Government's (GODR) comprehensive economic reform program with a 40 million dollar ESF program for FYs 1991-92. The proposed ESF would provide support for sustained implementation of the GODR's program and the IMF stand-by that was approved on August 28, 1991. Conditionality would focus on sustained implementation of the fiscal and monetary targets of the stand-by and continued implementation of market-determined exchange and interest rate policies. Complementary conditionality that support other elements of the GODR's economic reform program initiated in August, 1990, would be negotiated with the GODR, such as:

-- reform of the investment code
-- adoption of regulations affecting private power investments
-- privatization of state-owned enterprises
-- elimination of price controls
-- civil service reform
-- tax reform
-- customs administration reform
-- or, Paris Club and commercial bank debt restructuring.

The proposed ESF program would be disbursed in three tranches, with the dollars used for IFI and USG debt service. The only proposed local currency generations would be for USAID's OE Trust Fund. Mission requests authorization and budget allowance to obligate the FY 1991 program component by September 30, 1991.

## B. Economic Policy Environment

In the face of declining demand for primary exports, stagnating economic growth and mounting unemployment, beginning in 1986 the GODR embarked on a major public works program accompanied by expansionary monetary policies. However, this produced an increased fiscal deficit, mounting inflation and a widening of the external current account deficit, which in turn led to substantial losses of international reserves and massive increases of international debt payment arrears.

After repeated ad hoc attempts to deal with the deteriorating policy environment, the GODR initiated in August 1990 a comprehensive economic reform program that has produced dramatic results. Domestic financing of the public sector deficit has been eliminated through a combination of capital and operating expenditure reductions, tariff reform, and significant price increases for petroleum, electricity and other governmentally produced or controlled products. This has been accompanied by tight monetary policy, including reductions in the net domestic credit of the Central Bank, stringently enforced reserve requirements, and positive real interest rates facilitated by the decontrol of all financial system interest rates. Coupled with the adoption of a unified market-determined exchange rate, the new policy framework has produced price and exchange rate stability, increased net international reserves, and facilitated the elimination or reduction of arrears to the international financial institutions (IFIs).

While continued implementation of the program is projected to result in positive and accelerating growth beginning in 1992, the short-term costs in terms of economic decline (5.1 percent in 1990 and 2 percent in 1991) and increasing unemployment are serious constraints to sustained implementation of the program without significantly increased assistance from the international financial community. Hence, the GODR requested a 19 month stand-by arrangement for 53 million dollars that was approved by the Fund's Executive Board on August 28, 1991. The Board also approved the GODR's request for a 60 million dollar purchase from the Fund under the Compensatory and Contingency Financing Facility (CCFF) to compensate for the run-up in the cost of oil imports and reduced exports during 1990. It is expected that Paris Club rescheduling of substantial amounts of external debt will be negotiated during the final quarter of 1991. Commercial debt rescheduling is expected in early 1992.

C. Proposed ESF Program

The Mission proposes to support the sustained implementation of the GODR's comprehensive economic reform program and the stand-by arrangement with a 40 million dollar ESF program for FYs 1991-92. The Mission believes that the depth and breadth of the reform program and the associated short-term costs merit substantial ESF assistance over this critical period.

Since the priority objective of the proposed ESF program is economic stabilization supported by the international financial community, ESF resources would be disbursed as cash transfer grants with no requirement for the generation of local currency other than the provision of up to 10 percent of the grant as a peso contribution to USAID's OE Trust Fund. The dollars would be used to service external debt obligations with IFIs, such as the World Bank, the IDB and the IMF and the USG. Dollar disbursements would be in three tranches, with the first for 10 million dollars October 1991, the second for 15 million dollars in February 1992, and the third for 15 million dollars in August 1992.

The focus of conditionality would be on sustained implementation of the central elements of the GODR's reform program, including the financial programming targets of the stand-by. Complementary conditionality that would support other elements of the GODR program and be consistent with the Mission's strategic objectives and Action Plan policy work plan would also be negotiated.

## II. BACKGROUND

### A. Economic Performance in the 1970s and 1980s

The demand for traditional Dominican exports -- sugar, coffee, and tobacco -- was strong enough in the 1970s to generate economic growth of 7 percent per year, despite a policy environment badly distorted in favor of import substitution. When international demand fell and the value of these traditional exports declined in the early 1980s, real GDP growth plummeted and averaged less than 2 percent per year for the decade (see Tables I and II attached and/or available from LAC/DPP and LAC/CAR). The resulting increases in unemployment (averaging around 25 percent) and declining per capita income, generated strong political pressures for expansionary macroeconomic policies.

The Government that came to power in 1986 embarked on a major public works program accompanied by expansionary monetary policies. Real GDP growth increased to an unsustainable 6.6 percent in 1987, mainly as a result of the more than doubling of public investment to over 11 percent of GDP (Table III). However, the increased fiscal deficit was heavily financed by Central Bank credit (Table IV). This produced an increase in inflation and a widening of the external current account deficit, which in turn led to substantial international reserve losses and increases in international debt payment arrears.

Public investment continued to be excessive in 1988 and 1989, averaging 11.6 percent of GDP. The associated public sector deficit increased further (to around 6.5 percent of GDP), and necessitated continued Central Bank financing. Moreover, the operating losses of the Central Bank increased significantly as a result of exchange losses associated with preferential exchange rates. The resulting credit expansion led to sharp depreciation of the exchange rate while the rate of inflation jumped to 58 percent in 1988 before moderating to 41 percent in 1989. Despite significant export and tourism expansion in both 1988 and 1989, the destabilizing fiscal and monetary policies generated unstable growth, with stagnation in 1988 and 4 percent expansion in 1989.

### B. Economic Performance in 1990-91

In early 1990 economic activity weakened, inflation remained high and the balance of payments deficit widened as the public sector finances deteriorated. In response, public investment was reduced and the exchange rate devalued in April.

These actions proved inadequate and in August the GODR introduced a broader package of measures that included substantial price increases of products produced or controlled by the government (petroleum, sugar, and flour), and further exchange rate devaluation. At the same time, interest rates were increased, financial system reserve requirements were raised and enforcement was tightened on bank reserve deficiencies. In the latter part of 1990, as exchange shortages persisted and oil import costs rose, domestic petroleum prices were further increased, electricity rates were raised, and the exchange rate was again devalued. These measures, coupled with public investment cutbacks, produced a significant reduction of the public sector deficit in 1990 (equivalent to more than 1 percent of GDP).

However, inflation increased to over 100 percent in 1990, in part because of the corrective price increases, but also as a result of the continuing need to finance the public sector deficit domestically ( 1.4 percent of GDP in 1990). Economic activity declined markedly in the latter part of 1990 as the GODR's reform program took hold, the Gulf Crisis produced increased petroleum import prices and reduced tourism, the U.S. recession hit Dominican exports, and exchange rate shortages resulted in petroleum import curtailments and widespread electric power disruptions. As a consequence, real GDP fell by more than 5 percent for the year. In spite of the decline of imports in 1990, net capital outflows picked up and the overall balance of payments deficit widened to 507 million dollars and international arrears increased by 520 million dollars. By the end of 1990, international arrears amounted to 1.5 billion dollars.

Economic performance during the first part of 1991 has been more favorable, reflecting further exchange regime liberalization, interest rate decontrol, tight fiscal and monetary policies and the decline of the import price for petroleum. Inflation was reduced to only 0.6 percent for the first seven months of 1991 and the exchange rate has stabilized. Improved Central Bank access to foreign exchange has facilitated the clearance of arrears to the international financial institutions (IFIs), including the IMF, the World Bank, and the Inter-American Development Bank (IDB). Arrearage clearing in turn facilitated the IMF stand-by approved August 28, 1991, which will facilitate increased IFI lending and Paris Club and commercial bank debt rescheduling . The resulting improved private sector confidence has already produced net inflows of capital.

However, the ongoing Dominican economic recession produced an estimated 3.2 percent drop in GDP during the first half of 1991 and is yet to show signs of abating. While zero economic growth has been projected for 1991 by the GODR and IMF, USAID believes that this is optimistic and a 2 percent decline is more likely. With a growing labor force, continued increases in unemployment (29 percent in 1990) and in the incidence of poverty are anticipated until rapid, sustained growth is restored to the economy.

### C. Future Prospects

Until recently, economic policy implementation has been ad hoc, and not implemented in terms of a coherent medium-term framework that would provide sustained long-run, albeit moderate growth. However, the potential for increasing growth with sustained sound policy implementation is significant, with 3 percent real GDP growth projected for 1992 and average 3.9 percent per year during the 1993-96 period.

The primary growth sectors are projected to be tourism and free trade zone service exports. Tourism revenues, just 173 million dollars in 1980, reached 978 million dollars in 1990 (14 percent of GDP). Tourist arrivals are projected to increase 6 percent in 1992 and 2.7 percent per year for 1993-96. Income from free trade zones (FTZs) increased from 44 million dollars in 1980 to an estimated 225 million dollars in 1990 (3.2 percent of GDP). FTZ income is projected to increase by 8 percent in 1992 and by at least 10 percent a year during the period 1993-96.

Nevertheless, the Dominican economy will remain vulnerable to external shocks. Lower export growth, higher world interest rates, higher world petroleum prices, and lower tourism growth could significantly lower the base-line growth path outlined in these projections.

## III. THE GODR's ECONOMIC REFORM PROGRAM FOR 1990-92

### A. Overview

The comprehensive economic reform program that the GODR has been implementing since mid-1990 has produced dramatic results. Domestic financing of the public sector deficit has been eliminated through a combination of reduced capital and operating expenditures, tariff reform, and significant price increases for petroleum, electricity and other governmentally produced or controlled products. This has been accompanied by tight monetary policy, including reductions in net domestic credit balances of the public sector with the Central Bank, stringently enforced reserve requirements, and positive real interest rates facilitated by the decontrol of all financial system interest rates. Coupled with the adoption of a unified market-determined exchange rate, the new policy framework is designed to produce price and exchange rate stability and sustained future economic growth.

Based upon actions already taken and proposed measures, the GODR's reform program targets inflation at no more than 16 percent during 1991 and 10 percent during 1992 (Table I). Real

GDP is targeted to remain unchanged in 1991, but 3 percent growth is anticipated in 1992. The balance of payments would be strengthened, with net international reserves targeted to increase by 80 million dollars in 1991 and by an additional 85 million dollars in 1992 (Table II).

Support of the program by the international financial community is essential to attain these objectives. Hence, the GODR requested in a Letter of Intent a 19 month stand-by arrangement for 53 million dollars and it was approved by the Fund's Executive Board on August 28, 1991. The Board also approved on August 28 a 60 million dollar purchase from the Fund's Compensatory and Contingency Financing Facility (CCFF) to compensate for the run-up in the cost of oil imports and reduced exports during 1990. It is anticipated that Paris Club rescheduling of substantial amounts of bilateral debt may be negotiated during the final quarter of 1991. Commercial debt rescheduling is expected in early 1992.

B. Public Sector Finances

Improved public sector finances are central to the stabilization program. The program cut the overall public sector deficit (after grants) to 5.1 percent of GDP in 1990 from 6.2 percent in 1989 (Table III). The deficit is projected to decline to 2.1 percent of GDP in 1991 and 1.6 percent in 1992. The overall deficit is being monitored under the IMF stand-by on a quarterly basis, with fully satisfactory compliance indicated to date (Table V).

Domestic financing of the deficit, because of its effect on overall credit expansion, inflation and the crowding out of private sector investment, is a key measure of fiscal soundness. Expansive fiscal policy in the late 1980s necessitated net domestic financing that averaged 3.3 percent of GDP (Table III). The reform program's fiscal restraint in 1990 reduced net domestic financing to the equivalent of 1.4 percent of GDP. Net domestic financing is projected to be zero in 1991 and negative in 1992 (actually reducing domestic indebtedness of the public sector in 1992).

This dramatically improved fiscal performance is based upon a number of specific fiscal reforms. Public sector investment has already been cut from earlier unsustainable levels (over 11 percent of GDP) to 7.4 percent of GDP in 1990, and is projected to decline to 5.5 percent in 1991 before being allowed to increase moderately to 5.9 percent in 1992.

Tariff reform implemented by decree in late 1990 eliminated most exemptions from import duties, and reduced tariff rates to a range of 5 to 35 percent (previous maximum was almost 600 percent). Consumption taxes ranging from 15 to 80 were also imposed on selected luxury imports. In July 1991, the Government extended the base for the current 15 percent surcharge on imports from about half of imports to all items, except for petroleum, certain food items and medicines. Since July 1991, the market exchange rate has been used to determine import duties, as opposed to the earlier practice of using overvalued official exchange rates.

In an effort to shift the structure of taxes away from over reliance on indirect taxes and taxes on imports and ferronickel exports, the GODR has been working on a tax reform package developed in collaboration with the UNDP. The package would broaden the base of the value added tax, increase excise taxes and convert them from specific to ad-valorem, and lower and simplify personal and income taxes (with rates ranging between 15 and 35 percent). The over-all tax package is expected to increase tax revenue by the equivalent of 1 percent of GDP. While the Government is committed to sending the package to the Dominican Congress soon, timely Congressional approval cannot be assured. However, the Government intends to maintain domestic petroleum prices (which are yielding net revenue of about 1.3 percent of GDP) at least until equivalent additional revenue is generated by tax reform.

The public enterprises' overall deficit is projected to decline in 1991 to about 0.6 percent of GDP from 1.6 percent in 1990, as a result of the flexible pricing policies and rehabilitation programs adopted in late 1990. These programs include managerial and operational reforms, and efforts to divest some enterprises, including the Dominican Aviation Company and the National Glass Industry.

C. Monetary Policy

Monetary policy will focus on reducing inflation while supporting the balance of payments objectives of the GODR's reform program. Monetary performance is being monitored under the IMF stand-by on a quarterly basis, with fully satisfactory compliance indicated to date (Table V).

Central Bank financing of the public sector deficit was the key force driving excessive monetary expansion and surging inflation during the late 1980s. The GODR's recently implemented restrictive fiscal policies have eliminated the need for Central Bank financing, with zero net financing programmed for 1991 and negative financing on the order of 100 million pesos projected for 1992. The program has remained on target during the first six months of 1991, with Central Bank (and Reserve Bank) net financing of the public sector actually declining by 900 million pesos (Table V). This will facilitate up to 900 million pesos in net credit expansion during the second half of 1991 without violating the target of zero net financing for all of 1991.

Continued compliance with this quarterly target of the IMF stand-by remains critical to ensuring that other monetary targets are also satisfied, including the increase of net international reserves by 80 million dollars during 1991. However, compliance with the monetary targets of the stand-by could be jeopardized by a number of factors, including higher than forecast public sector capital expenditures or an unanticipated decline of grants and foreign financing of the public sector deficit.

Central Bank credit contraction, facilitated by its zero net financing of the public sector deficit and open market operations, coupled with continued enforcement of financial system reserve requirements and market-determined interest rates are projected to limit overall banking system credit expansion 20 percent in 1991 and 11 percent in 1992. This in turn should allow the indicative inflation targets of 16 percent in 1991 and 10 percent in 1992 to be easily met.

Dramatic evidence of the program's success in meeting its inflation objectives is provided by the low 0.6 percent increase of the consumer price index during the first seven months of 1991, in contrast to the 100.7 percent increase in 1990. Continued price stability will improve the prospects that the remaining price controls nominally affecting 17 commodities can be totally eliminated, as proposed by the GODR. However, this may not be feasible until economic growth is restored in 1992. One of the short-term costs of the anti-inflation policies is that the economy continues to decline in real terms, with real GDP estimated to have declined by 2.5 percent in the first quarter of 1991. The prospects are high that the anticipated recovery beginning in late 1991 will not compensate for earlier declines. Hence, the goal of zero growth for 1991 may not be obtained. USAID currently projects a 2 percent decline for all of 1991.

## D. External Policies

Exchange rate reforms initiated in January 1991 were designed to ensure a flexible and market-determined system. Coupled with sound fiscal and monetary policies, these reforms allowed for de facto unification of the rates in the official and free interbank markets and exchange rate stability. In July 1991 these gains were consolidated by the official unification of the two rates, with the official rate determined from the previous day's average interbank rate. At the same time, the GODR also committed itself to reducing the 2.5 percent tax on foreign exchange sales of the Central Bank to less than 2 percent prior to July 1992.

The new liberalized exchange regime virtually ensures that the international reserve targets of the IMF stand-by can be met, as reserve short falls can be overcome by Central Bank purchases of reserves in the interbank market. While this would not necessarily undermine other stand-by targets, it could add to exchange rate depreciation and inflation.

The liberalized exchange system should provide increased incentives to export, especially service exports from tourism and the rapidly growing free trade zones. To further enhance the prospects for export-led growth, the GODR is reviewing the incentive system for direct foreign investment. Liberalization of profit remittance ceilings have been proposed.

The liberalized foreign exchange regime will also encourage the private sector to economize on imports. This, coupled with the current economic recession and the growth projected for 1992 explains why imports are expected to first decline in 1991 and then expand moderately in 1992 (Table II). Combined with the anticipated expansion of export and private transfers, limited improvement of the current account deficit is projected, with a decline from 261 million dollars in 1990, to 212 million dollars in 1991 and 215 million dollars in 1992.

Assuming continued performance under the reform program, the capital account is projected to improve much more dramatically, with the 246 million dollar net outflow in 1990 shifted to a net inflow of some 70 million dollars in both 1991 and 1992. Limited growth in official transfers is anticipated. Public sector net capital flows are projected to remain negative, but significant increases of bilateral and multilateral lending are projected to significantly lower the levels of net outflows. Direct foreign investment is not expected to increase significantly. This may reflect the widespread private sector cynicism over the ability of the Government to sustain implementation of the reform program and frustration with now endemic electric power shortages.

Attainment of the program's projected reductions of the overall balance of payments deficit by nearly 150 million dollars in both 1991 and 1992 assumes substantial debt rescheduling with Paris Club and commercial creditors. Total public external debt at the end of 1990 stood at 4.5 billion dollars (Table III). This included some 1.1 billion dollars owed to multilateral donors, 1.7 million dollars to Paris Club bilateral donors (of which 971 million dollars is to the USG), almost 1.0 billion dollars to commercial banks, and about 140 million dollars to suppliers and others. At the end of 1990, total arrears amounted to 1.5 billion dollars, including 72 million dollars owed to multilateral donors, 725 million dollars to the Paris Club, 228 million dollars to other bilaterals, 231 million dollars to commercial banks, and 44 million dollars to suppliers and others.

By the end of June 1991 all arrears to the multilaterals had been cleared. Paris Club debt negotiations are expected to begin in September 1991 and be completed by the end of 1991. Negotiations with the advisory committee for the commercial banks has already commenced. While predicting when these negotiations will be completed is problematic, current expectations are for early 1992. As part of the commercial bank negotiations, the GODR is exploring the possibility of a debt buy-back scheme. Even if the commercial banks agreed to sell Dominican Republic debt for 20 cents on the dollar, 200 million dollars would be required to buy all the 1 billion dollar debt. The IMF is encouraging the GODR to explore this option, but no firm source of financing has been identified. However, one possible source would be an extended arrangement with the Fund. This possibility is expected to be considered when the Fund reviews the GODR's performance under the stand-by in January 1992.

The GODR should also attempt to qualify for USG debt forgiveness under the Enterprise for the Americas Initiative (EAI). This would require sustained implementation of the stand-by, and, as appropriate, a World Bank Structural Adjustment Program, an IDB sector investment program, and a satisfactory arrangement with the commercial banks. The debt forgiveness of between 40 and 80 percent of principal would be possible. However, since the debt forgiveness terms generally require continued dollar payments to the USG at current levels, there would be no cash flow advantage affecting the balance of payments over the short term, unless the negotiated debt forgiveness agreement included provision for interest payments otherwise due the USG being paid in local currency to, say, an environmental trust fund in the Dominican Republic.

Even under the assumptions of generous debt restructuring, the Dominican Republic will need to make cash payments of some 290 million dollars in 1991, of which 192 million dollars would be to the IFIs. Nearly 210 million dollars will need to be paid during the second half of 1991. While the proposed payment schedule is feasible, it results in an extremely tight reserve position, with gross reserves projected at just over four weeks of imports and interest payments by the end of 1991. Some exchange rate depreciation is also anticipated as the Central Bank buys dollars in the interbank market to help meet its large debt service needs in the later part of 1991.

While the IMF base-line balance of payments projections do not show financing gaps in 1991 and 1992, the assumptions used to generate these projections are open to question. Continued economic recession or stagnation in the industrial world could easily cut Dominican exports and tourism by several percent, generating a financing gap of 40 million dollars. In addition, excess supply of sugar could result in reduction of the U.S. sugar quota for the Dominican Republic, reducing export earnings an estimated $20 million or more. Raising world interest rates by one percentage point would increase Dominican debt service requirements and generate a gap of 48 million dollars. A world oil prices increase of 2 dollars per barrel would generate a gap of 50 million dollars. If several of these were to occur together, the balance of payments gap could easily exceed 100 million dollars. Furthermore, calculation of the gap is predicated on the assumption on zero economic growth in 1991 and 3 percent growth in 1992. Given the depth of the Dominican recession, USAID currently believes that these growth targets will not be met without at least an additional 80 million dollars foreign assistance in both 1991 and 1992. Hence, in contrast to IMF estimates, USAID sees a number of reasons for realistically expecting the unfinanced gaps to range between 80 and 160 million dollars in both 1991 and 1992.

Clearly increased external assistance is needed to close these expected gaps and help restore growth to the economy. Without a resumption of significant growth in the near future, pressures may be expected to build within the Dominican Republic for dropping the reform program and returning to the pump-priming economic policies that prevailed during the late 1980s.

## IV. USAID PROGRAM STRATEGY

In 1991 the Mission presented its new Country Development Strategy Statement (CDSS) for the period FY 1992 to FY 1996. The overall strategy goal of U.S. economic assistance to the Dominican Republic is to enhance the close and cooperative relationship between the Dominican Republic and the United States, as envisaged by the Enterprise for the Americas Initiative (EAI), by supporting Dominican efforts to promote economic growth and to strengthen democratic institutions. The Mission strategy for the Dominican Republic is consistent with the major LAC development objectives:

-- Achievement of broad-based, sustainable economic growth; and

-- Development/strengthening of stable democratic society.

In developing the new strategy, USAID has kept in mind the close interrelationship between the objectives of economic growth and strengthening democracy. The joint objectives of economic growth through policy liberalization and strengthening the Dominican democratic institutions are interdependent and mutually reinforcing. Strengthening Dominican efforts to liberalize the economy and facilitate the country's participation in the EAI will provide an important complement to efforts to strengthen Dominican democratic institutions.

To achieve sustainable broad-based growth, the Dominican economy must attract considerable private investment into emerging sectors, especially those with strong international potential. To do so, the GODR must address the issue of low efficiency investment caused by inflation, protective foreign exchange and trade regimes, tax distortions, and public sector inefficiency, especially in the electric power sector.

USAID strategy links expanded U.S. assistance to continued adherence to an internationally sanctioned reform program. The Mission has aggressively pushed for an agreement with the IMF and has directed its policy dialogue agenda with both the GODR and key private sector interests on the need to sustain adherence. Once that an agreement is well underway, the Mission's Action Plan proposes to provide ESF both to assist adherence to the program and to promote key reforms in restructuring the Dominican economy to attract investment. The Mission Work Plan outlined the core Mission policy agenda for the Action Plan period. In addition to the macro-economic issues identified with the internationally sanctioned reform program, the Mission is concentrating on issues of direct relevance to trade and investment, such as tariffs and external debt. To ensure the sustainability of the improved policy environment now in place, the Mission is providing selective support to improve the capacity of key Dominican institutions to develop and implement policies, such as the Central Bank and private sector associations. USAID plans to initiate its Economic Policy and Practice Project as a top priority in FY 1992. A new Investment Code and the adoption of commercial bank debt conversion regulations in 1992 will help to meet conditions required for participation in the EAI. Promoting a common approach among the donors will increasingly become important and the Mission will press for a reactivated Consultative Group.

## V. PROPOSED ESF PROGRAM

### A. Overview of the Program

The US Mission to Dominican Republic proposes to support the sustained implementation of the GODR's comprehensive economic reform program and the stand-by arrangement with a 40 million dollar ESF program for FYs 1991-92. With only limited ESF possible in FY 1991, it is proposed that funding for FYs 1991-92 be combined so that a coherent and appropriately phased ESF assistance program can be developed. The Mission believes that the depth and breadth of the reform program and the associated short-term costs merit substantial ESF assistance over this critical period.

Since the priority objective of the proposed ESF program is economic stabilization supported by the international financial community, ESF resources would be disbursed as cash transfer grants with no requirement for the generation of local currency other than the provision of up to 10 percent of the grant as a peso contribution to USAID's OE Trust Fund. The dollars would be used to service external debt obligations with IFIs, such as the World Bank, the IDB and the IMF (and the USG). Dollar disbursements would be in three tranches, with the first for 10 million dollars October 1991, the second for 15 million dollars in February 1992, and the third for 15 million dollars in August 1992.

Tho Mission proposes that the U.S. dollar cash transfers be used to service IFI debt. A major reason for the long delay in obtaining a Stand-by arrangement with the Fund was the need to first eliminate arrears with the Fund on the order of $40 million that accumulated in 1990. Moreover, arrears with the World Bank and the IDB stop disbursement to approved projects, damaging their effectiveness. Given the importance to the GODR's current economic program and its international credit worthiness of continued good relations with the Fund, and the benefits expected from possible structural adjustment and sectoral programs with the World Bank and the IDB, it is critical that repayments be made to all of these organizations as scheduled.

Although the GODR can theoretically meet all of its debt payment obligations, as well as program targets for increased international reserves by purchasing dollars on the open market, such purchases will put pressure on the balance of payments and the exchange rate and add to inflation at the same time that additional foreign exchange is needed to finance the large increases in imports necessary to underpin sustainability of emerging economic recovery. Significant rapid changes in the exchange rate or inflation could seriously undermine the GODR's reform program credibility and result in widespread political pressure to moderate or abandon the reform program, thereby reversing the progress purchased at very high political and economic costs over the past thirteen months.

The Mission considered utilization of ESF resources as financing for a commodity import program. However, a commodity import program would be a short-term program with one shot financing of many commodities that in large part would be imported from the U.S. without the program, since the U.S. is the Dominican Republic's largest trading partner. A use of ESF cash transfers that will provide assurances of raising the medium-to long-term growth path for imports, as will be the case if the dollars are used to service IFI debt, should be preferred. In addition, using ESF resources to pay down IFI debt is consistent with the GODR's medium term debt reduction program consisting of debt buy-back from foreign commercial banks at large discounts, the Mission supported debt conversion program, U.S. debt forgiveness expected from GODR participation in the Enterprise for the Americas Initiative, and tightened guidelines and improved monitoring for assumption of future external credit obligations.

For the past several years, GODR spending on basic social services, including education and health, has been severely curtailed. The GODR is now evaluating the consequences of this neglect, and is expected to attempt reversal of the damage as resources become available. Using the dollars generated from ESF cash transfers to service IFI debt will free up funding so as to allow for immediate attention to improving basic social services critical to enhancing the quality of the country's pool of human capital.

The Mission has analyzed the short-term and long-term impacts of the GODR's economic reform program. The major adverse impact on income and employment has already occurred. Over the course of the past year, the poor have increased in number, and the overall level of health and nutrition has declined. The GODR has responded with increased food subsidies, but targeted them only at the poorest groups of the population. Middle income families have also been affected, particularly since subsidies on petroleum products, electricity, and other products produced or controlled by the government have been reduced or eliminated.

At the same time, however, a significant redistribution of income from the country's elite to lower and middle income families may be occurring due to such actions as increasing the personal income tax exemption, significant lowering of customs duties and the removal of wide-spread exonerations on imported inputs for relatively high cost import substitution activities. Inflation has been stopped, and for many products, significant price reductions have occurred in recent months. The short-term negative impacts that over the past year were necessary corrections to an unsustainable pattern of high aggregate expenditure, including expenditure for many luxury products that has now been moderated. Although the burdens of the necessary adjustments may not be considered "equitable" by all parties concerned, there has been a concerted attempt on the part of the government to spread these burdens as widely as possible over a necessarily short period of time. When economic recovery occurs, it is expected that growth will be higher and more sustainable than in the past, and that the distribution of the benefits of this growth will be more broadly based.

B. Conditionality

The focus of conditionality would be on sustained implementation of the central elements of the GODR's reform program, including the financial programming targets of the stand-by. Complementary conditionality that would support other elements of the of GODR program and be consistent with the Mission's strategic objectives and Action Plan policy work plan would also be negotiated.

1. Condition Precedent to First Disbursement

The condition precedent to first disbursement of ESF program resources would be evidence satisfactory to AID that the GODR has sustained implementation of the principal elements of its economic program, including compliance with the fiscal and monetary targets of the stand-by arrangement, maintenance of a unified market-determined exchange rate and market-determined financial system interest rates.

The conditions precedent to disbursement of the remaining two tranches would include the condition precedent discussed above, but will refer to meeting the condition again at the date of each disbursement.

2. Possible Additional Conditions Precedent

Complementary conditionality proposed to be negotiated with the GODR would focus on policies to support structural reforms designed to improve allocative efficiency and attract investment needed to restore growth to the Dominican economy. These conditions would support actual implementation of the GODR reform program objectives articulated in the Letter of Intent to the IMF and in ongoing negotiations with USAID. It must be emphasized that while the IMF stand-by will require compliance with the fiscal and monetary targets (Table 5), it will not require implementation of the other proposed reforms. Hence ESF could play a significant role in ensuring that these proposals are actually implemented.

The proposed conditionality would be finalized in consultation with the GODR and be drawn from the menu of proposed reforms discussed below, including reform of the investment code, adoption of regulations affecting private power investments, privatization of state-owned enterprises, elimination of price controls, civil service reform, tax reform, customs administration reform, and Paris Club and commercial bank debt restructuring. The final negotiated conditionality would be sent for AA/LAC concurrence before actual obligation of the grant funds.

a. -- Revised Investment Code:

The GODR's program specifically commits the GODR to implement measures to encourage foreign investment, including liberalization of profit repatriation controls. The conditions necessary for attracting needed foreign investment include clear rules of the game with respect to the kinds of investment permitted, registration of investment costs, and profit repatriation.

The deficiencies of Law 861 dealing with foreign investment should be corrected soon. The rules for repatriation of an investment registered with the GODR, recognition of capital gains, reinvestment of profits and repatriation of profits are restrictive. Modification of Law 861 to reduce these restrictions would substantially enhance the ability of the country to attract substantially increased flows of direct foreign investment and improve Dominican competitiveness by reducing barriers to entry in a wide range of productive activities.

-- Proposed CP for the second tranche: Evidence that the GODR has established a high level Investment Code Reform Committee of GODR officials and private sector representatives to prepare draft legislation reforming the Investment Code (Law 861). Such evidence would include an official announcement of the representatives appointed to the committee and the objectives of the committee.

-- Proposed CP for third tranche: Evidence that the GODR has appropriately reviewed all proposals of the Investment Code Reform Committee and has prepared and forwarded to the Dominican Congress draft legislation reforming the Investment Code.

b. -- Promulgate Electric Power Implementing Regulations:

USAID has collaborated with the GODR the past three years to develop new legislation and a regulatory framework that would permit and encourage private investment in the electric power sector. Legislation establishing incentives for private sector investment in electric power projects was promulgated in February 1990. This legislation, Law 14-90, also established a new agency to coordinate and regulate commercial activities in the electric power sector. USAID responded with a special technical assistance project with the objectives of assisting the GODR to develop sound implementing regulations for Law 14-90 and provide assistance in the initial organization and start-up of the new regulatory agency.

Adequate draft implementing regulations resulting from this assistance are available but have not yet been promulgated. Promulgation of these regulations is essential to clarify and focus implementation of the legislation. Significant new private investment is unlikely to occur until these regulations have been promulgated.

Since Law 14-90 requires repeal or substitution of any other law or part of a law contrary to it, the implementing regulations of other legislation and monetary authority resolutions will also need to be amended to incorporate the provisions of Law 14-90 and corresponding implementing regulations.

-- Proposed CP for the second tranche: Evidence that the GODR has promulgated sound implementing regulations for Law 14-90 and that contradictory laws and regulations have been appropriately modified.

-- Proposed CP for the third tranche: Evidence that the GODR is fully implementing the promulgated implementing regulations for Law 14-90.

c. -- Privatization:

Divestiture of some state-owned enterprises, including efforts to privatize the Dominican Electric Power Company (CDE) and authorization of the sale of stock of the national airline and the state-owned glass company, are stated objectives of the Letter of Intent. There are companies that can be sold quickly to interested Dominican investors, in particular, the National glass factory, for which preliminary negotiations have already occurred. It is understood that should the government divest the glass factory, the expected purchasers are prepared to make substantial additional investments to modernize and expand installed capacity. ESF conditionality in support of this sale could break the ice in this politically sensitive area and pave the way for further privatization actions.

Some progress has already been made with efforts to privatize CDE in order to increase further the efficiency of its operations. CDE recently invested in a joint venture for a small power plant on the North Coast with private investors, and intends to contract certain operations such as meter reading and revenue collections with private sector managers. Options for eventual divestiture of CDE are being considered, but actual sale of the company is not likely over the near-term.

-- Proposed CP for the second tranche: Evidence that the GODR has initiated sale of the state-owned glass factory, or made other equivalent progress with a privatization acceptable to USAID.

-- Proposed CP for the third tranche: Evidence that the electric company (CDE) has been converted to a stock company, that all CDE debt obligations had been assumed by the GODR, that all sales proceeds in excess of debt service needs were being transferred to CDE for internal investment, that at least 5 percent of the shares had been placed for sale on the private market, and that an official public notice has been given of a schedule for selling a majority of shares to the public within two years.

d. -- Elimination of Price Controls:

The Letter of Intent indicates that the government intends to eliminate all remaining price controls as permitted by economic conditions and the availability of resources. Although price controls on most products were not generally enforced during 1990, and recent over-all price deflation has obviated the need for active enforcement, it is unlikely that remaining price controls will be removed during 1991. Politically, the government needs popular perception that the economy is recovering from the current recession, and implementation of a safety net for the poorest groups of society in order to remove price controls, even though removal of price controls would not significantly affect prices actually charged for nominally controlled products. Assuming the projected recovery occurs in 1992, price controls could be eliminated and the price control office closed. ESF conditionality could ensure that this occurs.

-- Proposed CP for the third tranche: Evidence that all price controls have been eliminated and the price control office closed. Such evidence would include the issuance of a decree or official public notice eliminating all price controls and the actual closure of the price control office.

e. -- Civil Service Reform:

The Letter of Intent refers to enabling the Dominican Republic to compete more effectively in an increasingly integrated international environment through an enhanced role for private sector initiative supported by an efficient public sector. Moreover, the Letter of Intent attributes recent declines in tax collections in part to problems of administration and control.

Legislation for civil service reform (Law 14-91) was recently approved by the Congress and promulgated by the executive. An efficient, professional civil service is the main objective of the recently promulgated civil service legislation. The legislation specifically identifies Customs and the Ministry of Finance as priority areas for initial implementation. Moreover, the Minister of Finance has recently indicated willingness to move quickly to implement priority reforms in her offices. A work plan has been developed to draft implementing regulations to be completed over a period of two years. Core implementing regulations could be completed in about six months. Their timely completion could be ensured by ESF conditionality.

-- Proposed CP for the second tranche: Evidence that core implementing regulations for civil service reform in Customs and the Ministry of Finance and Customs have been completed.

-- Proposed CP for the third tranche: Evidence acceptable to USAID of satisfactory progress with the GODR's preparation of remaining implementing regulations for civil service reform.

f. -- Tax Reform Legislation:

The GODR has indicated that it intends to submit to the Congress a tax reform package that will include measures to further reduce customs exonerations, increase the rates and broaden the base of the value added tax, broaden the base for individual and business income tax, and continue to replace specific taxes with ad valorem taxes. ESF conditionality in support of this could prevent further delay of this important tax legislation.

-- Proposed CP for the second tranche: Evidence that the GODR has submitted draft tax reform legislation to the Dominican Congress.

g. -- Customs Administrative Reform

Although the GODR has recently reduced the number of steps required to clear merchandise, customs administration remains a serious bottleneck to increased trade flows. It can take up to 60 days to clear customs.

-- Proposed CP for the third tranche: Progress acceptable to USAID of advances in reducing the time required for clearing merchandise.

h.-- Debt Restructuring

Arrears to the Paris Club donors and commercial banks block the resumption of capital flows into Dominican Republic. USG debt forgiveness under the Enterprise for the America's Initiative requires a satisfactory arrangement with commercial banks. Paris Club rescheduling is expected to be completed by the end of 1991, and commercial bank rescheduling should be finalized sometime during the first half of 1992. Because these negotiations require the agreement of many third parties, it probably would not be constructive to impose conditionality requiring completion of negotiations. But good-faith efforts on the part of the GODR could be required.

-- Proposed CP for the second and third tranches: Evidence acceptable to USAID that the GODR is making all good-faith efforts required to negotiate satisfactory debt restructuring with the Paris Club and commercial banks.

C. Negotiating Strategy

The above proposed conditionality is illustrative of the final conditionality that the Mission proposes to negotiate with the GODR. Preliminary informal discussions with various GODR officials suggest that once official negotiations are approved by the DAEC, conditionality similar to the above will be agreed to. However, the Mission fully expects that there will be some significant changes, including the deletion of some sensitive conditions and/or their substitution by alternatives developed during negotiations. Once the final conditionality has been negotiated, the Mission will seek the concurrence of the AA/LAC before obligating FY 1992 ESF funds.

The menu of proposed conditionality includes measures important to the sustained implementation of the GODR's reform program. The common element of all the conditionality components is that they have been described in the GODR's Letter of Intent or are related. However, the Stand-by program only requires performance with respect to financial programming targets. The Mission believes that ESF conditionality can enhance the prospects for actual implementation of the financial programming targets and the policy reform components of the GODR's over-all program begun in August 1990.

The Mission believes that approval of the PAAD for FYs 1991-92 at the 40 million dollar level will significantly enhance the prospects for successful negotiation and sustained implementation of a comprehensive package of policy reforms. It will also help to pull the economy out of the current recession and restore rapid, sustained growth needed to reduce unemployment and poverty.

VI. Program Financial Plan and Accountability

A. Implementing Arrangements

The Grantee would be the GODR represented by the Technical Secretariat of the Presidency (TSP) and the Central Bank. The TSP and Central Bank will ensure that all documentation necessary to monitor policy performance under the ESF program will be made available to USAID. The Central Bank will establish an uncommingled separate account for the dollars and maintain all documentation necessary for audit purposes. The project will be managed by USAID's Office of Policy and Democratic Initiatives. The Controller's Office will provide oversight of the GODR's dollar uses and USAID's use of the local currency for the OE Trust Fund.

B. Dollar Uses and Financial Oversight

The proposed 10 million dollars in FY 1991 ESF and 30 million dollars of FY 1992 ESF would be provided in three tranches. The first tranche of 10 million dollars is expected to be disbursed in October 1991, the second for 15 million dollars in February 1992, and the third for 15 million dollars in August 1992. The USG will deposit its ESF contribution in an uncommingled "Separate Account" in the name of the Central Bank of the D.R. in a designated bank until it is a withdrawn by the GODR for the purpose of making debt payments. The GODR will commit to repaying the IFIs and the USG directly from the Separate Account. The GODR will also agree to provide USAID with a monthly statement from the account, copies of telex orders relating to withdrawals from the account which indicate the institution and loan number for which payment is made, and copies of the telex receipt of funds from the IFI paid. With this documentation, USAID will track and monitor that funds are used only for eligible transactions. The ESF agreement will contain a redeposit clause in the event that a withdrawal is made for an ineligible use. The account will be interest bearing, and interest earned will also be used to make debt payments.

Disbursement into the Separate Account - Once the Dominican Republic has complied with the conditions precedent to disbursement for each tranche of the cash transfer program, the associated dollar funds will be deposited into the GODR's Separate Dollar Account (in the name of the Central Bank of the D.R.) in the designated bank and will be recognized as expenditure once so deposited. The account will be interest-bearing.

C. Local Currency Use

The Central Bank of the Dominican Republic will deposit the peso equivalent of up to 10 percent of each dollar disbursement into the account of the USAID OE Trust Fund to help cover operating expenses. The deposits will be made within thirty (30) days of the dollar disbursements and will use the highest not-illegal exchange rate on the day of the disbursement.

DRDAT2: LAC/DPP
8/91

TABLE I

DOMINICAN REPUBLIC: POPULATION, NAT'L ACCOUNTS and PRICES 1980-92

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | Prog 1991 | Prog 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| POPULATION | | | | | | | | | | | | | |
| Thousands | 5697 | 5836 | 5977 | 6122 | 6268 | 6416 | 6564 | 6712 | 6859 | 7017 | 7178 | 7343 | 7512 |
| Growth Rate | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.3 | 2.3 | 2.2 | 2.3 | 2.3 | 2.3 | 2.3 |
| NATIONAL ACCOUNTS | | | | | | | | | | | | | |
| GDP, curr. prices (mill pesos) | 6631 | 7267 | 7964 | 8623 | 10355 | 13973 | 15780 | 19536 | 28353 | 42393 | 60555 | 95923 | 114140 |
| GDP, 1980 prices (mill. pesos) | 6631 | 6905 | 7031 | 7398 | 7435 | 7244 | 7475 | 7966 | 8021 | 8346 | 7920 | 7920 | 8158 |
| Real GDP Growth Rate (%) | 6.1 | 4.1 | 1.8 | 5.2 | 0.5 | -2.6 | 3.2 | 6.6 | 0.7 | 4.1 | -5.1 | 0.0 | 3.0 |
| Real Per Capita GDP | 1164 | 1183 | 1176 | 1208 | 1186 | 1129 | 1139 | 1187 | 1169 | 1189 | 1103 | 1079 | 1086 |
| Real PC GDP Growth Rate (%) | 3.6 | 1.7 | -0.6 | 2.7 | -1.8 | -4.8 | 0.9 | 4.2 | -1.5 | 1.7 | -7.2 | -2.2 | 0.7 |
| Gross Domestic Investment/GDP | 24.9 | 23.4 | 20.3 | 21.2 | 21.4 | 19.5 | 19.7 | 25.2 | 22.8 | 20.2 | 16.1 | 15.7 | 17.3 |
| Private | 19.7 | 18.8 | 16.4 | 17.9 | 17.7 | 15.0 | 16.1 | 15.5 | 12.6 | 10.2 | 8.7 | 10.2 | 11.4 |
| Public | 5.2 | 4.5 | 3.9 | 3.3 | 3.6 | 4.5 | 3.6 | 9.7 | 10.2 | 10.0 | 7.4 | 5.5 | 5.9 |
| Gross National Savings/GDP (%) | 14.8 | 17.8 | 14.0 | 16.3 | 14.8 | 15.0 | 15.9 | 18.5 | 20.5 | 15.6 | 13.3 | 13.6 | 15.4 |
| Private | 13.3 | 17.3 | 15.3 | 17.6 | 17.8 | 11.8 | 17.6 | 12.9 | 15.4 | 10.6 | 11.0 | 10.2 | 11.1 |
| Public | 1.5 | 0.5 | -1.3 | -1.3 | -3.0 | 3.2 | -1.7 | 5.6 | 5.1 | 5.0 | 2.3 | 3.4 | 4.3 |
| Foreign Savings/GDP (%) | 10.1 | 5.6 | 6.3 | 4.9 | 6.6 | 4.5 | 3.8 | 6.7 | 2.3 | 4.6 | 2.8 | 2.1 | 1.9 |
| PRICES | | | | | | | | | | | | | |
| GDP Price Deflator | 100.0 | 105.2 | 113.3 | 116.6 | 139.3 | 192.9 | 211.1 | 245.2 | 353.5 | 507.9 | 764.6 | 1211.1 | 1399.2 |
| Annual Change (%) | 13.7 | 5.2 | 7.7 | 2.9 | 19.5 | 38.5 | 9.4 | 16.2 | 44.2 | 43.7 | 50.5 | 58.4 | 15.5 |
| Consumer Prices (Dec.) | 100.0 | 107.5 | 115.8 | 129.7 | 179.1 | 229.8 | 244.7 | 305.9 | 482.1 | 677.4 | 1359.4 | 1577.0 | 1742.5 |
| Annual Change (%) | 16.7 | 7.5 | 7.7 | 12.0 | 38.1 | 28.3 | 6.5 | 25.0 | 57.6 | 40.5 | 100.7 | 16.0 | 10.5 |
| Exchange Rate (Annual Average) | 1.0 | 1.0 | 1.1 | 1.3 | 2.1 | 3.1 | 2.9 | 3.8 | 6.1 | 6.30 | 8.54 | 12.5 | 13.8 |
| Depreciation (-, %) | 0.0 | 0.0 | -8.3 | -13.5 | -38.8 | -33.8 | 7.2 | -24.5 | -37.0 | -3.2 | -26.2 | -31.7 | -9.1 |

DRDAT3: LAC/DPP
8/91

TABLE II
DOMINICAN REPUBLIC: BALANCE OF PAYMENTS 1980-92
(In millions of US$)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | Prog 1991 | Prog 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BALANCE OF PAYMENTS (mill. US$) | | | | | | | | | | | | | |
| Current Account | -675 | -423 | -458 | -441 | -372 | -315 | -231 | -431 | -171 | -396 | -261 | -212 | -215 |
| Trade Balance | -558 | -264 | -490 | -497 | -422 | -548 | -630 | -880 | -718 | -1039 | -1057 | -976 | -1061 |
| Exports fob | 962 | 1188 | 768 | 785 | 835 | 739 | 722 | 711 | 890 | 925 | 735 | 775 | 806 |
| Imports fob | -1520 | -1452 | -1257 | -1282 | -1257 | -1285 | -1352 | -1592 | -1608 | -1964 | -1792 | -1751 | -1867 |
| Services (net) | -300 | -335 | -158 | -139 | -156 | -9 | 157 | 189 | 258 | 343 | 481 | 435 | 503 |
| Private Transfers | 183 | 176 | 190 | 196 | 205 | 242 | 242 | 260 | 289 | 301 | 315 | 330 | 343 |
| Capital Account | 536 | 321 | 150 | 78 | 218 | 779 | 130 | -127 | -43 | 165 | -246 | 64 | 70 |
| Official Transfers | 5 | 17 | 15 | 20 | 60 | 114 | 29 | 95 | 65 | 84 | 56 | 56 | 75 |
| Official Capital (net) | 366 | 174 | 226 | 72 | -19 | 429 | -279 | -320 | -235 | -16 | -302 | -57 | -75 |
| Direct Investment | 63 | 80 | -1 | 48 | 69 | 37 | 50 | 89 | 106 | 110 | 133 | 145 | 150 |
| Other Private (including errors and omissions) | 103 | 50 | -90 | -62 | 108 | 199 | 330 | 8 | 21 | -14 | -132 | -80 | -80 |
| Other | 31 | -8 | -3 | -3 | -7 | -32 | -48 | 184 | 1 | -221 | 0 | 0 | 0 |
| Overall Balance | -107 | -110 | -311 | -366 | -162 | 432 | -149 | -375 | -213 | -452 | -507 | -148 | -145 |
| EXTERNAL DEBT | | | | | | | | | | | | | |
| Outstanding, Dec. 31 | 1929 | 2222 | 2788 | 3164 | 3403 | 3638 | 3874 | 3754 | 3893 | 3893 | 4482 | 4673.1 | 4824.6 |
| Outstanding/GDP (%) | 29 | 31 | 41 | 46 | 64 | 78 | 69 | 61 | 61 | 61 | 63 | 65.0 | 65.7 |
| Debt Service ratio (%) | 22 | 24 | 33 | 27 | 38 | 27 | 35 | 28 | 26 | 26 | 33 | 15.8 | 13.4 |
| Arrears, Dec. 31 | | | | | | 139 | 179 | 346 | 503 | 788 | 1479 | | |

Sources: IMF Article IV, Dec. 1989, World Tables 1989-90, USAID 8/90 & 1/91.

DRDAT4: LAC/DPP
8/91

TABLE III

DOMINICAN REPUBLIC: PUBLIC SECTOR OPERATIONS 1980-92

(In millions of Dominican Pesos)

| Concepts\Years | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | Prog 1991 | Prog 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP, curr. prices (mill pesos) | 6631 | 7267 | 7964 | 8623 | 10355 | 13973 | 15780 | 19536 | 28353 | 42393 | 60555 | 95923 | 114140 |
| PUBLIC SECTOR OPERATIONS (mill pesos) | | | | | | | | | | | | | |
| Total Revenue | 977 | 1009 | 880 | 1074 | 1447 | 2401 | 2167 | 3273 | 5293 | 7163 | 7527 | 11576.0 | 14741.8 |
| Current Expenditures | 865 | 958 | 941 | 998 | 1125 | 2155 | 1808 | 1880 | 2620 | 4467 | 6009 | 8671.3 | 10202.2 |
| Capital Expenditures | 513 | 471 | 310 | 432 | 437 | 941 | 815 | 2178 | 4386 | 4788 | 4406 | 5245.4 | 6090.9 |
| Central Bank Losses | na | na | na | na | 283 | 70 | 365 | 267 | 768 | 77 | | | |
| Residual Deficit | | | | | 353 | 12 | 231 | 161 | 711 | 728 | 389 | 24.9 | 24.9 |
| Deficit before Grants(commitments) | -397 | -448 | -558 | -433 | -756 | -677 | -1052 | -1214 | -2192 | -2895 | -3367 | -2366 | -2182 |
| Grants | | | | | 60 | 348 | 129 | 222 | 240 | 265 | 265 | 359.0 | 359.0 |
| Deficit after Grants (commitments) | | | | | -696 | -329 | -924 | -992 | -1952 | -2630 | -3102 | -2007 | -1823 |
| Interest Arrears | na | na | na | na | 0 | 197 | 151 | 228 | 320 | 1097 | 1898 | 0.0 | 0.0 |
| Financing | 397 | 448 | 558 | 361 | 696 | 132 | 773 | 764 | 1632 | 1533 | 1204 | 2007 | 1823 |
| Foreign | 297 | 106 | 174 | 78 | 332 | 535 | 247 | 166 | 277 | 784 | 341 | 2007 | 1923 |
| Domestic | 100 | 343 | 383 | 283 | 365 | -403 | 526 | 598 | 1355 | 749 | 863 | 0 | -100 |
| PUBLIC SECTOR OPERATIONS (% GDP) | | | | | | | | | | | | | |
| Total Revenue | 14.7 | 13.9 | 11.0 | 12.5 | 14.0 | 17.2 | 13.7 | 16.8 | 18.7 | 16.9 | 12.4 | 12.1 | 12.9 |
| Current Expenditures | 13.0 | 13.2 | 11.8 | 11.6 | 10.9 | 15.4 | 11.5 | 9.6 | 9.2 | 10.5 | 9.9 | 9.0 | 8.9 |
| Capital Expenditures | 7.7 | 6.5 | 3.9 | 5.0 | 4.2 | 6.0 | 5.2 | 11.1 | 11.9 | 11.3 | 7.4 | 5.5 | 5.9 |
| Central Bank Losses | 0.0 | 0.0 | 0.0 | 0.0 | 2.7 | 0.5 | 2.3 | 1.4 | 2.7 | 0.2 | 0.0 | 0.0 | 0.0 |
| Residual Deficit | 0.0 | 0.0 | 0.0 | 0.0 | 3.5 | 0.1 | 1.5 | 0.8 | 2.5 | 1.7 | 0.6 | 0.0 | 0.0 |
| Deficit before Grants(commitments) | -6.0 | -6.2 | -7.0 | -5.0 | -7.3 | -4.8 | -6.7 | -6.2 | -7.7 | -6.8 | -5.6 | -2.5 | -1.9 |
| Grants | 0.0 | 0.0 | 0.0 | 0.0 | 0.6 | 2.5 | 0.8 | 1.1 | 0.8 | 0.6 | 0.4 | 0.4 | 0.3 |
| Deficit after Grants (commitments) | 0.0 | 0.0 | 0.0 | 0.0 | -6.7 | -2.4 | -5.9 | -5.1 | -6.9 | -6.2 | -5.1 | -2.1 | -1.6 |
| Interest Arrears | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 1.4 | 1.0 | 1.2 | 1.1 | 2.6 | 3.1 | 0.0 | 0.0 |
| Financing | 6.0 | 6.2 | 7.0 | 4.2 | 6.7 | 0.9 | 4.9 | 3.9 | 5.8 | 3.6 | 2.0 | 2.1 | 1.6 |
| Foreign | 4.5 | 1.5 | 2.2 | 0.9 | 3.2 | 3.8 | 1.6 | 0.9 | 1.0 | 1.9 | 0.6 | 2.1 | 1.7 |
| Domestic | 1.5 | 4.7 | 4.8 | 3.3 | 3.5 | -2.9 | 3.3 | 3.1 | 4.8 | 1.8 | 1.4 | 0.0 | -0.1 |

DRDATS: IAC/ODP
8/91

TABLE IV

DOMINICAN REPUBLIC: SUMMARY OPERATIONS OF THE CENTRAL BANK AND THE CONSOLIDATED BANKING SYSTEM 1986-92

(In millions of Dominican Pesos)

| Concepts\Years | 1986 | 1987 | 1988 | 1989 | 1990 | Prog 1991 | Prog 1992 |
|---|---|---|---|---|---|---|---|
| CENTRAL BANK | | | | | | | |
| Net Foreign Assets (End of Period) | -517.0 | -1427.0 | -1019.8 | -1731.3 | -2215.4 | -1772.9 | -526.8 |
| Net Domestic Credit | 2781.0 | 3531.0 | 4711.8 | 6622.1 | 10242.7 | 12255.6 | 13229.5 |
| Public Sector | 1982.0 | 2675.0 | 3876.0 | 4517.6 | 5498.2 | 7018.3 | 7886.7 |
| Other | 799.0 | 856.0 | 835.8 | 2104.5 | 4744.5 | 5237.3 | 5342.8 |
| Liabilities with the Private Sector | 949.0 | 1321.0 | 1886.0 | 2722.0 | 4022.1 | 4306.5 | 4738.1 |
| Currency in Circulation | 937.0 | 1313.0 | 1876.0 | 2664.5 | 3717.2 | 4284.4 | 4712.8 |
| Demand Deposits | 11.0 | 8.0 | 42.9 | 42.0 | 39.5 | 15.3 | 10.0 |
| Net Domestic Assets * | 1454.0 | 2740.0 | 2895.8 | 4395.8 | 5932.6 | 6057.3 | 5239.6 |
| * (Currency in Circul. - NFA) | | | | | | | |
| CONSOLIDATED BANKING SYSTEM | | | | | | | |
| Net Foreign Assets (End of Period) | -503 | -1276 | -443 | -1138 | -1602.3 | -949.0 | 352.4 |
| Net Domestic Credit | 5850 | 7615 | 9437 | 14519 | 20095.8 | 24072.3 | 26669.8 |
| Public Sector | 2456 | 3051 | 4407 | 5155 | 6017.9 | 7538.0 | 8406.4 |
| Private Sector | 2657 | 3324 | 4345 | 6701 | 8943.7 | 10648.6 | 12057.9 |
| Other | 356 | 723 | 745 | 2663 | 5134 | 5886 | 6206 |
| Private Capital and Surplus | 381.0 | 517.0 | - | - | - | - | - |
| Liabilities with the Private Sector | 4584.0 | 5392.0 | 8672.0 | 11602.0 | 15527.5 | 18329.4 | 20811.4 |
| Money (M3) | 4203.0 | 4876.0 | 7845.0 | 10497.9 | 13923.2 | 16635.4 | 19117.4 |
| Currency in Circulation | 937.0 | 1313.0 | 1876.0 | 2664.5 | 3717.2 | 4284.4 | 4712.8 |
| Demand Deposits | 899.0 | 1157.0 | 2215.0 | 2350.0 | 3373.0 | - | - |
| Time and Savings Deposits | 1890.0 | 1885.0 | 2846.0 | 4176.0 | 5817.0 | - | - |
| Other Liabilities (net) | 477.0 | 521.0 | 908.0 | 1307.4 | 1016.0 | - | - |
| Net Domestic Assets (M3-NFA) | 4706.0 | 6152.0 | 8287.8 | 11635.3 | 15525.5 | 17584.4 | 18765.0 |

ORDAT6: LAC/DPP

8/91

TABLE V

DOMINICAN REPUBLIC: Performance Criteria for Stand-By Arrangement in 1991

| Details | June 30 | September 30 | December 31 |
|---|---|---|---|
| | (In millions of Dominican Pesos) | | |
| Net Credit of the Central Bank and the Banco de Reservas to the Nonfinancial Public Sector | | | |
| Ceiling | 900 | -500 | - |
| Net Domestic Assets of the Monetary Authorities (effective flows) | | | |
| Ceiling | -1,200 | -900 | -500 |
| Overall deficit of the Nonfinancial Public Sector | | | |
| Ceiling | 910 | 1,550 | 2,007 |
| | (In millions of U.S. dollars) | | |
| Net foreign borrowing by thePublic Sector | | | |
| Ceiling | 45 | 45 | 45 |
| Subceiling | 10 | 10 | 10 |
| Net International Reserves of the Monetary Authorities | | | |
| Floor | 100 | 90 | 80 |
| Reduction in Nonrestructurable Arrears through cash payments | | | |
| Target | - | 20 | 80 |

Sources : DR Authorities and IMF staff estimates.

AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

# ENVIRONMENTAL THRESHOLD DECISION

| | | |
|---|---|---|
| Project Location | : | Dominican Republic |
| Project Title | : | Investment and Trade Expansion Program |
| Project Number | : | 517-0263 |
| Funding | : | 40.0 million (ESF) |
| Life of Project | : | 2 years (FY 91-92) |
| IEE Prepared by | : | Douglas A. Chiriboga<br>Acting Deputy Director, USAID/Dominican Republic |
| Recommended Threshold | : | Categorical Exclusion |
| Bureau Threshold Decision | : | Concur with Recommendation |
| Comments | : | None |
| Copy to | : | Jeffrey Evans, LAC/DR |
| Copy to | : | Gussie Daniels, LAC/CAR |
| Copy to | : | James Hradsky, LAC/DR/CAR |
| Copy to | : | IEE file |

____________ Date________
James Hester
Deputy Environmental Officer
Bureau for Latin America and the Caribbean

Agency for International Development
Washington, D.C. 20523

INITIAL ENVIRONMENTAL EXAMINATION

| | | |
|---|---|---|
| Project Location | : | Dominican Republic |
| Project Title | : | Investment and Trade Expansion |
| Project Number | : | 517-0263 |
| Funding | : | $40 million (ESF) |
| Life of Project | : | 2 Years (FY91 and FY92) |
| IEE Prepared by | : | Douglas A. Chiriboga<br>Acting Deputy Director, USAID/DR |

Recommended Threshold Decision:

a. Recommendation:

After repeated ad hoc attempts to deal with the deteriorating policy environment, in August 1990, the Government of the Dominican Republic (GODR) initiated a comprehensive economic reform program that has produced dramatic results. Domestic financing of the public sector deficit has been eliminated. A tight monetary policy, positive real interest rates coupled with the adoption of a unified market-determined exchange rate have produced price and exchange rate stability, increased the net international reserves, and the reduction of arrears to the International Financial Institutions (IFI)s. However, the short-term costs of the program in terms of economic recession and increasing unemployment are serious constraints to its sustained implementation without increased assistance from the donors. A.I.D. will support the sustained implementation of the reform program and the recently initiated stand-by arrangement with the IMF with the ESF resources in FY91 and FY92. The ESF resources will be provided in the form of a cash transfer to help the GODR meet its debt service to the IFIs and the United States Government. Disbursements will be made in three tranches, after the GODR satisfies certain conditionalities. Condition Precedent to disbursement of the first tranche would be the sustained implementation of the economic reform program and the stand-by arrangement with the IMF. Conditionalities for the second and thirds tranches would focus on policies to support structural reform designed to attract investments needed to restore growth to the Dominican economy, and continued compliance with sustained implementation of the economic reform program and the IMF stand-by arrangement. The only local currency generated under the program will be up to 10% of the amounts obligated for the Mission's operating expense trust fund.

Pursuant to A.I.D. environmental regulations [22 CFR Part 216.2 (c) (1) (i) and (ii)], no further environmental review is required and a categorical exclusion applies when:

(i) "The action does not have an effect on the natural or physical environment;" and
(ii) "A.I.D. does not have knowledge of or control over, and the objective of A.I.D. in furnishing assistance does not require, either prior to approval of financing or prior to implementation of specific activities, knowledge of or control over, the details of the specific activities that have an effect on the physical and natural environment for which financing is approved by A.I.D."

Based on A.I.D. regulations in Handbook 3, Chapter 2, the A.I.D. Mission to the Dominican Republic recommends that no further environmental study be undertaken for this PAAD and that a "categorical exclusion" be approved.

Concurrence: Raymond L. Ritenburg
Raymond Ritenburg, Director
USAID/Dominican Republic

draft:DAChiriboga