

PD-NAO-901
154 2-74

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

APR 29 1987

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR, LAC

FROM : LAC/DR, ~~Terrence J. Brown~~ *TJ*

SUBJECT : PAAD for FY87 Balance of Payments Support to the Dominican Republic

Action Requested: Your authorization of \$19.835 million for balance of payments support to the Dominican Republic is requested.

Background: In its FY87 Action Plan, the USAID/DR set forth its objective, performance benchmarks and related conditionality for FY87 program assistance. The proposal was accepted as a basis for preparation of the PAAD, which was presented for review in December, 1986. Since the Action Plan review there was an electoral process and installation of a new government in August, 1986. In the waning months of the outgoing administration there was significant monetary growth during FY86, and a resurgence of inflation. The new administration re-installed price controls on certain commodities, and changed spending priorities to favor investment over current spending. Overall, economic growth is somewhat below the projections in the Action Plan, and could further deteriorate by GODR failure to continue to maintain a viable macro-economic policy framework.

The PAAD proposed a \$20 million grant to the GODR. Maintenance of a viable macro-economic framework would be assured by covenants relating to monetary, exchange rate, and fiscal policies; long-term structural policies; and local currency uses. The major uses of the local currency will be for free zone expansion, agricultural credit guarantees, agricultural technology development, public works, and PVO support, mainly for small businesses. The Mission proposed that an additional contribution to the O.E. Trust Fund not be required. USAID/DR is fully covering local currency OE costs from the Trust Fund, but needs additional dollar OE budget.

Discussion: The PAAD was reviewed by the DAEC on December 9, 1986. The basic thrust of the Mission's conditionality strategy was accepted. Some changes in the wording of the proposed covenants were agreed on. They basically make the intent of the covenants clearer and add numerical criteria for related performance measurement. It was agreed that targets for other key aspects of the GODR's macro-economic performance would be incorporated into the program agreement. Once obligated, the funds will be disbursed immediately, subject only to satisfaction of the standard legal Conditions Precedent. It was agreed to recommend to you approval of a \$19.835 million ESF grant for FY87. The \$20 million originally budgeted for the program was reduced by \$165,000 to finance local cost operating expenses.

Under previous agreements, the GODR has placed both dollars and local currency in separate accounts. This practice, which meets the recently established legislative requirements, will be continued. The PAAD has been modified to reflect this fact. At the review, PPC advised that Agency policy requires that balance of payments support be provided on a loan basis. It was agreed that A/AID would be requested to approve an exception to this policy as the Mission requested. The memo through which A/AID approved provision of the proposed assistance on a grant basis is attached (TAB A). The Mission Director assured us that the OE Trust fund has sufficient local currency, including funds for a new building for USAID/DR, to cover projected local currency OE costs into FY88, at least. In view of the large balance in the OE Trust fund, and the sharp drop in ESF this year, it was agreed that no additional contribution would be required as counterpart to the proposed assistance. The Mission prepared a facesheet as agreed at the issues meeting. A statutory checklist did not accompany the PAAD submission. The Mission has now transmitted it. LAC/DR and GC/LAC have added the paragraphs needed to incorporate FY87 legal requirements.

After the PAAD review, Treasury held up the apportionment due to concerns about the DR's overall economic program. Specifically, Treasury believed that the program presented in the PAAD was incompatible with reasonable progress on reducing debt arrearages on previously rescheduled debt. In the absence of an IMF approved macro-economic program, which would pave the way for negotiations on further rescheduling debt, Treasury felt that the GODR should have in place a program acceptable to appropriate U.S.G. agencies prior to obligation of the funds. The apportionment was completed after A.I.D. sent Treasury a letter (TAB B) which agrees that A.I.D. will consult with Treasury and other appropriate U.S.G. agencies prior to obligation of the funds.

The Mission has continued its extensive policy dialogue with the GODR on its macro-economic policies. On March 27, 1987, the Mission cabled (TAB C) a summary of the dialogue, expected results from the GODR's program, and a revised conditionality program. The cable provides evidence of good GODR progress in establishing a viable macro-economic program, including measures to reduce growth of the money supply so as to keep it at or below the inflation rate.

The revised program and a draft response were reviewed at a meeting held on April 13. The meeting was attended by Mission Director Bassford, representatives of Treasury, EB/OMA, ARA/ECP, ARA/CAR, and appropriate AID offices. Wording was subsequently agreed to on a cable (TAB E) which authorizes the Mission to begin negotiation of an agreement based on the program presented in the March 27 cable. Thus, the consultations promised in the McPherson-Mulford letter (TAB A) have now been completed. LAC/DP has determined that a Congressional Notification is not needed prior to obligation.

Recommendation: That you sign: (1) the PAAD facesheet (TAB D), which authorizes \$19.835 million for the Private Enterprise Sector Program (517-0171) for the Dominican Republic; and (2) a cable to USAID/DR (TAB F) which advises that the PAAD has been signed.

TAB A - Memo to A/AID on Grant funding
TAB B - McPherson to Mulford Letter
TAB C - Santo Domingo 03233
TAB D - PAAD
TAB E - Cable which authorizes negotiations
TAB F - Proposed Outgoing Cable

CLASSIFICATION:

AID 1724-1 (8-88)	DEPARTMENT OF STATE AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO.	517-0171, as amended 517-K-603A
		2. COUNTRY	Dominican Republic
		3. CATEGORY	Cash Transfer
		4. DATE	April 22, 1987
5. TO	AA/LAC, Dwight Ink	6. OYB CHANGE NO.	
7. FROM	LAC/DR, Terrence J. Brown	8. OYB INCREASE	
APPROVAL REQUESTED FOR COMMITMENT OF:		9. TO BE TAKEN FROM	Economic Support Funds
\$ 19,835,000		10. APPROPRIATION - ALLOTMENT	72-1171037
		BPC:LESA87-35517-KG31	
11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION EFFECTIVE DATE
<input checked="" type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT <input type="checkbox"/> INFORMAL <input checked="" type="checkbox"/> FORMAL <input type="checkbox"/> NONE		N/A	N/A
15. COMMODITIES FINANCED			

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: 19,835,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: 19,835,000	Other:

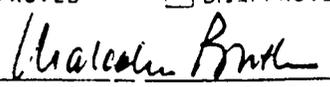
18. SUMMARY DESCRIPTION

The Grant will provide \$19.835 million for immediate balance of payments support to the Dominican Republic, facilitate GODR adherence to its ongoing macro-economic stabilization program, and support implementation of important actions underpinning USAID strategy in the areas of agricultural product marketing and pricing and diversification of government owned sugar land. The assistance will be obligated and disbursed subject to the satisfaction of standard CP's to disbursement (legal opinion and designation of authorized representatives).

The following covenants will be included in the agreement:

- Exchange rate policies. The GODR will covenant that it will maintain an exchange rate policy in which all transactions are at unified, market-determined rates of exchange between the Dominican peso and the currencies of other countries. The GODR will not impose additional controls on the purchase or holding of foreign exchange.
- Fiscal and Monetary Policies. The GODR will covenant that it will adopt measures sufficient to eliminate its domestically financed FY87 fiscal deficit. This will be interpreted to mean that the GODR will permit no net increase during FY87 in the combined banking system net lending to the public sector and losses of the Central Bank.

(continued on next page)

19. CLEARANCES	20. ACTION
LAC/DR: TJBrown 4/24	<input type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED
LAC/CAR: CCostello 4/22	 AUTHORIZED SIGNATURE DATE Assistant Administrator Bureau for Latin America and the TITLE Caribbean
LAC/DP: WWheeler 4/22	
GC/LAC: GDavidson 4/23	
PPC/EA: KKauffman 4/23	
ARA/ECP: DCleveland 4/23	
ARA/CAR: HEisner 4/23	
M/FM/CONT: CChristensen 4/24	

- Separate Accounts for Dollars and Local Currency. The GODR will deposit the U.S. Dollars in a separate account established for the Grant and will deposit an equivalent amount of Dominican Republic pesos in a separate peso account. The dollars in the special account will be used for private sector imports of raw materials, spare parts, machinery, and equipment during the nine months following the date of the disbursement by A.I.D. The pesos in the separate peso account will be used for mutually agreed upon, high priority development projects. The major expected uses are for free zone development, agricultural credit guarantees, agricultural technology development, public works, and PVO support, mainly for small businesses.

Prior to obligation the GODR will transmit its macro-economic program to USAID/DR. The program will contain performance targets for net domestic assets and net foreign assets of the Central Bank, banking system credit to the public sector, and new external public sector borrowing. The targets will be realistic and consistent with the above covenants and the objectives outlined in the PAAD and 87 Santo Domingo 3233.

USAID/DR FY-1987 ESF PAAD

A. SUMMARY

ESF RESOURCES IN THE AMOUNT OF \$25 MILLION ARE REQUESTED AS BALANCE OF PAYMENTS SUPPORT TO THE DOMINICAN REPUBLIC DURING FY-1987, TO BE DISBURSED AS A GRANT. IN ADDITION TO BALANCE OF PAYMENTS SUPPORT, THE REQUESTED ESF CASH TRANSFER WILL FACILITATE GODR ADHERENCE TO THE ONGOING MACRO-ECONOMIC STABILIZATION EFFORT, AND IMPLEMENTATION OF IMPORTANT POLICY ACTIONS UNDERPINNING USAID STRATEGY IN THE AREAS OF AGRICULTURAL PRODUCT MARKETING AND PRICING, AND FURTHER PROGRESS ON DIVERSIFICATION OF GOVERNMENT-OWNED SUGAR LAND. THE LOCAL CURRENCIES GENERATED BY THE PROGRAM WILL BE JOINTLY PROGRAMMED BY USAID AND THE GODR IN WAYS THAT DIRECTLY SUPPORT THE USAID STRATEGY OUTLINED IN THE APPROVED CDSS AND ACTION PLAN, WITH SPECIAL EMPHASIS ON PRIVATE SECTOR CREDIT NEEDS.

B. BACKGROUND

1. RECENT ECONOMIC PERFORMANCE

A PRINCIPAL CONCERN IN THE DOMINICAN REPUBLIC OVER THE PAST FIVE YEARS HAS BEEN HOW TO FORMULATE AND IMPLEMENT APPROPRIATE POLICIES AND ADJUSTMENT ACTIONS, NEEDED TO ASSURE MACRO-ECONOMIC STABILIZATION IN THE COUNTRY'S EXTERNAL AND INTERNAL ACCOUNTS. DURING THE 1982-1984 PERIOD, THE GODR DID NOT FULLY APPRECIATE THE MAGNITUDE OF REQUIRED ADJUSTMENT TO LARGE DECLINES IN THE VALUE OF TRADITIONAL COMMODITY EXPORTS, AND INCREASES IN THE FOREIGN EXCHANGE COST OF IMPORTS.

THE THRUST OF THE GODR RESPONSE WAS TO ATTEMPT TO PROTECT CONSUMPTION LEVELS FROM THE LARGE INCOME LOSSES RESULTING FROM DETERIORATING TERMS OF TRADE, BY EXPANDING SUBSIDY PROGRAMS AND INCREASING EXTERNAL BORROWING. ACCORDINGLY, EXTERNAL DEBT ROSE BY \$1 BILLION, OR 40 PERCENT, FROM \$2.5 BILLION AS OF END-1981, TO \$3.5 BILLION IN 1984.

EXTERNAL DEBT INCREASED FASTER THAN THE COUNTRY'S ABILITY TO SERVICE IT. BY THE END OF 1984, THE DOMINICAN REPUBLIC HAD EXTERNAL DEBT ARREARS OF MORE THAN \$0.5 BILLION, AND FACED ADDITIONAL SCHEDULED DEBT SERVICE OF \$1.1 BILLION IN 1985, FOR A TOTAL 1985 OBLIGATION OF \$1.6 BILLION. A DEBT SERVICE RATIO (DEBT SERVICE TO EXPORTS OF GOODS AND NON-FACTOR SERVICES) OF 115 PERCENT, EQUIVALENT TO MORE THAN 30 PERCENT OF PROJECTED 1985 GDP, WAS CLEARLY UNTENABLE.

MOREOVER, THE NARROW EXPORT BASE, AN OVER-VALUED OFFICIAL EXCHANGE RATE, EXTENSIVE REGULATION OF THE TRADE REGIME, AND OTHER STRUCTURAL RIGIDITIES SEVERELY RESTRICTED THE COUNTRY'S ABILITY TO ADJUST SMOOTHLY TO ADVERSE ECONOMIC SHOCKS.

DURING THE ONE-YEAR PERIOD, FROM DECEMBER 1984 TO DECEMBER 1985, USAID PROVIDED A TOTAL OF \$135 MILLION IN ESF RESOURCES IN SUPPORT OF AN INTENSIFICATION OF THE GODR ADJUSTMENT EFFORT. THE INITIAL DISBURSEMENT OF \$50 MILLION IN DECEMBER 1984 FACILITATED THE JANUARY 1985 UNIFICATION OF A SYSTEM OF ADMINISTERED EXCHANGE RATES AT A SINGLE, MARKET DETERMINED RATE, REDUCTIONS IN COSTLY SUBSIDIES, AND IMPLEMENTATION OF APPROPRIATE FISCAL AND MONETARY POLICIES. TWO MONTHS LATER, THE IMF AGREED TO SUPPORT THE ADJUSTMENT PROCESS WITH A ONE-YEAR STAND-BY ARRANGEMENT.

THE GODR ADJUSTMENT PERFORMANCE DURING 1985 AND EARLY 1986 EXCEEDED EXPECTATIONS. BY MAY 1986, THE FLOATING EXCHANGE RATE HAD APPRECIATED SOME 10 PERCENT FROM AVERAGE 1985 LEVELS, AND STABILIZED. ALTHOUGH THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS IN 1985, AT -3.2 PERCENT OF GDP, WAS NOT SIGNIFICANTLY DIFFERENT FROM 1984 PERFORMANCE, IT REPRESENTED AN IMPROVEMENT OVER THE -6.0 TO -6.5 PERCENT OF GDP RECORDED FOR 1982-1983. NET INTERNATIONAL RESERVES OF THE CENTRAL BANK GREW 23 PERCENT IN 1985, TO -\$260 MILLION. THIS PROGRESS IN IMPROVING THE CENTRAL BANK'S RESERVE POSITION IS IMPORTANT TO THE MAINTENANCE OF THE DOMINICAN REPUBLIC'S INTERNATIONAL CREDIT-WORTHINESS. INFLATION (CPI), WHICH AVERAGED 24 PERCENT IN 1984, AND AN ADDITIONAL 38 PERCENT IN 1985, IS NOT EXPECTED TO EXCEED AN AVERAGE 11 PERCENT IN 1986. SOME \$1 BILLION OF EXTERNAL DEBT HAS BEEN SUCCESSFULLY RESCHEDULED, AND THE GODR IS SEEKING ADDITIONAL RESCHEDULING DURING 1987. THE TEMPORARY EXCHANGE TAXES ON EXPORTS, IMPOSED AT THE TIME OF EXCHANGE RATE UNIFICATION, HAVE BEEN REMOVED, AND THE RESULTING IMPROVED ALIGNMENT OF RELATIVE PRICES PROVIDE ADEQUATE INCENTIVES TO BROADEN THE EXPORT BASE, AND STIMULATE ACCELERATED ECONOMIC ACTIVITY. REAL GDP, WHICH DECLINED AN ESTIMATED 2.4 PERCENT IN 1985, IS AGAIN GROWING, AND IS EXPECTED TO GROW SOME 1.5 PERCENT TO 2.5 PERCENT IN 1986. PER CAPITA INCOME FELL BY 4.8 PERCENT IN 1985; FURTHER DECLINE IN 1986 WILL BE MODERATE, IF AT ALL.

CENTRAL GOVERNMENT FISCAL PERFORMANCE WAS ADEQUATE DURING 1985 AND 1986. THE CENTRAL GOVERNMENT CURRENT ACCOUNT REFLECTED A SURPLUS EQUIVALENT TO 2.2 PERCENT OF GDP IN 1985, AND A SURPLUS OF 1.5 PERCENT OF GDP IS EXPECTED FOR 1986. THIS PERFORMANCE COMPARES TO A CENTRAL GOVERNMENT CURRENT ACCOUNT DEFICIT EQUIVALENT TO 0.7 PERCENT OF GDP IN 1983, AND A SURPLUS OF 0.4 PERCENT OF GDP IN 1984. THE CENTRAL GOVERNMENT OVERALL DEFICIT OF 0.7 PERCENT OF GDP IN 1985, WAS SIMILAR TO THE DEFICIT OF 0.8 PERCENT OF GDP IN 1984, BUT WAS FULLY FINANCED BY NET EXTERNAL RESOURCES IN AN AMOUNT EQUIVALENT TO 0.9 PERCENT OF GDP. THE OVERALL CENTRAL GOVERNMENT DEFICIT IS EXPECTED TO REMAIN AT 0.7 PERCENT OF GDP, WITH NET EXTERNAL FINANCING AVAILABLE IN AN AMOUNT EQUIVALENT TO 1.3 PERCENT OF GDP. THE MODEST OVERALL DEFICITS, AND THE AVAILABILITY OF ADEQUATE EXTERNAL FINANCING, HAS PERMITTED REDUCTIONS IN NET DOMESTIC FINANCING EQUIVALENT TO 0.2 PERCENT, AND 0.7 PERCENT OF GDP, FOR 1985 AND 1986, RESPECTIVELY.

THE ADEQUATE FISCAL PERFORMANCE WAS FACILITATED BY LARGE INCREASES IN REVENUES FROM THE EXPORT SURCHARGES IMPOSED IN JANUARY 1985. CURRENT REVENUES INCREASED 89 PERCENT IN 1985, BUT ARE EXPECTED TO DECLINE SOME 4 PERCENT IN 1986, DUE TO ELIMINATION OF THE EXPORT SURCHARGES.

THE MAIN USE OF THE INCREASE IN REVENUES DURING 1985 WAS TO INCREASE CENTRAL GOVERNMENT SUBSIDIES TO PARASTATALS. SOME 60 PERCENT OF THE INCREASED REVENUES WAS USED TO INCREASE TRANSFERS TO PARASTATALS, PRINCIPALLY CDE AND INESPRE. ABOUT 20 PERCENT WAS ASSIGNED TO THE CENTRAL BANK TO COVER LOSSES ASSOCIATED WITH EXCHANGE RATE UNIFICATION, AND THE REMAINDER WAS USED FOR INCREASED CURRENT SPENDING FOR SUCH THINGS AS WAGE AND SALARY COSTS. NEW INVESTMENT AND REDUCTIONS IN DOMESTIC CREDIT BALANCES WERE FULLY FINANCED BY EXTERNAL RESOURCE FLOWS. A SUBSTANTIAL (30 PERCENT) DECLINE IS EXPECTED IN CENTRAL GOVERNMENT TRANSFERS TO PARASTATALS AND THE CENTRAL BANK IN 1986, AND SOME OF THE EXPECTED INCREASE IN REVENUES WILL BE USED FOR NEW INVESTMENT AND FURTHER REDUCTIONS IN NET DOMESTIC CREDIT BALANCES TO THE CENTRAL GOVERNMENT.

MONETARY POLICY DURING 1985 AND EARLY 1986 WAS MORE THAN ADEQUATE TO MEET STABILIZATION IMPERATIVES. IN FACT, THE DEGREE OF MONETARY CONSTRAINT IMPOSED DURING 1985 MAY HAVE BEEN GREATER THAN OPTIMUM, SINCE THE VIRTUAL DRYING UP OF CREDIT TO CONSTRUCTION AND MANUFACTURING ACTIVITIES CONTRIBUTED HEAVILY TO LARGE DECLINES IN VALUE ADDED IN THESE SECTORS, AND THE CONSEQUENT UNPRECEDENTED 2.4 PERCENT DECLINE IN GDP FOR THE YEAR.

HOWEVER, GIVEN THE HUGE 42 PERCENT INCREASE IN M1 DURING 1984, THE LARGE INCREASES IN INFLATION IN EARLY 1985 (6.0 PERCENT IN JANUARY; 4.7 PERCENT IN FEBRUARY), AND APPARENT SPECULATIVE DEPRECIATION OF THE PESO AFTER THE JANUARY EXCHANGE UNIFICATION (EXCEEDING RD\$3.30:US\$1.00 BY MARCH), THE CAUTION EXERCISED BY THE AUTHORITIES WAS NOT UNWARRANTED.

CONSOLIDATED BANKING SYSTEM CREDIT GREW JUST 3.5 PERCENT DURING 1985; NET CREDIT BALANCES TO THE PUBLIC SECTOR SHRANK BY 4.0 PERCENT, AND CREDIT TO THE PRIVATE SECTOR WAS CONSTRAINED TO 17.4 PERCENT--SUBSTANTIALLY NEGATIVE IN REAL TERMS, GIVEN AVERAGE INFLATION OF 38 PERCENT (DECEMBER - DECEMBER: 28 PERCENT).

THE MAIN IMPACT OF TIGHT MONETARY POLICY DURING 1985 HAS BEEN FELT DURING 1986. THE EXCHANGE RATE APPRECIATED SOME 18 PERCENT FROM MARCH 1985 TO FEBRUARY 1986, AND REMAINED STABLE FOR SEVERAL MONTHS. INFLATION DURING 1986 HAS BEEN MODERATE, AND EVEN THE PROSPECT OF HIGH LEVELS OF INFLATION DURING THE LAST FOUR MONTHS OF 1986 OF THE ORDER OF 3 PERCENT PER MONTH, WILL NOT DAMAGE FORECASTS OF AVERAGE INFLATION FOR THE YEAR OF 11 PERCENT OR LESS.

AFTER THE FIRST QUARTER OF 1986, THE RESOLVE (OR ABILITY) OF THE AUTHORITIES TO CONTROL MONETARY AGGREGATES DETERIORATED. THIS IS PARTICULARLY EVIDENT WHEN ANNUALIZED GROWTH RATES OF MONEY SUPPLY AND CREDIT FOR THE SIX-MONTH PERIOD, MARCH 1986 TO SEPTEMBER 1986 ARE EXAMINED. M1 WAS GROWING BY 61 PERCENT A YEAR, AND M2 BY 73 PERCENT. COMMERCIAL BANK CREDIT WAS INCREASING 26 PERCENT A YEAR (PUBLIC SECTOR, -13 PERCENT; PRIVATE SECTOR, 48 PERCENT), AS COMMERCIAL BANK DEPOSITS WERE INCREASING 83 PERCENT A YEAR (CHECKING ACCOUNTS, 85 PERCENT; SAVINGS AND CD'S, 87 PERCENT). THE SEPTEMBER CPI MONTHLY INCREASE OF 3.3 PERCENT (ANNUALIZED: 48 PERCENT) REFLECTS THIS RAPID GROWTH IN THE MONEY SUPPLY AND NEW CREDIT. PRELIMINARY ESTIMATES OF THE OCTOBER CPI HAVE BEEN CHARACTERIZED AS VERY HIGH, AND LARGER THAN THE SEPTEMBER INCREASE.

EXPLANATIONS FOR THE RAPID ACCELERATION IN THE GROWTH OF MONEY SUPPLY AND CREDIT INCLUDE: THE IMPACT OF THE LARGE INCREASES IN TRANSFERS TO PARASTATALS DURING 1985 AND 1986, FACILITATED BY THE EXCHANGE TAXES ON EXPORTS; THE INCREASED PESO VALUE OF EXPORTS AND REMITTANCES, RESULTING FROM EXCHANGE RATE UNIFICATION AND ELIMINATION OF EXCHANGE TAXES; ENDING CENTRAL BANK ISSUES OF STABILIZATION BONDS; AND RELAXED TAX ADMINISTRATION AND COLLECTION.

EXCLUDING PRIVATE SECTOR DEBT NOT GUARANTEED BY THE GODR OR THE CENTRAL BANK, THE DOMINICAN REPUBLIC'S TOTAL EXTERNAL DEBT PAYABLE IN FOREIGN CURRENCY AT THE END OF 1985 WAS OF THE ORDER OF \$3.7 BILLION. OF THIS TOTAL, \$0.7 BILLION CORRESPONDED TO SHORT-TERM LIABILITIES OF THE CENTRAL BANK. AFTER RESCHEDULING OF \$110 MILLION OF PRINCIPAL AND INTEREST WITH VENEZUELA, EXTERNAL DEBT SERVICE FOR 1986 IS ESTIMATED AT \$0.9 BILLION, OF WHICH SOME \$0.3 BILLION CORRESPONDS TO INTEREST.

CENTRAL BANK RECORDS INDICATE THAT, AS OF SEPTEMBER 30, \$0.6 BILLION OF DEBT SERVICE HAD BEEN PAID, AND ARREARS HAD BEEN REDUCED TO \$155 MILLION. (NOTE: SCHEDULED SERVICE AND ARREARS EXCLUDE \$48 MILLION OF PRINCIPAL AND INTEREST ASSOCIATED WITH COMMERCIAL OBLIGATIONS DATING FROM 1984 AND EARLY 1985, EXPECTED TO BE PAID DURING 1987, PENDING RESOLUTION OF LEGAL ISSUES.)

IF THE GODR WERE TO PAY ALL SCHEDULED DEBT, THIS WOULD REDUCE OUTSTANDING EXTERNAL DEBT TO ABOUT \$3.5 BILLION BY THE END OF 1986. TOTAL DEBT SERVICE, INCLUDING INTEREST, IS EXPECTED TO RESULT IN A NET FINANCIAL TRANSFER OF THE ORDER OF -\$0.5 BILLION. DESPITE THE LARGE DEBT SERVICE BURDEN, WE ESTIMATE A BALANCE OF PAYMENTS FINANCING GAP, AFTER RESCHEDULING WITH VENEZUELA, OF ONLY \$60 MILLION (SEE BALANCE OF PAYMENTS FINANCING GAP TABLE).

2. NEAR-TERM ECONOMIC PROSPECTS

AS INDICATED IN SECTION B.1., ABOVE, ESTIMATES OF GDP GROWTH FOR 1986 ARE IN THE RANGE OF 1.5 PERCENT TO 2.5 PERCENT, LED BY INCREASED TOURISM, CONSTRUCTION, AND INDUSTRIAL ACTIVITIES. APPROPRIATE ECONOMIC POLICIES CAN RESULT IN GDP GROWTH DURING 1987 OF THE ORDER OF 3.5-4.0 PERCENT.

A RESURGENCE OF INFLATION RESULTING FROM THE LARGE INCREASES IN THE MONEY SUPPLY DURING THE SECOND AND THIRD QUARTERS OF 1986 WILL BE A MAJOR PROBLEM DURING THE FINAL QUARTER OF 1986 AND EARLY 1987. NEVERTHELESS, WE EXPECT AVERAGE INFLATION, AS MEASURED BY THE CPI, TO BE OF THE ORDER OF 11 PERCENT DURING 1986 AND RISE TO 14 PERCENT TO 15 PERCENT DURING 1987. MONEY SUPPLY GROWTH (M1) MAY EXCEED 30 PERCENT DURING 1986, BUT WITH APPROPRIATE GODR POLICY ACTIONS, DECLINE TO A RANGE OF 13 PERCENT TO 21 PERCENT DURING 1987.

THE CENTRAL GOVERNMENT OVERALL DEFICIT DURING 1986 IS EXPECTED TO BE OF THE ORDER OF 0.7 PERCENT OF GDP, AND OUR CONVERSATIONS WITH THE AUTHORITIES ABOUT PROSPECTS AND INTENTIONS FOR 1987 INDICATE THAT A DECLINE IN THE CENTRAL GOVERNMENT BUDGET DEFICIT TO 0.5 PERCENT OF GDP IS FEASIBLE. DETAILED

INFORMATION ADEQUATE FOR EVALUATING CONSOLIDATED PUBLIC SECTOR PERFORMANCE DURING 1986 IS NOT AVAILABLE, BUT THE OVERALL CONSOLIDATED PUBLIC SECTOR DEFICIT MAY EXCEED PRELIMINARY ESTIMATES OF 3 PERCENT OF GDP, DUE TO THE CONTINUED LARGE INVESTMENT REQUIREMENTS OF THE ELECTRIC COMPANY (CDE) AND THE LARGE OPERATING LOSSES INCURRED BY THE PRICE STABILIZATION INSTITUTE (INESPRE) UNDER THE PREVIOUS ADMINISTRATION. PROJECTIONS OF THE CONSOLIDATED PUBLIC SECTOR DEFICIT FOR 1987 ARE OF THE ORDER OF 2.7 PERCENT OF GDP.

PRESSURE ON THE BALANCE OF PAYMENTS DURING 1986 WAS MODERATE, COMPARED TO PAST YEARS. EXCHANGE RATE UNIFICATION IN 1985 AND THE ELIMINATION DURING 1986 OF ALL REMAINING EXCHANGE TAXES ON EXPORTS, RESULTED IN A SYSTEM OF RELATIVE PRICES ADEQUATE TO STIMULATE THE GROWTH OF NON-TRADITIONAL EXPORTS AND SUBSTANTIAL INCREASES IN FREE ZONE INDUSTRIAL ACTIVITY AND TOURISM SERVICES.

THE EXCHANGE RATE WAS RELATIVELY STABLE DURING THE SECOND AND THIRD QUARTER OF 1986, BUT IS EXPECTED TO BE UNDER SUBSTANTIAL PRESSURE DURING THE FINAL QUARTER OF 1986 AND EARLY 1987, DUE TO LARGE SCHEDULED DEBT SERVICE REQUIREMENTS AND THE SPILL-OVER INTO THE EXTERNAL SECTOR OF THE LARGE INCREASES IN AGGREGATE DEMAND EXPECTED FROM RECENT RAPID GROWTH IN THE MONEY SUPPLY. EVEN SO, THE AVERAGE EXCHANGE RATE FOR 1986 IS EXPECTED TO REFLECT A NOMINAL APPRECIATION OF THE ORDER OF 5 PERCENT, IN TERMS OF U.S. DOLLARS, COMPARED TO AVERAGE 1985 LEVELS, AND TO EXPERIENCE A MODERATE DEPRECIATION OF SOME 10 PERCENT DURING 1987, AS A RESULT OF HIGHER AVERAGE INFLATION IN THE DOMINICAN REPUBLIC OF 14 PERCENT, COMPARED TO U.S. INFLATION OF THE ORDER OF 3 PERCENT. THESE ESTIMATES ASSUME THAT NOMINAL BALANCE OF PAYMENTS FINANCING GAPS, ESTIMATED AT \$60 MILLION FOR 1986 AND \$127 MILLION FOR 1987, WILL BE FILLED.

ACTION PLAN TARGETS INDICATING PERFORMANCE IN ACHIEVING ECONOMIC STABILIZATION AND GROWTH DURING 1986 AND 1987 ARE BROADLY ON TRACK, AND THE MISSION EXPECTS CONTINUED PROGRESS ON MEETING THESE TARGETS. THE FOLLOWING TABLE EXHIBITS THE PRINCIPAL TARGETS FOR 1986 AND 1987, EXPECTED OUTCOMES FOR 1986, AND MODIFIED TARGETS FOR 1987.

INDICATORS	----- TARGETS -----		PRO-	MODIFIED
	CY-1986	CY-1987	JECTION CY-1986	TARGET CY-1987
GDP GROWTH (PERCENT)	3.5	4.0	1.5-2.5	3.5-4.0
PER CAPITA GDP GROWTH	1.0	1.6	(-)1.0-0.0	1.1-1.6
INFLATION (PERCENT)				
ANNUAL AVERAGE	13.0	8.0-10.0	11	14-15
DEC. - DEC.	-	-	12	8-10
MONEY SUPPLY, GROWTH				
M1 (PERCENT)	15	12-14	30-33	13-21
EXCHANGE RATE				
ANNUAL AVERAGE	2.8-3.0	2.8-3.0	2.90-2.95	3.25
END-YEAR	-	-	3.05-3.15	3.30
NON-TRADITIONAL EXPORTS GROWTH (PERCENT)	15	17	18	17
UNEMPLOYMENT RATE (PERCENT)	27	26	27	26
FORMAL SECTOR INTEREST RATES (PERCENT)	17-20	12-15	16-20	14-20
CENTRAL GOV'T DEFICIT (PERCENT OF GDP)	-	-	-0.7	-0.5
BALANCE OF PAYMENTS (A)				
CURRENT ACCOUNT DEFICIT	-140	-218	-241	-253
CAPITAL ACCOUNT SURPLUS	209	294	16	220
CENTRAL BANK NET INT'L RESERVES (BALANCE)	-181	-105	-316	-266

(A) EXCLUDES ESF DISBURSEMENTS.

3. THE POLICY ENVIRONMENT

MACRO-ECONOMIC POLICIES. MACRO-ECONOMIC POLICY IMPLEMENTATION DURING 1985 AND EARLY 1986 WAS WELL COORDINATED, AND ALLOWED FOR RAPID PROGRESS ON ACHIEVING MACRO-ECONOMIC STABILIZATION OBJECTIVES, NOTWITHSTANDING THE ADVERSE IMPACT ON ECONOMIC ACTIVITY DURING 1985, WHICH CAN BE PARTLY ATTRIBUTED TO FUNDAMENTAL STRUCTURAL IMPEDIMENTS THAT LIMITED THE ABILITY OF THE ECONOMY TO RESPOND RAPIDLY TO A CHANGED, ALBEIT IMPROVED, MACRO-ECONOMIC ENVIRONMENT.

DURING THE 6-MONTH PERIOD, MARCH-AUGUST 1986, THE ADJUSTMENT EFFORT WAS MUCH LESS INTENSE, AS THE OUTGOING GOVERNMENT'S COMMITMENT TO BOTH MONETARY AND FISCAL POLICY IMPLEMENTATION LESSENER. THE RESULT HAS BEEN THE RESURGENCE OF INFLATION, AND PRESSURE ON THE BALANCE OF PAYMENTS AND THE EXCHANGE RATE DURING THE FINAL MONTHS OF 1986.

MONETARY POLICY PERFORMANCE DURING 1986 HAS BEEN LESS RESTRICTIVE THAN IN 1985. IN 1985, A 100 PERCENT MARGINAL RESERVE REQUIREMENT WAS ESTABLISHED, AND REDUCTIONS IN CENTRAL BANK DISCOUNT AND REDISCOUNT BALANCES TO COMMERCIAL BANKS WERE MANDATED. STABILIZATION BONDS WERE ISSUED, AND NET DOMESTIC CREDIT BALANCES TO THE PUBLIC SECTOR WERE REDUCED. A FLEXIBLE INTEREST RATE STRUCTURE, ACCOMPLISHED BY RAISING LEGAL MAXIMUM RATES PAYABLE ON LIABILITY INSTRUMENTS WAS IMPLEMENTED. THEN, IN JANUARY, THE MARGINAL RESERVE REQUIREMENTS TO BE MET BY CASH WERE REDUCED FROM 25 TO 10 PERCENT. BY MID-YEAR, GROWTH IN THE MONEY SUPPLY WAS ACCELERATING RAPIDLY AS A RESULT OF RELATIVELY HIGH PUBLIC SECTOR SPENDING, BUT NOTHING WAS DONE TO CONTAIN THE INCREASES. IN SEPTEMBER, THE RESERVE REQUIREMENTS OF COMMERCIAL BANKS WERE REDUCED BY 5 PERCENT TO FACILITATE COMMERCIAL BANK FINANCING OF GOVERNMENT SUGAR COMPANY (CEA) REHABILITATION AND WORKING CAPITAL REQUIREMENTS. IN OCTOBER, LEGAL MAXIMUM INTEREST RATES ON CERTIFICATES OF DEPOSIT WERE REDUCED FROM 18 PERCENT TO 16 PERCENT, MAXIMUM INTEREST RATES ON FIDE LOANS WERE REDUCED FROM 20 PERCENT TO 17 PERCENT, AND THE INTEREST RATE OFFERED BY THE CENTRAL BANK ON NEW STABILIZATION BONDS WAS REDUCED FROM 16 PERCENT TO 14 PERCENT.

IT SHOULD BE NOTED THAT REAL INTEREST RATES HAVE BEEN BROADLY POSITIVE SINCE MID-1985, AND THE RECENT DECLINES IN INTEREST RATES WERE REALISTIC RESPONSES TO NOMINALLY HIGH BANKING SYSTEM LIQUIDITY AND DECLINING INFLATION. (THE AUGUST CPI WAS 2.5 PERCENT LOWER THAN THE JANUARY CPI.)

THE EXISTENCE OF A LARGE, INFORMAL FINANCIAL SECTOR HAS MADE MONETARY POLICY AN INEXACT SCIENCE, AND FORCED THE AUTHORITIES TO BE MORE RESTRICTIVE VIS-A-VIS THE FORMAL BANKING SYSTEM DURING 1985 THAN WOULD HAVE BEEN THE CASE HAD THE TWO SECTORS BEEN BETTER INTEGRATED. RECOGNIZING THIS, THE AUTHORITIES HAVE DETERMINED TO BEGIN INTEGRATION IN EARLY 1987.

THE NEW GOVERNMENT HAS NOT YET ESTABLISHED A CLEAR EXCHANGE RATE POLICY, ALTHOUGH THERE ARE INDICATIONS THAT APPRECIATION OF THE NOMINAL EXCHANGE RATE IS A NEAR-TERM OBJECTIVE OF THE GOVERNOR OF THE CENTRAL BANK. ALTHOUGH THE RESOURCES ARE NOT AVAILABLE FOR DIRECT INTERVENTION IN THE

EXCHANGE MARKETS, THE GOVERNOR HAS SIGNALLED HIS INTENTIONS BY RECENT SYMBOLIC INTERVENTIONS THROUGH SUBSIDIZED TRANSACTIONS BY THE RESERVE BANK AND THE CENTRAL BANK.

THE AUTHORITIES HAVE NOT DEMONSTRATED SUFFICIENT CONCERN ABOUT THE ADEQUACY OF THE UNDERLYING REAL EXCHANGE RATE. WE ESTIMATE THAT THE AVERAGE REAL EXCHANGE RATE PREVAILING DURING 1986 HAS BEEN BROADLY ADEQUATE FOR ASSURING INTERNATIONAL COMPETITIVENESS AND STIMULATING THE GROWTH OF NON-TRADITIONAL EXPORTS. MAINTENANCE OF THIS REAL EXCHANGE RATE DURING 1987 WILL REQUIRE AN AVERAGE 10 PERCENT DEPRECIATION OF THE PESO, TO A NOMINAL LEVEL OF THE ORDER OF RD\$3.25 EQUALS US\$1.00, SHOULD OUR FORECASTS OF AVERAGE INFLATION DURING 1987 BE CONFIRMED.

FISCAL POLICY DURING 1985 AND EARLY 1986 WAS ADEQUATE FOR THE ACCOMPLISHMENT OF MACRO-ECONOMIC STABILIZATION OBJECTIVES, BUT MAY NOT HAVE BEEN OPTIMUM WITH RESPECT TO PROVIDING A SOUND BASIS FOR ECONOMIC RECOVERY AND SUSTAINED FUTURE GROWTH. ALTHOUGH FINANCING WAS AVAILABLE TO ACTUALLY INCREASE TOTAL SPENDING, THE INCREASES WERE NOT CHANNLED INTO THE CENTRAL GOVERNMENT'S INVESTMENT BUDGET. IN FACT, THE LACK OF COUNTERPART AVAILABILITY MAY HAVE REDUCED NEEDED FOREIGN EXCHANGE INFLOWS FOR IMPORTANT DONOR PROJECTS. CENTRAL GOVERNMENT INVESTMENT, ALTHOUGH INCREASING IN NOMINAL TERMS, WAS LARGELY FINANCED WITH EXTERNAL RESOURCES. FISCAL POLICY CAN AND SHOULD BE DIRECTED AT FREEING UP RESOURCES FOR GROWTH, AS WELL AS THE ACHIEVEMENT OF ECONOMIC STABILIZATION OBJECTIVES.

THE NEW GOVERNMENT HAS INDICATED THAT IT WILL CHANGE THE PRIORITIES INDICATED IN THE SPENDING PATTERNS OF THE PUBLIC SECTOR IN RECENT YEARS. RECENT PUBLISHED DATA FOR THE GOVERNMENT'S SPENDING DURING SEPTEMBER AND OCTOBER 1986 INDICATE THAT THIS CHANGE IN PRIORITIES IS ALREADY TAKING PLACE. NO LINE ITEMS ARE INDICATED FOR CURRENT TRANSFERS TO PARASTATALS, AND WAGE AND SALARY COSTS ARE DECLINING.

THE AUTHORITIES ALSO HAVE INDICATED A RESOLVE TO REDUCE CENTRAL GOVERNMENT CURRENT BUDGET SPENDING FOR 1987 TO NOMINAL 1985 LEVELS, OR BY ABOUT 22 PERCENT, AND PLAN TO USE THE INCREASED SAVINGS TO FINANCE INVESTMENT. THE LARGEST SOURCE OF SAVINGS WILL RESULT FROM LARGE REDUCTIONS IN CURRENT TRANSFERS TO PARASTATALS. CAPITAL TRANSFERS ARE ALSO EXPECTED TO DECLINE (SEE TABLE OF CENTRAL GOVERNMENT REVENUES AND EXPENDITURES).

LONG-TERM STRUCTURAL POLICIES. PROGRESS IS BEING MADE ON DIVERSIFICATION OF GOVERNMENT-OWNED SUGAR LANDS TO NON-SUGARCANE USES. CEA HAS OFFERED JOINT-VENTURE ACCESS TO SUGAR LANDS, AND HAS PROPOSED THE SALE OF SOME LAND FOR NON-AGRICULTURAL USES, SUCH AS THE DEVELOPMENT OF NEW TOURISM FACILITIES. NEVERTHELESS, GOVERNMENT ACTIONS TO DATE TO PROMOTE DIVERSIFICATION OUT OF SUGAR AND INTO NON-TRADITIONAL AGRICULTURAL CROPS HAS BEEN TENTATIVE, AND NOT AS AGGRESSIVE AS OUR EVALUATION OF THE POTENTIAL WOULD INDICATE IT SHOULD BE.

SUBSTANTIAL PROGRESS WAS MADE ON REDUCING EXPLICIT SUBSIDIES ON BASIC FOODS AND SERVICES DURING THE LAST ADMINISTRATION. THE NEW GOVERNMENT

IS ACTING TO FURTHER REDUCE SUBSIDIES ON BASIC FOODS, SUCH AS RICE, EGGS, AND MILK, BUT INTENDS TO PROVIDE FOOD SECURITY TO LOW INCOME GROUPS BY ASSURING THE AVAILABILITY OF A LOW PRICED GRADE OF THESE COMMODITIES TO LOWER INCOME GROUPS, WITH BETTER GRADES BEING SOLD AT HIGHER PRICES. IT IS NOT UNCOMMON FOR A NEW GOVERNMENT IN THE DOMINICAN REPUBLIC TO BE CONCERNED ABOUT THE COST OF BASIC NECESSITIES, ESPECIALLY FOOD PRICES, AND TAKING FIRM ACTION AGAINST "SPECULATORS" THAT CHARGE PRICES HIGHER THAN PERMITTED BY THE OFFICE OF PRICE CONTROL IS POLITICALLY POPULAR. THE GOVERNMENT IS ENCOURAGING THE IMPORT OF BASIC FOODS THAT ARE IN SHORT SUPPLY, OR UNAVAILABLE AT CONTROLLED PRICES, TO BE SOLD AT CONTROLLED PRICES. OSTENSIBLY, THESE IMPORTS ARE TO BE TEMPORARY UNTIL LOCAL PRODUCERS CAN ADEQUATELY RESPOND TO DEMAND. THE QUID PRO QUO IS TO ASSURE PRODUCERS OF ADEQUATE FINANCING OF NEW INVESTMENT AND WORKING CAPITAL REQUIREMENTS, AND DUTY EXONERATIONS ON IMPORTED FEEDS AND OTHER INPUTS.

EXCHANGE RATE UNIFICATION, THE RATIONALIZATION OF SUBSIDIES, AND PROGRESS ON REDUCING EXPORT RESTRICTIONS AND TAXES ON EXPORTS HAVE SUBSTANTIALLY IMPROVED RELATIVE PRICES OF THE TRADED GOODS SECTORS IN THE DOMINICAN REPUBLIC, AND REDUCED A LARGE MEASURE OF STRUCTURAL BIAS AGAINST AGRICULTURE AND NON-TRADITIONAL EXPORTS. THE IMPLEMENTATION OF THESE MEASURES, HOWEVER, LEAVES UNADDRESSED THE STILL SIGNIFICANT IMPORT SUBSTITUTION BIAS PROVIDED BY THE IMPORT TARIFF SYSTEM, EXONERATIONS, AND RESTRICTIONS ON IMPORTS.

THE IMPORT TARIFF STRUCTURE, CUMBERSOME CUSTOMS ADMINISTRATION, AND THE SYSTEM OF EXONERATIONS AND IMPORT RESTRICTIONS CONTINUE TO PROVIDE HIGH EFFECTIVE PROTECTION TO IMPORT SUBSTITUTION ACTIVITIES, AND UNTIL MODIFIED, WILL LIMIT THE EFFECTIVENESS OF EXPORT PROMOTION POLICIES, AND THE ABILITY OF THE COUNTRY TO SMOOTHLY ADJUST TO ADVERSE ECONOMIC SHOCKS.

IMPROVING THE EFFICIENCY OF THE TAX SYSTEM AS A RELIABLE PRODUCER OF REVENUES FOR THE GOVERNMENT IS A PRIORITY OF THE AUTHORITIES, BEGINNING WITH EFFORTS TO IMPROVE TAX ADMINISTRATION. THIS INCLUDES LIMITING EXEMPTIONS AND EXONERATIONS TO THOSE EXPRESSLY PRESCRIBED BY LAW. THE PRINCIPAL CHANGE IN TAX STRUCTURE PRESENTLY CONTEMPLATED IS TO BROADEN THE TAX BASE TO INCLUDE EQUITABLE TAXATION OF LAND AND IMPROVEMENTS.

THE AUTHORITIES HAVE INDICATED A WILLINGNESS, AS DID THE LAST ADMINISTRATION, TO CLOSE UNPRODUCTIVE STATE ENTERPRISES, AND HAS EXPRESSED INTEREST IN SELLING SHARES IN THESE ENTERPRISES TO THE PUBLIC OR TO PRIVATE INVESTORS. THE AUTHORITIES DO NOT ENVISION INCREASED PUBLIC SECTOR OWNERSHIP OF PRODUCTIVE ENTERPRISES.

C. MISSION STRATEGY

MISSION STRATEGY FOR THE FY-1987 ESF PROGRAM WILL SEEK TO BALANCE THE NEED TO MAINTAIN THE MONETARY AND FISCAL DISCIPLINE NEEDED TO KEEP MACRO-ECONOMIC STABILIZATION OBJECTIVES ON TRACK, WITH THE IMPERATIVES OF NEAR-TERM ECONOMIC RECOVERY, AND IMPLEMENTATION OF ADDITIONAL STRUCTURAL REFORMS AND ADJUSTMENTS ESSENTIAL TO LONG-TERM DEVELOPMENT OBJECTIVES.

1. RATIONALE FOR FY-1987 ESF SUPPORT

ESF RESOURCES IN THE AMOUNT OF \$25 MILLION ARE REQUESTED AS BALANCE OF PAYMENTS SUPPORT TO THE DOMINICAN REPUBLIC DURING FY-1987. THE COUNTRY'S BALANCE OF PAYMENTS FINANCING GAP FOR 1986 IS ESTIMATED AT \$60 MILLION, AND AN ADDITIONAL FINANCING GAP OF THE ORDER OF \$127 MILLION IS ESTIMATED FOR 1987 (SEE BALANCE OF PAYMENTS FINANCING GAP TABLE). THE FINANCING GAP INDICATED FOR 1987 DOES NOT TAKE INTO ACCOUNT THE LIKELIHOOD OF A 30-35 PERCENT REDUCTION IN THE DOMINICAN REPUBLIC'S SUGAR QUOTA FOR 1987, WHICH WOULD WIDEN THE 1987 BALANCE OF PAYMENTS FINANCING GAP TO AT LEAST \$150 MILLION.

APART FROM A WEAKENING DURING THE ELECTION CAMPAIGN AND THE PERIOD OF TRANSITION TO A NEW, ELECTED GOVERNMENT DURING THE SECOND AND THIRD QUARTERS OF 1986, THE GODR ADJUSTMENT PERFORMANCE HAS BEEN EXEMPLARY OVER THE PAST TWO YEARS. ESF SUPPORT DURING FY-1985 AND FY-1986 WAS CRITICAL TO THE GODR'S ABILITY TO SUCCESSFULLY IMPLEMENT A COMPREHENSIVE ADJUSTMENT PROGRAM THAT RESULTED IN MACRO-ECONOMIC STABILIZATION AND A SIGNIFICANT IMPROVEMENT IN ECONOMIC ACTIVITY DURING 1986.

EXPECTATIONS OF THE NEWLY ELECTED AUTHORITIES AND THE PUBLIC AT LARGE ARE GENERALLY OPTIMISTIC. THE MOOD OF THE COUNTRY IS BULLISH, BOTH IN TERMS OF POLITICAL STABILITY AND PERCEPTIONS THAT AN ECONOMIC RECOVERY IS UNDERWAY. THIS SITUATION CONTRASTS SHARPLY WITH THE CRISIS ATMOSPHERE OF TWO YEARS AGO.

NEVERTHELESS, THERE ARE DANGER SIGNS. MACRO-ECONOMIC STABILIZATION AND ECONOMIC RECOVERY ARE NOT ASSURED. THE NEW GOVERNMENT HAS ONLY RECENTLY BEGUN TO FOCUS ON THE ESSENTIAL POLICY ELEMENTS OF A MEDIUM-TERM ECONOMIC PROGRAM, AND ACTIONS TO DATE HAVE LARGELY BEEN SHORT-TERM REACTIONS TO PROBLEMS AS THEY ARISE. HOW THE GOVERNMENT RESPONDS TO RISING PRICES AND INCREASED PRESSURE ON THE BALANCE OF PAYMENTS AND THE EXCHANGE RATE OVER THE NEAR-TERM WILL BE CRITICAL TO KEEPING ON TRACK THE ADJUSTMENT PROCESS NECESSARY TO ASSURE COMPLETION OF THE NASCENT ECONOMIC RECOVERY AND MEDIUM-TERM MACRO-ECONOMIC STABILIZATION.

OVER THE COURSE OF 1987, MUCH OF THE BALANCE OF PAYMENTS FINANCING GAP IS EXPECTED TO BE FILLED, BUT A BUILD-UP OF SHORT-TERM ARREARAGES IS EXPECTED UNTIL INCREASED MULTILATERAL LENDING IS FORTHCOMING, AND DESIRED RESCHEDULING OF EXTERNAL DEBT CAN BE NEGOTIATED. NEW LOANS FROM THE WORLD BANK, FOR EXAMPLE, CANNOT BE MADE AVAILABLE UNTIL LATE 1987.

THE AUTHORITIES ARE AWARE OF THE IMPORTANCE OF IMF ENDORSEMENT OF THE GODR'S ECONOMIC PROGRAM FOR SUCCESSFUL NEGOTIATION OF ADDITIONAL RESCHEDULING OF EXTERNAL DEBT DURING 1987, AND HAVE INDICATED WILLINGNESS TO DISCUSS WITH THE FUND THE PARAMETERS OF AN APPROPRIATE ARRANGEMENT, SUCH AS A STAND-BY, THAT COULD QUALIFY THE COUNTRY FOR EARLY PARIS CLUB CONSIDERATION. SUCCESS IN OBTAINING AN EARLY ARRANGEMENT WITH THE FUND AND ADDITIONAL RESCHEDULING OF EXTERNAL DEBT DURING 1987 IS ESSENTIAL FOR FREEING UP RESOURCES NEEDED FOR ECONOMIC RECOVERY AND GROWTH.

SCHEDULED GODR DEBT SERVICE FOR THE FINAL QUARTER OF 1986 AMOUNTS TO SOME \$432 MILLION, INCLUDING \$155 MILLION OF ACCUMULATED ARREARS. AFTER RESCHEDULING OF \$110 MILLION WITH VENEZUELA, ONLY ABOUT \$262 MILLION IS EXPECTED TO BE AVAILABLE FOR DEBT SERVICE FROM CENTRAL BANK REVENUES AND RESERVES, RESULTING IN A FINANCING GAP OF SOME \$60 MILLION. WE ESTIMATE THAT NOT MORE THAN AN ADDITIONAL \$30 MILLION TO \$35 MILLION OF SCHEDULED GODR DEBT SERVICE OBLIGATIONS CAN BE DEFERRED PAST THE END OF THE YEAR WITHOUT SERIOUSLY JEOPARDIZING THE GODR'S RECENTLY ENHANCED CREDIT WORTHINESS. ACCORDINGLY, ESF FINANCING OF NOT LESS THAN \$25 MILLION IS CRITICAL.

IT IS IN THE U.S. GOVERNMENT'S INTEREST TO FACILITATE MAINTENANCE OF THE GODR'S INTERNATIONAL CREDIT WORTHINESS. TIMELY DISBURSEMENTS OF ESF RESOURCES DURING FY-1985 AND FY-1986 SUPPORTED THE IMPLEMENTATION OF SEVERAL IMPORTANT POLICY ACTIONS, THAT ESTABLISHED THE BASIS FOR A RARE, SUCCESSFUL IMF STAND-BY ARRANGEMENT AND RESCHEDULING OF A DIFFICULT DEBT SERVICE SITUATION.

THE RESOURCES REQUIRED TO POSITION THE GODR FOR FAVORABLE CONSIDERATION FOR A NEW FUND ARRANGEMENT, AND SUBSEQUENT ADDITIONAL EXTERNAL DEBT RESCHEDULING DURING 1987 ARE NOT LARGE, COMPARED TO \$135 MILLION DISBURSED DURING THE PERIOD DECEMBER 1984 TO DECEMBER 1985. THE REQUIREMENTS ARE NOT LARGE BECAUSE WE ARE BUILDING ON SUCCESS. THE OBJECTIVE IS TO CONSOLIDATE THIS SUCCESS, AND ALLOW THE DOMINICAN REPUBLIC ACCESS TO THE MINIMUM AMOUNT OF RESOURCES IT NEEDS TO FINANCE A LARGE NET FINANCIAL TRANSFER TO CREDITORS DURING 1986, AND PROVIDE THE BASIS FOR SECURING THE FINANCING OF IMPORTED RAW MATERIALS AND CAPITAL EQUIPMENT NEEDED TO SUSTAIN DURING 1987 THE ECONOMIC RECOVERY BEGUN IN 1986.

2. POLICY ISSUES

MACRO-ECONOMIC POLICIES. THE CRITICAL MACRO-ECONOMIC POLICY CONCERNS DURING 1987 WILL BE TO CONTINUE TO IMPLEMENT FISCAL AND MONETARY POLICIES CONSISTENT WITH MAINTAINING THE MACRO-ECONOMIC STABILIZATION ALREADY ACHIEVED AND, AT THE SAME TIME, ENCOURAGE GROWTH-ORIENTED ECONOMIC RECOVERY.

MONETARY POLICY SHOULD BE DIRECTED AT MANAGING THE GROWTH OF THE MONEY SUPPLY AT LEVELS COMPATIBLE WITH MAINTAINING THE UNDERLYING REAL EXCHANGE RATE AT AVERAGE 1985 LEVELS, WHILE PERMITTING CREDIT GROWTH ADEQUATE TO FINANCE INVESTMENT AND WORKING CAPITAL REQUIREMENTS OF THE PRIVATE SECTOR. INTEREST RATES SHOULD IDEALLY BE ALLOWED TO FLUCTUATE AS NECESSARY, AND NOT BE CONSTRAINED BY ADMINISTERED MAXIMUMS ON EITHER LIABILITY INSTRUMENTS OR LENDING RATES. THIS SUGGESTS THE IMPLEMENTATION OF A FLEXIBLE INTEREST RATE POLICY, WHICH WOULD ALLOW REGULATED BANKING SYSTEM INTEREST RATES TO REMAIN POSITIVE IN REAL TERMS, SHOULD INFLATION PROVE DIFFICULT TO CONTAIN.

DOMESTIC MONETARY POLICY AND EXCHANGE RATE POLICIES MUST BE CLOSELY COORDINATED DURING 1987. THE MISSION'S BALANCE OF PAYMENTS FINANCING GAP ANALYSIS IS PREDICATED ON OUR ASSESSMENT THAT THE AVERAGE REAL EXCHANGE RATE PREVAILING DURING 1986 IS ADEQUATE TO FACILITATE CONTINUED GROWTH IN NON-TRADITIONAL EXPORTS OF GOODS AND SERVICES, AND NEED NOT CHANGE DURING

1987. IT IS PARTICULARLY IMPORTANT THAT THE GODR NOT ATTEMPT TO TARGET AN UNREALISTIC NOMINAL EXCHANGE RATE THAT WOULD RESULT IN SIGNIFICANT APPRECIATION OF THE UNDERLYING REAL EXCHANGE RATE.

FINANCING IS NOT AVAILABLE FOR OTHER THAN SYMBOLIC INTERVENTIONS TO SUPPORT A MARKET EXCHANGE RATE, AND THE AUTHORITIES HAVE NOT INDICATED ANY INTENTION TO RETURN TO A FIXED EXCHANGE RATE REGIME. MOREOVER, THE MONETARY TIGHTNESS THAT WOULD BE REQUIRED TO SUPPORT APPRECIATION OF THE NOMINAL EXCHANGE RATE DURING 1987 COULD EASILY HALT THE ECONOMIC EXPANSION, AND RESULT IN A NEW RECESSION DURING 1987. WE ESTIMATE THAT DOMESTIC MONETARY POLICY SHOULD BE DIRECTED AT MAINTAINING INCREASES IN THE MONEY SUPPLY (M1) OVER A FLEXIBLE RANGE OF, SAY, 13-21 PERCENT. THIS WOULD RESULT IN ADEQUATE CREDIT AVAILABILITY FOR ACCELERATING THE ECONOMIC RECOVERY, FACILITATE GDP GROWTH OF THE ORDER OF 3.5-4.0 PERCENT, AND CONTAIN AVERAGE INFLATION TO 14-15 PERCENT DURING THE YEAR (DECEMBER-DECEMBER: 8-10 PERCENT). THIS SCENARIO IS COMPATIBLE WITH MAINTENANCE OF THE REAL EXCHANGE RATE AT AVERAGE 1986 LEVELS, AND A MODERATE AVERAGE DEPRECIATION OF THE NOMINAL EXCHANGE RATE OF SOME 10 PERCENT.

FISCAL POLICY CAN BE RESPONSIVE TO BOTH STABILIZATION IMPERATIVES, AND THE REQUIREMENTS OF ECONOMIC RECOVERY AND LONG-TERM GROWTH BY CHANGES IN CENTRAL GOVERNMENT SPENDING, IN WAYS THAT ELIMINATE NON-ESSENTIAL CURRENT SPENDING, WHILE PROVIDING FOR SIGNIFICANT INCREASES IN THE PROVISION OF NEEDED PRODUCTIVE INFRASTRUCTURE. CENTRAL GOVERNMENT CURRENT SPENDING, WHICH IS PROJECTED TO DECLINE FROM 13 PERCENT OF GDP IN 1985 TO 11 PERCENT OF GDP IN 1986, CAN BE FURTHER REDUCED TO 8-9 PERCENT OF GDP IN 1987, WITHOUT JEOPARDIZING THE QUALITY OF SERVICES PROVIDED. THIS WOULD PROVIDE A SURPLUS LARGE ENOUGH TO PERMIT A DOUBLING OF CENTRAL GOVERNMENT INVESTMENT SPENDING, FROM 1.5 PERCENT OF GDP IN 1986, TO 3.0 PERCENT OF GDP IN 1987. THIS CAN BE ACCOMPLISHED BY REDUCTIONS IN CENTRAL GOVERNMENT TRANSFERS AND SUBSIDIES TO THE PRINCIPAL PARASTATALS, REDUCTIONS IN WAGES AND SALARIES ASSOCIATED WITH REDUNDANT PERSONNEL, AND REDUCTIONS IN CENTRAL GOVERNMENT PURCHASES OF NON-ESSENTIAL GOODS AND SERVICES. MOREOVER, SUFFICIENT EXTERNAL FINANCING IS EXPECTED TO BE AVAILABLE TO PERMIT THE INDICATED INCREASE IN CENTRAL GOVERNMENT INVESTMENT ACTIVITIES WITHOUT THE NEED FOR ADDITIONAL NET DOMESTIC FINANCING.

THE AUTHORITIES HAVE INDICATED THAT MONETARY AND FISCAL POLICY DURING THE LAST QUARTER OF 1986 AND DURING 1987 WILL BE PRUDENT. MEASURES ARE BEING TAKEN TO MODERATE THE HIGH GROWTH RATES IN M1 THAT OCCURED DURING THE THIRD QUARTER OF 1986, WHICH SHOULD RESULT IN SIGNIFICANT REDUCTIONS IN INFLATION BY THE SECOND QUARTER OF 1987.

LONG-TERM STRUCTURAL POLICIES: THE GODR HAS RECENTLY ELIMINATED EXPLICIT SUBSIDIES ON MOST FOOD ITEMS AND ON INPUTS TO AGRICULTURAL PRODUCTION. THE REMOVAL OF EXPLICIT SUBSIDIES ON SEVERAL IMPORTANT COMMODITIES (RICE, EGGS) HAS BEEN ACCOMPANIED BY THE CREATION OF GRADES, WITH SUBSTANTIALLY HIGHER PRICES FOR THE HIGHER QUALITY GRADES. THIS HAS ENABLED THE GODR TO MAINTAIN THE LOWER QUALITY GRADES AT EQUAL OR LOWER PRICES THAN BEFORE THE REMOVAL OF THE SUBSIDIES. HOWEVER, CONTINUED RIGID GOVERNMENT

PRICE CONTROLS CREATE UNCERTAINTY AND REDUCE INCENTIVES FOR PRODUCTION AND INVESTMENT.

WHEN THE BALAGUER GOVERNMENT ASSUMED POWER ON AUGUST 16TH, INESPRE (THE GOVERNMENT MONOPOLY RICE TRADER) OWED RD\$115 MILLION TO THE RICE MILLERS. IN CONJUNCTION WITH THE REMOVAL OF THE EXPLICIT CONSUMER SUBSIDY ON RICE, THE GODR ALSO TRANSFERRED RESPONSIBILITY FOR THE MARKETING OF RICE TO THE AGRICULTURAL BANK (BAGRICOLA), AS A TEMPORARY MEASURE. BAGRICOLA IS CURRENTLY BUYING, STORING, AND SELLING MILLED RICE, MUCH AS INESPRE DID IN THE PAST, ALBERT WITHOUT THE LARGE SUBSIDIES. THE MISSION WILL SEEK TO REDUCE GOVERNMENT INVOLVEMENT AND PRICE CONTROL IN THE MARKETING OF AGRICULTURAL PRODUCTS, PARTICULARLY RICE.

THE MISSION HAS ENCOURAGED AND WILL CONTINUE TO URGE THE GODR TO DIVERSIFY OUT OF SUGAR PRODUCTION. THE MAJOR FOCUS OF THESE EFFORTS WILL INVOLVE THE CLOSING OF SELECTED UNPROFITABLE CEA MILLS AND DIVERSIFICATION, BY PRIVATE INVESTORS, OF THE LANDS CURRENTLY UNDER SUGAR CULTIVATION AROUND THOSE MILLS. CEA HAS DEVELOPED GUIDELINES FOR INVESTORS INTERESTED IN ACCESSING THEIR LAND. A STUDY WHICH PROVIDES THE BASIS FOR THE DEVELOPMENT OF A SYSTEMATIC DIVERSIFICATION PROGRAM HAS ALSO BEEN COMPLETED. THE VICE-PRESIDENT OF THE DOMINICAN REPUBLIC, WHO IS ALSO THE ADMINISTRATOR OF CEA, HAS FORMED A HIGH LEVEL COMMISSION TO FINALIZE THESE PLANS. THROUGH POLICY DIALOGUE WITH THIS COMMISSION, THE MISSION WILL URGE THE GODR TO EXPEDITE THE PRIVATIZATION OF CEA LANDS.

3. ECONOMIC POLICY COVENANTS

THE ECONOMIC POLICY IMPLEMENTATION THAT USAID WILL SUPPORT WITH THE FY-1987 ESF PROGRAM WILL TAKE THE FORM OF THE FOLLOWING COVENANTS:

MONETARY AND EXCHANGE RATE POLICIES:

(A) THE GODR AGREES TO MANAGE THE GROWTH OF THE MONEY SUPPLY AT LEVELS COMPATIBLE WITH MAINTAINING THE UNDERLYING REAL EXCHANGE RATE AT AVERAGE 1986 LEVELS, WHILE PERMITTING CREDIT GROWTH ADEQUATE TO FINANCE PRIVATE SECTOR INVESTMENT AND WORKING CAPITAL REQUIREMENTS.

(B) THE GODR AGREES TO PURSUE AN EXCHANGE RATE POLICY IN WHICH ALL TRANSACTIONS ARE AT A UNIFIED, MARKET EXCHANGE RATE.

FISCAL POLICY:

(C) THE GODR AGREES TO PREPARE AND IMPLEMENT A CENTRAL GOVERNMENT BUDGET THAT ALLOWS FOR AN INCREASE IN THE CURRENT BUDGET SURPLUS OVER 1986, TO BE USED FOR HIGHER CENTRAL GOVERNMENT INVESTMENT SPENDING, INCLUDING COUNTERPART FOR DONOR PROJECTS.

LONG-RUN STRUCTURAL POLICIES:

(D) THE GODR AGREES TO DEVELOP, BY MARCH 31, 1987, A DETAILED, TIME-PHASED PLAN FOR THE IMPLEMENTATION OF A RICE MARKETING MECHANISM THAT PROVIDES FOR:

- (1) MARKET DETERMINED PRICES.
- (2) REMOVAL FROM BAGRICOLA OF COMMODITY MARKETING FUNCTIONS.
- (3) LIMITS GODR INVOLVEMENT TO FOOD SECURITY/PRICE STABILIZATION FUNCTIONS.

THE GODR FURTHER AGREES TO INITIATE IMPLEMENTATION OF THIS PLAN BY MAY 2, 1987.

(E) THE GODR AGREES TO FINALIZE A PLAN FOR THE DIVERSIFICATION OF CEA LAND BY MARCH 31, 1987, WHICH WILL:

- (1) PROVIDE CLEAR GUIDELINES FOR PROSPECTIVE INVESTORS FOR THE PURCHASE, LEASE, OR JOINT-VENTURE ACCESS TO CEA LAND.
- (2) ESTABLISH ANNUAL TARGETS FOR THE AMOUNT OF LAND TO BE DIVERSIFIED.

THE GODR FURTHER AGREES TO PUBLISH AND WIDELY DISTRIBUTE THE GUIDELINES FOR PROSPECTIVE INVESTORS, AND TO VIGOROUSLY PURSUE THE DIVERSIFICATION PLAN.

4. PERFORMANCE BENCHMARKS

BENCHMARKS FOR EVALUATING MACRO-ECONOMIC PERFORMANCE DURING 1987 ARE SUMMARIZED IN THE TABLE OF MACRO-ECONOMIC INDICATORS. BENCHMARKS FOR EVALUATING PROGRESS ON LONG-RUN STRUCTURAL ISSUES ARE:

- (A) NON-TRADITIONAL AGRICULTURAL EXPORTS WILL INCREASE BY 25 PERCENT IN 1987, COMPARED TO 15 PERCENT IN 1986.
- (B) BY THE END OF 1987, 20,000 HECTARES OF CEA LAND WILL BE UTILIZED FOR CROPS OTHER THAN SUGARCANE.
- (C) BY THE END OF 1987, RICE PRICES FOR AT LEAST THE TWO HIGHER GRADES WILL BE MARKET DETERMINED.

5. INITIAL CONDITIONS PRECEDENT TO DISBURSEMENT

PRIOR TO THE DISBURSEMENT OF FUNDS OR ISSUANCE OF DOCUMENTATION PURSUANT TO THE DISBURSEMENT OF FUNDS, THE GODR WILL SUBMIT AN OPINION OF LEGAL COUNSEL ACCEPTABLE TO AID, THAT THIS AGREEMENT HAS BEEN DULY AUTHORIZED BY AND

EXECUTED ON BEHALF OF THE GRANTEE, AND THAT IT CONSTITUTES A VALID, LEGALLY BINDING OBLIGATION OF THE GRANTEE IN ACCORDANCE WITH ALL ITS TERMS; AND

A STATEMENT OF THE NAME OF THE PERSON HOLDING OR ACTING IN THE OFFICE OF THE TECHNICAL SECRETARY OF THE PRESIDENCY.

6. LOCAL CURRENCY COVENANTS

(A) THE GODR AGREES TO PROGRAM, JOINTLY WITH AID, THE USE OF LOCAL CURRENCY PROCEEDS BY JANUARY 31, 1987, AND TO DEPOSIT ALL LOCAL CURRENCY PROCEEDS UNDER THE FY 1987 ESF INTO A SPECIAL ACCOUNT IN THE CENTRAL BANK WITHIN 45 DAYS FROM THE DISBURSEMENT OF FUNDS BY AID.

(B) THE GODR AGREES TO MAKE NO THIRD PARTY AGREEMENTS OF UNDERSTANDINGS WHICH WOULD RESTRICT EITHER THE USE OR DISBURSEMENT OF SUCH LOCAL CURRENCIES WITHOUT THE PRIOR CONSULTATION AND WRITTEN CONCURRENCE OF THE MISSION.

(C) THE GODR AGREES TO REVIEW AND REVISE THE PROCEDURES BY WHICH IT RELEASES RESOURCES FROM THE CENTRAL BANK FOR ALL AID-FINANCED PROJECTS, WITH THE OBJECTIVE OF STREAMLINING SUCH PROCEDURES BY FEBRUARY 28, 1987.

D. TRANSFER MODALITY AND LOCAL CURRENCY PROGRAMMING

1. CASH TRANSFER

(A) USES

THE MISSION PROPOSES THAT THE DOMINICAN GOVERNMENT BE PROVIDED WITH A \$25.0 MILLION CASH TRANSFER TO ASSIST IT TO ADDRESS ITS BALANCE OF PAYMENTS PROBLEM. THE FUNDS WILL BE MADE AVAILABLE TO THE CENTRAL BANK OF THE COUNTRY AS A GRANT. A GRANT IS REQUESTED BECAUSE: (1) IT PROVIDES GREATER POLICY LEVERAGE THAN A LOAN; (2) A LOAN WOULD REQUIRE CONGRESSIONAL DISCUSSION AND APPROVAL, WHICH IS A TIME-CONSUMING PROCESS THAT WOULD DELAY OBLIGATION; (3) PUBLIC DISCUSSION OF CONDITIONALITY IS NOT IN THE INTERESTS OF THE U.S. GOVERNMENT; (4) A LOAN WOULD BE POLITICALLY INOPPORTUNE, IN THAT THE PROPOSED ESF CASH TRANSFER IS SIGNIFICANTLY LESS THAN ORIGINAL EXPECTATIONS OF THE NEW GOVERNMENT, AND A LOAN, AS OPPOSED TO A GRANT, FURTHER ERODES THE VALUE OF THE ASSISTANCE; AND (5) A LOAN WOULD INCREASE THE COUNTRY'S ALREADY HIGH EXTERNAL DEBT AND CORRESPONDING HIGH DEBT SERVICE BURDEN.

THE GODR AGREES THAT THE COUNTRY WILL IMPORT FROM THE U.S. AN AMOUNT EQUIVALENT TO THE CASH TRANSFER IN RAW MATERIALS, SPARE PARTS, MACHINERY AND EQUIPMENT FOR PRIVATE SECTOR USE. THESE IMPORTS WILL BE BROUGHT IN OVER THE COURSE OF NINE MONTHS FROM THE DATE OF THE DISBURSEMENT OF THE GRANT TO THE CENTRAL BANK. A REPORT WILL BE REQUIRED FROM THE GODR WHICH WILL IDENTIFY THE TYPE OF IMPORTED GOOD, THEIR SOURCE AND ORIGIN, AND THEIR U.S. DOLLAR VALUE. THE PURPOSE OF THIS REPORT WILL BE TO VERIFY THAT \$25 MILLION WORTH OF ELIGIBLE IMPORTS WERE ACTUALLY RECEIVED. THE REPORT, TO BE SUBMITTED NO LATER THAN TEN MONTHS AFTER THE DISBURSEMENT OF THE GRANT, MUST BE SUPPORTED BY DOCUMENTATION, MAINTAINED BY THE CENTRAL BANK, WHICH WILL INCLUDE

CUSTOMS RECEIPTS, BILLS OF LADING, CENTRAL BANK AUTHORIZATIONS OF FOREIGN EXCHANGE IMPORTS, AND OTHER STANDARD BANKING DOCUMENTS.

(B) DISBURSEMENT AND PAYMENT VERIFICATION

THE CASH TRANSFER WILL BE DISBURSED ONCE THE INITIAL CONDITIONS PRECEDENT HAVE BEEN MET. THE METHOD OF DISBURSEMENT FOR NON-PROJECT ASSISTANCE AUTHORIZED UNDER THIS PAAD WILL BE A DOLLAR PAYMENT THROUGH THE ELECTRONIC FUNDS TRANSFER METHOD, WHICH IS A PREFERRED METHOD OF FINANCING UNDER THE ADMINISTRATION'S PAYMENT VERIFICATION POLICY STATEMENT. THEREFORE, NO FURTHER JUSTIFICATION IS REQUIRED. SINCE THIS IS A CASH TRANSFER, NO METHOD OF IMPLEMENTATION IS APPLICABLE.

THE USAID CONTROLLER HAS REVIEWED AND APPROVED THE IMPLEMENTATION/FINANCING PROCEDURES CONTAINED IN THIS PAAD.

2. LOCAL CURRENCY PROGRAM

(A) OVERVIEW

AS A CONDITION TO RECEIVING THE DOLLAR CASH TRANSFER, THE GODR WILL BE REQUIRED TO PROVIDE AND DEPOSIT THE PESO EQUIVALENT OF THE CASH TRANSFER INTO A SPECIAL ACCOUNT AS PROGRAM COUNTERPART. THE EXCHANGE RATE USED TO CALCULATE THE AMOUNT OF COUNTERPART REQUIRED OF THE GODR WILL BE DETERMINED BY AVERAGING THE SALES RATES FOR DOLLARS, AS PUBLISHED BY THE CENTRAL BANK'S DEPARTMENT OF FOREIGN EXCHANGE, FOR THE 30-DAY PERIOD FOLLOWING THE DATE OF THE DOLLAR DISBURSEMENT.

THE PROCEDURES FOR HANDLING THE LOCAL CURRENCY WILL NOT VARY SIGNIFICANTLY FROM THOSE THAT PREVIOUSLY HAVE BEEN EMPLOYED. THESE RESOURCES WILL BE DEPOSITED IN A SPECIAL ACCOUNT IN THE CENTRAL BANK NO LATER THAN 45 DAYS FROM THE DATE OF DISBURSEMENT OF THE CASH TRANSFER. AS IN THE PAST, THE CENTRAL BANK WILL INFORM THE TECHNICAL SECRETARY OF THE PRESIDENCY OF THE DEPOSIT AND THE AVERAGE EXCHANGE RATE USED TO CALCULATE THE TOTAL AMOUNT OF THE DEPOSIT. THE TECHNICAL SECRETARY WILL, IN TURN, ADVISE AID.

LOCAL CURRENCIES RESULTING FROM THE CASH TRANSFER ARE TO BE PROGRAMMED JOINTLY BY THE GODR AND AID. THE LOCAL CURRENCY COORDINATING UNIT WITHIN THE TECHNICAL SECRETARIAT OF THE PRESIDENCY WILL BE THE ENTITY RESPONSIBLE FOR COORDINATING THE PLANNING AND PROGRAMMING OF THE SPECIFIC USES OF THE LC RESOURCES FOR THE GODR. AS IN THE PAST, PRIOR TO THE DISBURSEMENT OF LOCAL CURRENCIES FOR PROJECTS OR ACTIVITIES, THE TECHNICAL SECRETARY WILL SUBMIT A DESCRIPTION, IMPLEMENTATION PLAN, AND BUDGET OF EACH PROJECT AND/OR ACTIVITY FOR AID APPROVAL. IN ADDITION, AID APPROVES ALL RELEASES OF LC FUNDS FOR PROGRAM ACTIVITIES FROM THE SPECIAL ACCOUNT.

(B) ILLUSTRATIVE ALLOCATION

LOCAL CURRENCY FUNDS WILL BE PROGRAMMED PRINCIPALLY FOR ACTIVITIES WHICH FALL WITHIN THREE OF THE FOUR CATEGORIES OF THE USAID

STRATEGY: INCREASING INDUSTRIAL PRODUCTION, ENHANCING AGRICULTURE DIVERSIFICATION, AND IMPROVING SUPPORTING INFRASTRUCTURE. BECAUSE OF PROGRESS MADE IN THE AREA OF SHORT-TERM ECONOMIC STABILIZATION, NO ADDITIONAL LOCAL CURRENCY FUNDS WILL BE PROGRAMMED IN THIS AREA. THIS YEAR'S PROGRAM WILL PLACE SPECIAL EMPHASIS ON PROVIDING CREDIT FOR FREE TRADE ZONE EXPANSION, NON-TRADITIONAL EXPORTS, DIVERSIFIED AGRICULTURAL PRODUCTION, AND INFRASTRUCTURE. THIS EMPHASIS IS IN DIRECT SUPPORT OF THE USAID STRATEGY WHICH IS DESIGNED TO ENHANCE THE ROLE OF THE PRIVATE SECTOR AS WELL AS TO DEVELOP SUSTAINED AND EQUITABLY DISTRIBUTED ECONOMIC GROWTH IN THE DOMINICAN REPUBLIC. THE BASIC ALLOCATION AGREED TO WITH THE CODR IS AS FOLLOWS:

	AMOUNT (1) (RD\$ MIL.)
I. INCREASING INDUSTRIAL PRODUCTION	15.0
A. FREE ZONE EXPANSION	15.0
II. ENHANCING AGRICULTURAL DIVERSIFICATION	25.0
A. GUARANTY FUND FOR COMMERCIAL FARMING	10.0
B. AGRICULTURAL TECHNOLOGY DEV. FOUNDATION	15.0
III. SUPPORTING INFRASTRUCTURE	30.5
A. PUBLIC WORKS (ROADS, HIGHWAYS, ELECTRIC PLANTS, IRRIGATION SYSTEMS)	25.0
B. PVO SUPPORT, MAINLY SMALL BUSINESS	5.5
IV. OTHER	4.5
A. TRUST FUND	4.0
B. COORDINATING UNIT	0.5
TOTAL	75.0

(1) THE EXCHANGE RATE OF RD\$3.00 TO US\$1.00 WAS USED TO ESTIMATE THE TOTAL AMOUNT OF PESOS TO BE GENERATED UNDER THE PROPOSED CASH TRANSFER GRANT.

(1) SHORT-TERM ECONOMIC STABILIZATION CATEGORY. ALTHOUGH LOCAL CURRENCIES WILL NOT BE PROGRAMMED FOR NEW PROJECTS IN THIS AREA, CERTAIN PROJECTS ARE STILL ACTIVE THAT HELP TO IMPROVE THE COUNTRY'S ECONOMIC POLICY FOUNDATION SO THAT THE GODR'S STRUCTURAL ADJUSTMENT EFFORTS CAN BETTER SUCCEED. FOR EXAMPLE, ACTIVITIES UNDER THE ONGOING AID-FINANCED AGRICULTURAL POLICY ANALYSIS PROJECT WILL BE CONTINUED. DURING THE PAST YEAR, STUDIES BY

THE AG. POLICY UNIT ON RICE PRICES, MACHINERY SUBSIDIES, AND SUBSIDIES ON OTHER AGRICULTURAL INPUTS WERE LARGELY RESPONSIBLE FOR THE RECENT REMOVAL OF THESE SUBSIDIES. THIS UNIT IS NOW ENGAGED IN A STUDY INVOLVING THE RATIONALIZATION OF RICE MARKETING IN THE DOMINICAN REPUBLIC. THE ONGOING AID-FINANCED RURAL SAVINGS MOBILIZATION PROJECT, WHICH HAS BEEN SUPPORTED WITH LOCAL CURRENCY RESOURCES, HAS MOBILIZED SAVINGS OF RD\$8.6 MILLION IN THE AGRICULTURAL DEVELOPMENT BANK IN 30 AG. BANK OFFICES AND RD\$2.3 MILLION IN FOUR PRIVATE CREDIT UNIONS. POLICY ANALYSES CARRIED OUT UNDER THE PROJECT WERE THE BASIS FOR A RECENT AGREEMENT BETWEEN THE CENTRAL BANK, THE TECHNICAL SECRETARY OF THE PRESIDENCY (STP), AND THE AG. BANK, THAT LOCAL CURRENCY CHANNELLED TO THE AG. BANK BY THE CENTRAL BANK SHOULD CARRY AN INTEREST CHARGE OF 8.5 PERCENT (APPROXIMATELY THE COST OF MOBILIZING SAVINGS) AND SHOULD BE REPAYABLE TO THE CENTRAL BANK. THE AG. BANK WOULD THEN ON-LEND THESE FUNDS AT BETWEEN 16-18 PERCENT, APPROXIMATING THE CURRENT MARKET RATE OF INTEREST. BASED ON THIS AGREEMENT, AID AND THE GODR REPROGRAMMED RD\$33.5 MILLION TO CREATE A NEW LINE OF CREDIT FOR THE AG. BANK. THE CREDIT WILL BE FOR AGRICULTURAL PRODUCTION AND PROCESSING. OVER RD\$11.5 MILLION IN LOAN APPLICATIONS HAVE BEEN APPROVED THUS FAR WITH THE REMAINING FUNDS EXPECTED TO BE FULLY COMMITTED BY THE END OF CY-1986.

(2) INCREASING INDUSTRIAL PRODUCTION CATEGORY. A CONSIDERABLE AMOUNT OF CREDIT HAS BEEN PROVIDED TO THE PRIVATE SECTOR THROUGH FIDE TO COMMERCIAL AND DEVELOPMENT BANKS TO STRENGTHEN AND EXPAND THE PRIVATE SECTOR ENDEAVORS. SINCE JANUARY 1986, UNDER THE AGRIBUSINESS CREDIT FUND, FIDE HAS APPROVED APPROXIMATELY RD\$65 MILLION FOR 41 SUB-LOANS. THE CREDIT IS FOR MEDIUM TO LONG-TERM CAPITAL INVESTMENT OR WORKING CAPITAL. AS A RESULT OF THIS CREDIT, IT IS PROJECTED THAT ABOUT 35,000 DIRECT AND INDIRECT JOBS WILL BE CREATED OR MAINTAINED BY THE END OF THE PROJECTS FINANCED WITH AN AVERAGE INVESTMENT PER JOB OF RD\$4,700. THE PROJECTED FOREIGN EXCHANGE EARNINGS FROM THESE INVESTMENTS ARE EXPECTED TO BE US\$229 MILLION AND PROJECTED FOREIGN EXCHANGE SAVINGS TO BE US\$21 MILLION.

WITH LOCAL CURRENCIES PROVIDED UNDER THE PROGRAM, ADEMI, AN ENTITY ORGANIZED TO MAKE LOANS TO MICRO-BUSINESSES, HAS ESTABLISHED OFFICES IN SANTO DOMINGO AND 12 SECONDARY CITIES. BESIDES THE CAPITAL, IT NOW SERVES A TOTAL OF 45 COMMUNITIES IN THE SOUTH-WESTERN AND EASTERN REGIONS OF THE COUNTRY. IN THESE NEW AREAS ALONE, OVER 1,500 LOANS HAVE BEEN MADE TOTALING APPROXIMATELY RD\$1 MILLION SINCE FEBRUARY 1985. TO DATE, ABOUT RD\$8 MILLION HAS BEEN LENT FOR 7,900 LOANS, SERVING 2,500 SMALL AND MICRO-INDUSTRIES WITH AN AVERAGE LOAN OF RD\$1,000. THUS FAR, A TOTAL OF 1,540 NEW JOBS HAVE BEEN CREATED BY ADEMI. WITH ADDITIONAL RESOURCES TO BE PROVIDED UNDER THE LOCAL CURRENCY PROGRAM, ADEMI WILL BE ABLE TO CONSOLIDATE ITS EXPANDED PROGRAM. IN ADDITION, TWO NEW SMALL BUSINESS LENDING ORGANIZATIONS WILL BE SUPPORTED: PROAPE, A NON-PROFIT ORGANIZATION LOCATED IN THE CIBAO REGION; AND ADOPEM, AN AFFILIATE OF THE WOMEN'S WORLD BANK.

THE LOCAL CURRENCY PROGRAM HAS BEEN A PRINCIPAL REASON FOR THE EXPANSION OF FREE TRADE ZONES IN THE DOMINICAN REPUBLIC. DURING THE YEAR, LOCAL CURRENCY RESOURCES FINANCED THE CONSTRUCTION OF 26 NEW BUILDINGS, INCLUDING 10 IN BANI, 12 IN SANTIAGO, AND 4 IN PUERTO PLATA. FIRMS OCCUPYING

THESE LOCATIONS WILL EMPLOY ABOUT 6,000 PEOPLE WHEN THEIR PROJECTS ARE FULLY OPERATIONAL. ADDITIONAL RESOURCES AMOUNTING TO RD\$15 MILLION WILL BE PROGRAMMED FOR NEW FREE TRADE ZONES, INCLUDING LOCATIONS SUCH AS SAN ISIDRO, BANI, LA VEGA AND SAN FRANCISCO DE MACORIS.

DURING THE PAST YEAR, TWO NEW LINES OF CREDIT WERE ESTABLISHED. THE FIRST IS A RD\$30 MILLION FUND TO FINANCE TOURISM INFRASTRUCTURE. THIS IS PART OF AN OPIC GUARANTEE FUND THROUGH THE CENTRAL BANK, AND WILL FINANCE MAINLY HOTEL PROJECTS. SEVEN APPLICATIONS ARE UNDER REVIEW, AND THE TOTAL REQUESTS FOR CREDIT EXCEED THE AMOUNT AVAILABLE. ALSO, A RD\$4 MILLION FUND HAS BEEN ESTABLISHED IN FIDE TO CHANNEL RESOURCES THROUGH PRIVATE COMMERCIAL BANKS FOR LOANS TO THE PRIVATE SECTOR TO FINANCE ENERGY FARM DEVELOPMENT ACTIVITIES. OVER 26 APPLICATIONS HAVE BEEN RECEIVED. THUS FAR, SIX APPLICATIONS HAVE BEEN TECHNICALLY APPROVED AND SUBMITTED TO THE COMMERCIAL BANKS FOR LOAN PROCESSING. THE AMOUNT REQUESTED IN THESE SIX APPLICATIONS IS RD\$3 MILLION AND WILL COVER A PLANTING AREA OF 27,000 TAREAS, OR APPROXIMATELY 1,700 HECTARES.

(3) ENHANCING AGRICULTURAL DIVERSIFICATION CATEGORY. IN PREVIOUS YEARS, ACTIVITIES AND PROJECTS IN THIS CATEGORY WERE FINANCED MAINLY WITH PL-480 TITLE I LOCAL CURRENCY GENERATIONS. ACTIVITIES TYPICALLY INCLUDED THE AFRICAN SWINE FEVER PROGRAM AND AID'S NATURAL RESOURCES AND ON-FARM WATER MANAGEMENT PROJECTS. FUNDS HAVE ALSO SUPPORTED AN APHIS LABORATORY, A SEED LABORATORY, AND VEGETABLE CROP SANITATION ACTIVITIES. BEGINNING THIS FY, FUNDS WILL BE PROGRAMMED FOR TWO NEW MAJOR ACTIVITIES WHICH WILL BE THE CORNER-STONES OF THE AID AGRICULTURAL DIVERSIFICATION STRATEGY: THE FINANCING OF A GUARANTY FUND FOR COMMERCIAL FARMING, AND THE ESTABLISHMENT OF A PRIVATE, AGRICULTURAL TECHNOLOGY DEVELOPMENT FOUNDATION. THESE TWO ACTIVITIES ARE DESIGNED TO EFFECTIVELY ADDRESS BOTH THE FINANCING AND THE TECHNOLOGY PROBLEMS ASSOCIATED WITH INCREASED PRODUCTION BY SMALL/MEDIUM SCALE FARMERS OF NON-TRADITIONAL CROPS. THE GUARANTY FUND WILL BE ESTABLISHED IN AN AMOUNT OF RD\$10 MILLION. THE FUND WILL BE CHANNELLED THROUGH PRIVATE BANKS AND MADE AVAILABLE TO QUALIFIED AGRIBUSINESSES NEEDING INCREASED WORKING CAPITAL CREDIT FOR TECHNICAL INPUTS AND SERVICES TO OUTGROWERS. THE AGRICULTURE FOUNDATION WILL STRENGTHEN THE PRIVATE SECTOR'S CAPACITY TO DEAL WITH THE TECHNOLOGY DEVELOPMENT AND TRANSFER REQUIREMENTS OF PRODUCING NON-TRADITIONAL AGRICULTURAL CROPS. LOCAL CURRENCY RESOURCES WILL BE USED FOR THE ESTABLISHMENT OF AN ENDOWMENT FUND OF WHICH RD\$15 MILLION WILL BE PROVIDED THIS YEAR. THE FOUNDATION, A COMPLETELY PRIVATE ENTITY, WILL ALSO SEEK CONTRIBUTIONS AND SUPPORT FROM OTHER SOURCES. THE FOUNDATION WILL FUND INDIVIDUAL RESEARCH ACTIVITIES THROUGH AGREEMENTS WITH UNIVERSITIES, PRIVATE FIRMS, GOVERNMENT ENTITIES, OR ANY OTHER CAPABLE ORGANIZATIONS.

(4) SUPPORTING INFRASTRUCTURE CATEGORY. AS IN THE PAST, PROJECTS AND ACTIVITIES FINANCED IN THIS CATEGORY WILL HAVE A DIRECT POSITIVE IMPACT ON THE PRIVATE, PRODUCTIVE SECTOR. FOR INSTANCE, IN THE LAST TWO YEARS OVER RD\$71 MILLION HAS BEEN APPROVED FOR THE REPAIR AND REHABILITATION OF THE DOMINICAN ELECTRICITY CORPORATION (CDE) POWER GENERATION SYSTEM THROUGHOUT THE COUNTRY. AS A RESULT, SOME 50 MW OF ADDITIONAL ELECTRIC POWER IS NOW ON-LINE AND ANOTHER 50 MW WILL SOON BE ON-LINE. OTHER ACTIVITIES INCLUDE IMPROVEMENT

OF THE TRANSMISSION SYSTEM IN SANTO DOMINGO; AND INFRASTRUCTURE FOR THE MOORING OF THE POWER BARGE IMPEDANCE. ADDITIONAL RESOURCES WILL BE PROVIDED FOR A PREVENTIVE MAINTENANCE PROGRAM AND FOR SPARE PARTS TO PROTECT THE INVESTMENT IN THE REPAIR AND REHABILITATION THAT HAS BEEN CARRIED OUT TO DATE. RD\$10 MILLION OUT OF THIS YEAR'S LC PROGRAM WILL BE PROVIDED FOR THIS EFFORT.

THE DUARTE HIGHWAY PROJECT, FOR WHICH LOCAL CURRENCY RESOURCES TOTALING RD\$30 MILLION HAS BEEN PROVIDED, IS COMPLETE. OVER 17 KMS. OF HIGHWAY HAVE BEEN UPGRADED FROM 2 TO 4 LANES, PASSING LANES FOR STEEP GRADES HAVE BEEN ADDED, AND ANOTHER 143 KMS. OF ROAD HAS BEEN RECONSTRUCTED, SIGNIFICANTLY IMPROVING LAND TRANSPORTATION BETWEEN THE MAJOR AGRICULTURAL AND AGRO-INDUSTRIAL ZONE OF SANTIAGO AND THE MARKETS AND PORTS OF SANTO DOMINGO. ADDITIONALLY, OVER 300 KMS. OF SECONDARY HIGHWAYS AND 600 KMS. OF RURAL ROADS IN AGRICULTURALLY PRODUCTIVE AREAS HAVE BEEN UPGRADED. THIS PROGRAM WILL BE CONTINUED WITH SELECTION BASED PRIMARILY ON ECONOMICALLY PRODUCTIVE CRITERIA.

THE IDB-FINANCED HAINA PORT PROJECT, FOR WHICH OVER RD\$13 MILLION HAS BEEN PROVIDED UNDER THE LC PROGRAM, IS 60 PERCENT COMPLETE. THE PROJECT IS EXPECTED TO BE COMPLETED IN 1990, AT WHICH TIME THE HAINA PORT WILL BE THE LARGEST FACILITY IN THE CARIBBEAN, INCREASING ITS HANDLING CAPACITY 20 FOLD. LOCAL CURRENCY RESOURCES TO FINANCE GODR COUNTERPART REQUIREMENTS TO THIS PROJECT WILL CONTINUE TO BE PROGRAMMED.

THE REHABILITATION AND UPGRADING OF IRRIGATION SYSTEMS IS CENTRAL TO INCREASED AGRICULTURAL PRODUCTION AND DIVERSIFICATION. WHILE THE MAJORITY OF RESOURCES USED TO FINANCE IRRIGATION SYSTEMS IS FUNDED WITH PL-480 RESOURCES, RD\$9.7 MILLION HAS BEEN PROVIDED UNDER THE ESF PROGRAM, RESULTING IN 135 KMS. OF CANALS REHABILITATED AND 23,000 HECTARES OF LAND RECLAIMED. FUTURE ACTIVITIES WILL INCLUDE THE DEVELOPMENT AND FINANCING OF A PREVENTIVE MAINTENANCE PROGRAM FOR BOTH CANALS AND INDRHI EQUIPMENT.

A NEW ACTIVITY RECENTLY PROGRAMMED UNDER THE SUPPORTING INFRASTRUCTURE CATEGORY IS A LOAN/SCHOLARSHIP PROJECT FOR UNDERGRADUATE AND GRADUATE STUDIES IN THE DOMINICAN REPUBLIC. THE FOUNDATION FOR EDUCATIONAL CREDIT, A PRIVATE, NON-PROFIT ORGANIZATION, WILL ADMINISTER THIS RD\$1.5 MILLION FUND. IT IS EXPECTED THAT ABOUT 200 UNDERGRADUATES AND 50 GRADUATE DEGREES WILL BE FINANCED IN PRIORITY AREAS RELATED TO PRIVATE SECTOR GROWTH AND DEVELOPMENT. ALSO, FUNDS HAVE BEEN PROVIDED TO THE SECRETARIAT OF EDUCATION (SEEBAC) FOR THE REMODELING OF A BUILDING TO HOUSE THE RADIO EDUCATION PROJECT (RADECO) ORIGINALLY FINANCED WITH AID CENTRAL FUNDS. RADECO HAS BEEN INSTITUTIONALIZED WITHIN SEEBAC WHICH WILL CONTINUE THIS SUCCESSFUL, PRIMARY EDUCATION PROGRAM.

THE SECRETARIAT OF HEALTH WILL RECEIVE RESOURCES TO CONTINUE THE RURAL POTABLE WATER PROGRAM, WHICH HAS BEEN SUCCESSFULLY COMPLETED UNDER THE AID-FINANCED HEALTH SECTOR LOAN II PROJECT. AN ADDITIONAL 6,000 RURAL FAMILIES PER YEAR WILL RECEIVE POTABLE WATER SERVICES THROUGH THIS 3-YEAR ACTIVITY. ALSO, COUNTERPART RESOURCES WILL BE PROVIDED TO THE RECENTLY

APPROVED AID-FINANCED VECTOR CONTROL AND FAMILY PLANNING SERVICES EXPANSION PROJECTS.

PRIVATE VOLUNTARY ORGANIZATIONS HAVE BEEN SUPPORTED WITH THE PURPOSE OF ASSISTING THEM TO BECOME SELF-SUFFICIENT OR TO CARRY-OUT PROJECTS THAT ARE INCOME GENERATING. TWO INDIGENOUS PVO'S THAT HAVE RECEIVED LOCAL CURRENCY ASSISTANCE AND HAVE DEMONSTRATED THE CAPACITY TO GENERATE THEIR OWN FUNDS OR OBTAIN SUPPORT FROM OTHER NON-GOVERNMENTAL SOURCES ARE THE COMMUNITY DEVELOPMENT FOUNDATION, INC. (FUDECO) AND THE ASSOCIATION FOR THE DEVELOPMENT OF SMALL BUSINESSES, INC. (ADEMI). CONCENTRATING ITS EFFORTS IN THE FRONTIER RURAL AREAS, FUDECO PROVIDES BOTH TECHNICAL ASSISTANCE AND SUB-LOANS TO INDIVIDUALS AS WELL AS SMALL FARMER ASSOCIATIONS. ADEMI, AS DISCUSSED PREVIOUSLY, MAKES LOANS TO SMALL BUSINESSMEN AND COTTAGE INDUSTRIES.

(5) THE OTHER CATEGORY. THE TRUST FUND, ADMINISTERED BY THE USAID, WILL BE INCREASED BY RD\$4.0 MILLION AND WILL BE USED TO FINANCE ADMINISTRATIVE AND OPERATING COSTS OF THE USAID. TO THE EXTENT POSSIBLE, WITH THE LIMITED AMOUNT OF RESOURCES PROGRAMMED, THE TRUST FUND WILL ALSO BE USED FOR USAID PROGRAM SUPPORT AND IMPLEMENTATION (PS AND I) ACTIVITIES IN AGRICULTURE, HUMAN RESOURCES, HEALTH AND POPULATION, AND THE PRIVATE SECTOR. USE OF TRUST FUNDS FOR THESE PURPOSES IS CONSISTENT WITH THE ADMINISTRATOR'S GUIDANCE TO FREE UP U.S. DOLLAR FUNDS THROUGH THE UTILIZATION OF LOCAL CURRENCY RESOURCES TO FINANCE ADMINISTRATIVE, OPERATING, AND PROGRAM SUPPORT EXPENSES. THE USAID CONTROLLER'S OFFICE WILL MAINTAIN RECORDS ON ALL DISBURSEMENTS FROM THE ACCOUNT, AND WILL PREPARE AND FURNISH AN ANNUAL REPORT TO THE GODR ON THE DEPOSIT, DISBURSEMENT, AND BALANCES IN THE ACCOUNT. IN ADDITION, THE COORDINATING UNIT WITHIN STP WILL RECEIVE RD\$500,000 FOR OPERATING AND ADMINISTRATIVE EXPENSES RELATED TO THE ADMINISTRATION AND MONITORING OF THE LOCAL CURRENCY PROGRAM.

(C) ALTERNATIVE ALLOCATION. THE ABOVE DESCRIBED PROGRAM INCORPORATES THE CONTINUATION OF SEVERAL KEY ACTIVITIES WHICH HAVE ALREADY PRODUCED SIGNIFICANT ACCOMPLISHMENTS, SUCH AS THE FREE TRADE ZONE CONSTRUCTION, PRIVATE SECTOR CREDIT AND SUPPORT TO PRODUCTIVE INFRASTRUCTURE, AS WELL AS THE INITIATION OF IMPORTANT NEW ACTIVITIES IN AGRICULTURE DIVERSIFICATION. THE LEVELS PROGRAMMED REPRESENT THE MINIMUM AMOUNT REQUIRED TO EFFECTIVELY CARRY OUT THE LOCAL CURRENCY PROGRAM DESCRIBED ABOVE. FURTHER, THESE RESOURCES REPRESENT A CRITICAL ELEMENT IN THE GODR'S INVESTMENT PROGRAM AND ITS POLICY OF SUPPORT TO THE PRIVATE SECTOR. THEREFORE, SHOULD IT BECOME NECESSARY TO FURTHER REDUCE THESE ALLOCATIONS, BECAUSE OF CUTS IN THE ESP CASH TRANSFER REQUEST, THE USAID BELIEVES THAT IT MUST BEGIN WITH THE ELIMINATION OF THE RD\$4.0 MILLION ALLOCATION TO THE USAID TRUST FUND. SUCH AN ACTION COULD HAVE NEGATIVE CONSEQUENCES ON THE OPERATION OF THE USAID, BY ELIMINATING A SOURCE OF FUNDS THAT WE RELY ON FOR OPERATING AND ADMINISTRATIVE EXPENSES. THE EFFECTS OF SUCH A REDUCTION IN TRUST FUND RESOURCES WOULD BE FELT BY FY-1988.

3. PROGRAM MONITORING, COORDINATION, AND OVERSIGHT

THE LOCAL CURRENCY COORDINATING UNIT WITHIN STP HAS OVERALL RESPONSIBILITY FOR MONITORING THE LOCAL CURRENCY PROGRAM FOR THE GODR. OVER THE PAST YEAR, THIS UNIT HAS BEEN STRENGTHENED CONSIDERABLY. FOR EXAMPLE, ADDITIONAL PROFESSIONAL STAFF HAVE BEEN HIRED, AND VEHICLES AND COMPUTERS PROCURED. THE USAID RECENTLY FUNDED A SPECIAL ASSESSMENT OF THE LOCAL CURRENCY PROGRAM. BASED ON THE RESULTS OF THIS ASSESSMENT, THE COORDINATING UNIT WILL FOCUS ITS EFFORTS ON IMPROVING ITS PROJECT DATA BASE, DEVELOPING UNIFORM REPORTING SYSTEMS FOR PROJECTS, AND STRENGTHENING ITS ABILITY TO MONITOR PROJECTS BOTH ON THE FINANCIAL AND TECHNICAL REVIEW SIDE. IN ADDITION, WAYS TO STREAMLINE THE PROCESS OF DISBURSING FUNDS ONCE THESE FUNDS HAVE BEEN APPROVED FOR RELEASE BY AID WILL BE EXAMINED. THESE MODIFICATIONS WILL IMPROVE THE UNIT'S ABILITY TO ADMINISTER AND MONITOR THE PROGRAM AND REPORT TO AID MORE EFFECTIVELY ON THE STATUS OF THE PROGRAM.

ON THE USAID SIDE, THE LOCAL CURRENCY PROGRAM TEAM MADE UP OF TECHNICAL DIVISION CHIEFS, THE PROGRAM OFFICER, PROGRAM ECONOMIST, AND THE CONTROLLER, WITH THE PROJECT DEVELOPMENT OFFICER AS CHAIRMAN, HAS BEEN INSTITUTED. THE PRINCIPAL RESPONSIBILITY OF THIS TEAM IS TO MAKE RECOMMENDATIONS ON THE ALLOCATION, PROGRAMMING, AND INDIVIDUAL PROJECT APPROVALS TO USAID MANAGEMENT. THE CAPITAL RESOURCES DEVELOPMENT OFFICE/LOCAL CURRENCY DIVISION CONTINUES TO BE THE PRINCIPAL COUNTERPART OF THE COORDINATING UNIT. THE CRD/LCD COORDINATES THE PROGRAMMING AND PROJECT APPROVAL PROCESS, AND MAINTAINS THE USAID PROJECT RECORDS AND OTHER FINANCIAL DATA ON THE LOCAL CURRENCY PROGRAM. THIS DATA IS ORGANIZED INTO THE USAID'S FOUR STRATEGIC PROGRAMMING CATEGORIES MENTIONED ABOVE; DIFFERENTIATES PROJECTS BY PRIVATE AND PUBLIC SECTOR; IDENTIFIES LC ALLOCATIONS AS AID COUNTERPART, OTHER-DONOR COUNTERPART, OR GODR INVESTMENT PROGRAM; AND INDICATES THE FINANCIAL STATUS OF PROJECTS INCLUDING AMOUNTS PROGRAMMED, APPROVALS, RELEASES, AND EXPENDITURES BY PROJECT. THE CONTROLLER'S OFFICE MAINTAINS ACCOUNTING RECORDS OF LOCAL CURRENCY GENERATIONS AND DEPOSITS, AND PERIODICALLY RECONCILES CRD FINANCIAL REPORTS WITH ITS ACCOUNTING RECORDS.

CENTRAL GOVERNMENT REVENUES AND EXPENDITURES
1984/1987
(In RD\$ Millions)

	REFERENCE 1984		ESTIMATED 1985		PROJECTED 1986		TARGETED 1987		VARIATION 1987/1986	
	RD\$	% GDP	RD\$	% GDP	RD\$	% GDP	RD\$	% GDP	RD\$	% Chang
<u>CURRENT ACCOUNT</u>										
Revenues	1156	10.6	2184	15.1	2093	12.8	2105	11.1	+12	+0.6
Spending	1014	9.3	1863	12.9	1841	11.3	1430	7.5	-411	-22.3
Wages/Salaries	500	4.6	610	4.2	677	4.1	660	3.5	-17	-2.5
Private Transf.	102	0.9	120	0.8	144	0.9	120	0.6	-24	-16.7
Interest	46	0.4	53	0.4	38	0.2	60	3.2	+22	+57.9
Public Transf.	157	1.4	815	5.6	599	3.7	360	1.9	-239	-39.9
Other	209	1.9	265	1.8	383	2.3	230	1.2	-153	-39.9
Surplus	142	1.3	321	2.2	252	1.5	675	3.6	+423	+167.9
<u>CAPITAL ACCOUNT</u>										
Revenues	7	0.1	14	0.1	16	0.1	15	0.1	-1	-0.2
Spending	232	2.1	441	3.1	371	2.3	790	4.2	+419	+112.9
Investment	106	1.0	198	1.4	237	1.5	585	3.1	+348	+146.8
Capital Transfers	126	1.2	243	1.7	134	0.8	205	1.1	+71	+53.0
- Public	123	1.1	238	1.6	131	0.8	200	1.1	69	+52.7
Deficit	-225	-2.1	-427	-3.0	-355	-2.2	-775	-4.1	-420	+18.0
OVERALL BALANCE	-83	-0.8	-106	-0.7	-119	-0.7	-116	-0.5	+3	-2.5
<u>FINANCING</u>										
Domestic, Net	-18	-0.2	-27	-0.2	-116	-0.7	-23	-0.1	-	-
External, Net	101	0.9	133	0.9	209	1.3	123	0.6	-	-
Disbursements	131	1.2	269	1.9	327	2.0	245	1.3	-	-
Loan Amortization or Deposits	-30	0.3	-136	-0.9	-118	-0.7	-122	0.6	-	-
NOTE: Totals may not add due to rounding.										
MEMORANDUM GDP	10931	100.0	14488	100.0	16335	100.0	19000	100.0	-	-
TOTAL PUBLIC TRANSFERS	280	2.6	1053	7.3	730	4.5	430	2.3	-173	-

BALANCE OF PAYMENTS FINANCING GAP
1986 AND 1987

	(Millions of US\$)	
	1986	1987
<u>CURRENT ACCOUNT</u>	<u>-241</u>	<u>-253</u>
Trade Balance	<u>-530</u>	<u>-580</u>
Exports, FOB	(730) /1/	(762) /14/
Imports, FOB	(-1,260) /2/	(-1,342) /15/
Services Balance	<u>-10</u>	<u>30</u>
Receipts	(665) /3/	(718) /16/
Payments	(675) /4/	(688)
Transfers Balance	<u>299</u> /5/	<u>297</u> /17/
Private	(259)	(267)
Public	(40)	(30)
<u>CAPITAL ACCOUNT</u>	<u>16</u>	<u>220</u>
Direct Investment	<u>60</u>	<u>100</u> /18/
Medium, Long-Term Loans	<u>1</u>	<u>80</u> /19/
Disbursements	(220)	(310) /19/
Amortizations	(-219)	(-230) /20/
Short-Term, Net	<u>-45</u>	<u>40</u> /21/
<u>OVERALL BALANCE</u>	<u>-225</u>	<u>-33</u>
<u>FINANCING</u>	<u>225</u>	<u>33</u>
Net International Reserves of Central Bank	<u>6</u> /6/	<u>-50</u> /22/
Assets	(203) /7/	(...)
Liabilities	(-197) /8/	(...)
IMF, Net	4 /9/	...
Arrears	-35 /10/	-48 /23/
Other Reserve Liabilities	-166	...
Other, Net	<u>49</u> /11/	<u>...</u>
<u>FINANCING GAP</u>	<u>-170</u>	<u>...</u>
<u>SOURCES</u>		
Rescheduling	<u>110</u> /12/	<u>-110</u> /24/
ESF
Other	... /13/	...
<u>REMAINING GAP OR ADJUSTMENT</u>	<u>-60</u> /13/	<u>-127</u>

NOTES TO BALANCE OF PAYMENTS

FINANCING GAP CALCULATIONS

- 1/ Central Bank projections of the value of 1986 exports, as of July 31, 1986, were of the order of \$708 million. Embassy and USAID projections during August were about the same: \$711 million. However, increased Central Bank receipts since mid-August indicates that exports may be as much as \$730 million.
- 2/ Mid-year Central Bank projections of 1986 imports were of the order of \$1,205 million, of which \$252 million corresponded to petroleum imports. Unofficial Central Bank projections made in late October project total imports at \$1,260 million, of which \$266 million correspond to petroleum imports. Embassy and USAID August projections of 1986 imports were of the order of \$1,220 million.
- 3/ Assumes tourism receipts of the order of \$500 million, which may be optimistic.
- 4/ Includes \$15 million of interest on obligations to Venezuela, that may be rescheduled.
- 5/ Central Bank mid-year projections; projections exclude ESF.
- 6/ IMF methodology; balance: -\$266 million, excluding inflow of ESF resources; assumes payment of \$50 million to Central Bank of Venezuela that may be rescheduled.
- 7/ Central Bank cash flow projections, excluding ESF inflow and including all scheduled payments to Venezuela, indicate gross reserve losses on the order of \$313 million, which are untenable. \$203 million is targeted maximum gross reserve loss.
- 8/ Assumes payment of \$50 million to Central Bank of Venezuela, that may be rescheduled; cash reduction of Central Bank reserve liabilities projected at \$228 million, less accounting adjustment of the order of \$31 million to reflect increase in U.S. dollar obligations to IMF, due to depreciation of U.S. dollar in terms of SDRs.
- 9/ Before accounting revaluation of liabilities to IMF, reduction of \$27 million (see note 8, above).

Receipts	\$19 million
Payments	-46
Net Cash Activity	=27
Revaluation	+31
Change in Liability	\$ 4 million

- 10/ Excludes arrears reductions and other payments of short-term Central Bank liabilities not usually considered reserve liabilities.
- 11/ Includes reduction of Central bank arrears outside reserve liability accounts, and reductions in net foreign assets of commercial banking system.
- 12/ Rescheduling with Venezuelan Investment Fund and Central Bank of Venezuela; principal = \$95 million, interest = \$15 million.
- 13/ Up to \$25 million could probably be deferred until early 1987, but would technically be in arrears, so not considered.
- 14/ Does not assume any reduction in U.S. sugar quota. Assumes increase of 20,000 tons of sugar exports to the world market. Assumes export of 572,000 sixty-kilo bags of coffee at an average export price of \$1.60/lb. Assumes value of non-traditional exports of \$165 million.
- 15/ Assumes 4% increase in petroleum imports at prices similar to 1986; assumes 4% increase in volume of non-petroleum imports at average prices 3% higher than 1986 prices.
- 16/ Assumes increase in foreign exchange proceeds from tourism of 7% to \$535 million. Assumes 26% increase in peso costs of free zone operations, equivalent to increased dollar costs of the order of 15%, due to expected increase in average nominal exchange rate from RD\$2.95 = US\$1.00 during 1986, to RD\$3.75 during 1987.
- 17/ Excludes ESF.
- 18/ Target estimate.
- 19/ Tentative; will be revised when results of ongoing IBRD and IDB consultations and negotiations concluded.
- 20/ Subject to reduction, if appropriate rescheduling agreed on.
- 21/ Assumes significant increases in trade credits, and an expanding economy with targeted real growth of 4%.
- 22/ Target, excluding ESF disbursements during 1987; assumes appropriate IMF arrangement.
- 23/ Assumes resolution of legal issues associated with outstanding commercial arrears, plus payment of accumulated fees and interest outstanding as of end-1986.
- 24/ Assumes full payment of 1986 rescheduling with Venezuela, although it is understood repayment may be scheduled through 1988.

3. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government? No

4. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? No

5. FAA Sec. 620(a), 620(f), 620D; FY 1986 Continuing Resolution Sec. 512. Is recipient country a Communist country? If so, has the President determined that assistance to the country is important to the national interests of the United States? Will assistance be provided to Angola, Cambodia, Cuba, Iraq, Syria, Vietnam, Libya, or South Yemen? Will assistance be provided to Afghanistan without a certification? No

6. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property? No

7/2

7. FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC? No
8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters? No
- (b) If so, has any deduction required by the Fishermen's Protective Act been made?
9. FAA Sec. 620(q); FY 1986 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill (or continuing resolution) appropriates funds? a) Yes, but the GODR is not in default.
b) No.
10. FAA SEC. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.) Yes, taken into account by the Administrator at time of approval of the Agency OYB.

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? No
12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.) The GODR is current on payment of its U.N. obligations.
13. FAA Sec. 620A. Has the government of the recipient country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? No
14. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? No

15. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? No
16. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) No
17. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported illegally (or attempted to export illegally) from the United States any material, equipment, or technology which would contribute significantly to the ability of such country to manufacture a nuclear explosive device? No

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable generally to FAA funds, and criteria applicable to individual fund sources: Development Assistance and Economic Support Fund.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481(h)(1); FY 1966 Continuing Resolution Sec. 527. has it been determined or certified to the Congress by the President that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971) which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? No

2. FAA Sec. 481(h)(4). Has the President determined that the recipient country has not taken adequate steps to prevent (a) the processing, in whole or in part, in such country of narcotic and psychotropic drugs or other controlled substances, (b) the transportation through such country of narcotic and psychotropic drugs or other controlled substances, and (c) the use of such country as a refuge for illegal drug traffickers? No

18. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.) No

19. FY 1986 Continuing Resolution Sec. 541.

Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions? No

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations? No

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? No

20. FY 1987 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined as supporting or participating in the management of a program of coercive abortion or involuntary sterilization? (20) No
- If assistance is from the population functional account, are any of the funds to be made available to family planning projects which do not offer, either directly or through referral to or information about -- access to, a broad range of family planning methods and services? N/A
21. FY 1987 Continuing Resolution Sec. 528. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States? (21) No
22. FY 1987 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? (22) No
23. FY 1987 Continuing Resolution Sec. 536. If the assistance is for Peru or Jamaica, has the President certified and reported to Congress that these countries are "sufficiently responsive to the United States Government concerns on drug control and that the added expenditures of the funds for that country are in the national interest of the United States"? N/A

If not, will 50% or less of the funds made available by the Appropriation Act (other than international narcotic control funds) be made available for obligation prior to such certification and report?

N/A

With regard to Bolivia, has the President certified that Bolivia "has engaged in narcotics interdiction operations which have significantly disrupted the illicit coca industry in Bolivia or has cooperated with the United States in such operations"?

N/A

With regard to Bolivia, has the President certified that Bolivia has met in 1986 its 1985 eradication targets, or has entered into an agreement with the United States for implementing a plan for 1987 and beyond and is making substantial progress towards the plan's objectives?

N/A

24. Anti-Drug Abuse Act of 1986 Sec. 2005. Has the country been identified as a major drug producing or drug-transit country?

No

If so, is not more than 50% of the assistance (other than international narcotics control, disaster and refugee relief, provision of food and medicine, Inter-American Foundation and Child Survival Fund assistance) being made available for obligation?

Has the President determined and certified to Congress that either (1) during the previous year the country has "cooperated fully with the United States" or has "taken adequate steps on its own" to prevent the sale or transport of illicit drugs to the United States and to prevent laundering of drug profits, or (2) U.S. "vital national interests" require provision of the assistance?

3(A)2 NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY
CHECKLIST UP TO DATE? IDENTIFY. Yes
HAS STANDARD ITEM
CHECKLIST BEEN
REVIEWED? Yes

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1986 Continuing Resolution
Sec. 524; FAA Sec. 634A.

Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

Congress was notified in the FY 1987 Congressional Presentation, Annex III

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislative action is required.

3. FAA Sec. 209 Is assistance more efficiently and effectively given through regional or multilateral organizations? If

No, assistance is not more efficiently and effectively given through a regional or multilateral organization.

so, why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs.

4. FAA Sec. 601(a) Information and conclusions whether assistance will encourage efforts of the country to:
(a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.
5. FAA Sec. 601(b) Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).
6. FAA Sec. 612(b), 636(h); FY 1986 Continuing Resolution Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

Assistance will increase the flow of trade and foster private initiative and competition through the requirement that the country make available an equivalent amount of dollars for the importation of spare parts, machinery and equipment from the United States for the private sector's use.

See 4. above.

The Agreement will require that the country contribute an amount equivalent to the cash transfer in local currency be deposited into a Special Account.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? No
8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? NA, assistance is in the form of a cash transfer.
9. FAA 12(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds? NA
10. FY 1986 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? No, assistance is not conditioned on the basis of policies of a multilateral institution.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

- a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of part I of the FAA? Yes, it will promote economic and political stability and is consistent with part I of the FAA.
- b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities? No

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

Local currencies will be contributed and will support activities consistent with the objectives of FAA Sections 103 through 106.

d. ISDCA of 1985 Sec. 205. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used?

NA

e. ISDCA of 1985 Sec. 801. If ESF funds will be used to finance imports by an African country (under a commodity import program or sector program), will the agreement require that those imports be used to meet long-term development needs in those countries in accordance with the following criteria?

NA

(i) spare parts and other imports shall be allocated on the basis of evaluations, by A.I.D., of the ability of likely recipients to use such spare parts and imports in a maximally productive, employment generating, and cost effective way;

(ii) imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. A.I.D. shall

assess such plans to determine whether they will effectively promote economic development;

(iii) emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products;

(iv) emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions;

(v) in order to maximize the likelihood that the imports financed by the United States under the ESF chapter are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses;

(vi)(A) seventy-five percent of the foreign currencies generated by the sale of such imports by the government of the country shall be deposited in a special account established by that government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities

which are consistent with the policy directions of section 102 of the FAA and which are the types of activities for which assistance may be provided under sections 103 through 106 of the FAA;

(B) the agreement shall require that the government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government.

f. ISDCA of 1985 Sec. 207.
Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

No

g. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

Special Account arrangements have been made.

h. Special Foreign Assistance Act of 1986 Sec. 202(c). If ESF is to be paid to the Government of Haiti in the form of cash transfer assistance, will the Government of Haiti maintain those funds in a separate account and not commingle them with other funds?

N/A

i. FY '87 Continuing Resolution. If the ESF assistance is to be provided to a country after February 1, 1987, in the form of a cash transfer in excess of \$5 million, will the recipient country maintain such funds in a separate account and not commingle such funds with any other funds?

YES

If such cash transfer generates local currencies, will such local currencies be deposited in a special account to be used in accordance with FAA Sec. 609?

YES

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TELEGRAM

PAGE 01 - -SANTO 12692 01 OF 07 042103Z 2430 076332 AID0533
ACTION AID-00

SANTO 12692 01 OF 07 042103Z 2430 076332 AID0533

INFO TELE-01 /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PPPB-02
GC-01 GCLA-03 PPEC-01 PPMF-01 GCOM-02 APPC-02 PFR-01
PVC-02 RELO-01 DO-01 PFE-05 /038 A4 305

INFO LOG-00 CIAE-00 EB-00 DODE-00 ARA-00 /000 W
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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0768

UNCLAS SECTION 01 OF 07 SANTO DOMINGO 12692

AID00

PASS TO ARA/CAR

E.O. 12356: N/A

SUBJECT: USAID/DF FY 1987 ESF FAAD UPDATE

REFS: (A) STATE 141204, (B) SANTO DOMINGO 14827,
(C) STATE 140021

1. SUMMARY

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

2. BACKGROUND

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

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

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

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

THE "ADJUSTMENT WITH GROWTH" SCENARIO WE HAVE SKETCHED OUT ASSUMES THAT STABILIZATION AND GROWTH OBJECTIVES CAN BE ACHIEVED WITHOUT ACTUAL REDUCTIONS IN AVERAGE CONSUMPTION LEVELS, BUT DOES NOT ALLOW FOR INCREASES IN PER CAPITA CONSUMPTION. THAT IS, ALL IMPROVEMENTS IN PER CAPITA GDP LEVELS ARE ASSUMED TO BE INVESTED. EVEN SO, SIGNIFICANT RESOURCE GAPS AVERAGING \$13 MILLION PER YEAR ARE PROJECTED AND WILL REQUIRE FINANCING. FAILURE

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TELEGRAM

PAGE 01 SANTO 12692 02 OF 07 042058Z 2451 076333 AID0542
ACTION AID-00

SANTO 12692 02 OF 07 042058Z 2451 076333 AID
4. FOREIGN EXCHANGE REGIME

INFO TELE-01 /001 A6

ACTION OFFICE LACA-03
INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PPPF-02
GC-01 GCLA-03 FFCC-01 PPF-01 GCOM-02 APPC-02 PPR-01
PVC-02 RELO-01 DO-01 PRE-06 /038 A1 305

INFO LOG-00 COPY-01 CIAE-00 EB-00 BODE-00 ARA-00 /001 W
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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0769

UNCLAS SECTION 02 OF 07 SANTO DOMINGO 12692

AIDAC

INFO TO DIRECTOR

E.O. 12356: M/A

SUBJECT: USAID/OA FY 1987 EST PAAD UPDATE

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

3. PROGRAM STRATEGY

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

IN PARTICULAR, WE WILL SEEK AN ADJUSTMENT SCENARIO THAT WILL REDUCE INFLATION FROM A PROJECTED 26 PERCENT IN 1987 TO 6 PERCENT BY 1990, STABILIZE THE EXCHANGE RATE, AND RESTORE PER CAPITA INCOME LEVELS AND ANNUAL ECONOMIC GROWTH AS MEASURED BY PER CAPITA GDP TO 1968 LEVELS BY 1990/91. IN 1987 PRICES, PER CAPITA GDP WOULD THEN ONCE AGAIN BE OF THE ORDER OF \$900 AND ANNUAL PER CAPITA GROWTH WOULD AGAIN APPROACH 5 PERCENT. THIS STRATEGY OF ADJUSTMENT WITH GROWTH IS ATTAINABLE, BUT WILL REQUIRE CAREFUL COORDINATION OF GOOR FISCAL AND MONETARY POLICIES, SIGNIFICANT INCREASES IN PRIVATE SECTOR INVESTMENT, AND SUBSTANTIAL EXTERNAL FINANCING OVER THE NEXT THREE YEARS.

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

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

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

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Department of State

INCOMING
TELEGRAM

PAGE #1 SANTO 12692 #3 OF #7 #420592 2455 #76334 A100543
ACTION A10-#7

SANTO 12692 #3 OF #7 #420592 2455 #76334 A101

INFO TILE-01 /001 A6

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

ACTION OFFICE LACA-#3

INFO FPA-#2 AALA-#1 LACO-#1 LADP-#4 LADR-#3 FVA-#1 PPPB-#2
GC-#1 GCLA-#2 PPDC-#1 PPPF-#1 GCCM-#2 APPC-#2 PPR-#1
PVC-#2 RELO-#1 DO-#1 PRE-#6 /#38 A4 385

WE ANTICIPATE A CURRENT ACCOUNT BALANCE OF PAYMENTS DEFICIT THIS YEAR OF THE ORDER OF \$276 MILLION, EQUIVALENT TO 5 PERCENT OF GDP (INTEREST PAYMENTS BASED ON ACCRUALS, WHETHER OR NOT PAID; PUBLIC TRANSFERS EXCLUDED). THIS COMPARES TO A CURRENT ACCOUNT DEFICIT IN 1986 OF \$218 MILLION, OR LESS THAN 4 PERCENT OF GDP.

INFO LOG-#8 COPY-#1 CIAE-#8 EE-#8 DODE-#8 ARA-#8 /001 W
-----342222 #421122 /65 38

O #420432 DEC 87

FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 877#

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

UNCLAS SECTION #3 OF #7 SANTO DOMINGO 12692

AIDAC

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

PASS TO AAA/CAR

I.O. 12356: #/A

SUBJECT: USAID/DR FY 1987 EST PAAD UPDATE

CENTRAL BANK ARREARS ON RESERVE LIABILITIES DECLINED BY \$26 MILLION IN 1986, AND MAY HAVE DECLINED FURTHER THIS YEAR. HOWEVER, PARIS CLUB AND BILATERAL ARREARS INCREASED SOME \$130 MILLION IN 1986. ADJUSTING FOR ADDITIONAL NET REDUCTIONS IN ARREARS ON THE ORDER OF \$22 MILLION, NET BUILD-UP OF EXTERNAL DEBT ARREARS IN 1986 AMOUNTED TO SOME \$82 MILLION. WE ESTIMATE THAT, AS OF THE END OF OCTOBER 1987, ADDITIONAL ARREARAGES ON THE

LEGISLATURE A LARGE TAX PACKAGE THAT WOULD PERMIT PESO FINANCING TO THE CENTRAL BANK OF EXTERNAL DEBT SERVICE, AND ALLOW SOME FLEXIBILITY IN PETROLEUM PRICING POLICIES. THE EXCHANGE COMMISSION ON SUGAR AND MINING EXPORTS WAS PUBLISHED SIMULTANEOUSLY WITH A NEW DECREE WHICH RAISED THE PUMP PRICE OF GASOLINE BY 20 PERCENT; EVEN SO, PUMP PRICES FOR REGULAR GASOLINE ARE STILL RELATIVELY CHEAP AT THE EQUIVALENT OF U.S. 68 CENTS PER GALLON. THE OFFICIAL MARKET EXCHANGE RATE IS TO BE CALCULATED EACH DAY AS A WEIGHTED AVERAGE OF FREE MARKET SELLING RATES OF THE PREVIOUS DAY. THE OFFICIAL MARKET WILL RECEIVE FOREIGN EXCHANGE FROM EXPORTS OF GOODS AND SPECIFIED SERVICES, AND WILL PROVIDE FOREIGN EXCHANGE FOR EXTERNAL PUBLIC DEBT SERVICE, PETROLEUM IMPORTS, PUBLIC SECTOR IMPORT REQUIREMENTS, SPECIFIED PRIORITY PRIVATE SECTOR IMPORTS AND PENDING OBLIGATIONS INCURRED BY THE CENTRAL BANK UNDER THE SYSTEM OF CONTROLS.

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

5. BALANCE OF PAYMENTS ISSUES

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

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INCOMING
 TELEGRAM

PAGE #1 SANTO 12692 04 OF 07 042100Z 2438 076335 AID0539
 ACTION AID-00

SANTO 12692 04 OF 07 042100Z 2438 076335 AID0539

INFO TELE-01 /001 06

PERCENT EXCHANGE COMMISSION ON NON-ESSENTIAL IMPORTS, ESTIMATED TO YIELD RD\$710 MILLION DURING 1988, WILL FINANCE MOST INTEREST OBLIGATIONS FOR THE COMING YEAR, SO THIS PROBLEM HAS BEEN "SOLVED" FOR THE NEAR-TERM.

ACTION OFFICE LACA-02

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PFPB-02
 GC-01 GCLA-03 PPCC-01 PPHF-01 G'CH-02 APPC-02 PPR-01
 PLC-02 RELO-01 DO-01 PRE-06 /038 A4 305

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

INFO LOG-00 COPY-01 CIAI-00 EB-00 DODE-00 ARA-00 /001 W

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O 042043Z DEC 87

FM AMEMBASSY SANTO DOMINGO
 TO SECSTATE WASHDC IMMEDIATE 0771

IN ADDITION TO THE EXCHANGE COMMISSIONS ALREADY DESCRIBED, THE CODR HAS RECENTLY RAISED THE PUMP PRICE OF GASOLINE BY 20 PERCENT; THIS SHOULD YIELD RD\$90 MILLION TO THE TREASURY DURING 1988, AFTER DISCOUNTS TO SUCH PREFERRED CUSTOMERS AS CEE. THE TAX PACKAGE SUBMITTED TO THE LEGISLATURE, IF APPROVED AS PROPOSED, COULD YIELD UP TO AN ADDITIONAL RD\$240 MILLION. THIS TAX PACKAGE INCLUDES THE FOLLOWING MEASURES:

UNCLAS SECTION 04 OF 07 SANTO DOMINGO 12692

AIDAC

FILE TO 000000

E.O. 12356: N/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

MEASURE	EXPECTED YIELD, 1988 (MILLIONS OF PESOS)
1) BROADEN COVERAGE OF SALES TAX (ITB1)	18
2) ADDITIONAL TAXES ON BEVERAGES AND CIGARETTES	51
3) ADDITIONAL DUTY ON PREVIOUSLY EXONERATED IMPORTS	19
4) STRENGTHENED SANCTIONS AGAINST INCOME TAX EVASION	50
5) SPECIAL TAX ON LUXURY HOUSES	10

ORDER OF \$120 MILLION, INCLUDING \$60 MILLION OF INTEREST OBLIGATIONS, ACCRUED. TOTAL OUTSTANDING ARREARS AS OF OCTOBER 31 STOOD AT APPROXIMATELY \$336 MILLION. OUR REVISED ESTIMATE OF THE BALANCE OF PAYMENTS FINANCING GAP FOR 1987 IS \$173 MILLION. THE CUMULATIVE PROJECTED FINANCING GAP THROUGH THE END OF 1988, BASED ON PROJECTED RESOURCE GAPS NEEDED TO ATTAIN TARGETED GDP GROWTH DURING 1988 AND 1989, APPROPRIATE REDUCTION OF ARREARS, AND CONFIRMED DONOR DISBURSEMENTS, IS \$413 MILLION. THIS IS ROUGHLY THE AMOUNT OF NEW FINANCING INCLUDING DEBT RESCHEDULING, THAT WILL BE NECESSARY DURING 1988. WITH THIS FINANCING, THE COUNTRY WILL BE POSITIONED FOR REALIZATION OF POSITIVE AND SUSTAINABLE GROWTH OVER THE MEDIUM TERM, AND THE ADJUSTMENT NEEDED FOR A POTENTIAL, ALBEIT SMALL, CURRENT ACCOUNT SURPLUS IN BALANCE OF PAYMENTS FOR 1988 WILL BE ON TRACK.

6. FISCAL AND MONETARY POLICY

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

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

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INCOMING TELEGRAM

PAGE 01 SANTO 12692 05 OF 07 042101Z 2457 076336 AID0544
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SANTO 12692 05 OF 07 042101Z 2457 076336 AID1

INFO ~~TEL-01~~ /001 A6

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

ACTION OFFICE LACA-03
INFO FPA-02 AALA-01 LACD-01 LADP-04 LADR-03 FVA-01 PPPB-02
GC-01 GCLA-03 PPOC-01 PPMF-01 GOCM-02 APPC-02 PPR-01
PVC-02 RELO-01 DO-01 PRE-06 /J38 A4 395

INFO LCG-03 COPY-01 CIAE-00 EB-00 DCOE-00 ARA-00 /J01 V
-----342341 042113Z /65 30

O 042043Z DEC 87
FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 8772

ON THE MONETARY SIDE, NARROW MONEY, DEFINED AS CURRENCY IN CIRCULATION AND PRIVATE SECTOR DEPOSIT DEPOSITS, ROSE 46 PERCENT IN 1986. BROAD MONEY, WHICH CONSISTS OF NARROW MONEY PLUS SAVINGS AND TIME DEPOSITS, GREW 70 PERCENT IN 1986. WE EXPECT THESE AGGREGATES TO INCREASE SOME 12 PERCENT TO 14 PERCENT IN 1987 AND AGAIN IN A LIKE AMOUNT IN 1988. MONETARY POLICY HAS BEEN GENERALLY ADEQUATE, BUT COMMERCIAL BANKS HAVE HAD DIFFICULTY IN RECENT MONTHS MEETING RESERVE REQUIREMENTS, LARGELY DUE TO THE LINKING OF RESERVE REQUIREMENTS WITH COMPLEX PORTFOLIO COMPOSITION IMPERATIVES. AS OF THE END OF NOVEMBER, WE UNDERSTAND THAT ONLY 2 OF 24 COMMERCIAL BANKS WERE IN COMPLIANCE WITH RESERVE REQUIREMENTS. THE CENTRAL BANK HAS THESE ISSUES UNDER REVIEW AND WE EXPECT A CHANGE IN THE RESERVE/PORTFOLIO COMPOSITION SYSTEM, PERHAPS AS EARLY AS DECEMBER. EXPECTED CHANGES WOULD REDUCE THE COMPLEXITY OF THE SYSTEM, LOWER DIRECTED CREDIT REQUIREMENTS AND LEAD TO RESTORATION OF BANKING SYSTEM RESERVE REQUIREMENTS AS AN INSTRUMENT OF MONETARY POLICY, RATHER THAN BEING USED PRIMARILY AS AN INSTRUMENT FOR RESOURCE ALLOCATION.

UNCLAS SECTION 05 OF 07 SANTO DOMINGO 12697

AIDAC

PASS TO ARA/CAR

L.O. 12356: M/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

6) SPECIAL TAX ON FINANCIAL ACTIVITIES 02

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

7. POLICY COVENANTS

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

THE GOVERNMENT'S INTENTION TO ELIMINATE DOMESTICALLY FINANCED FISCAL AND QUASI-FISCAL FINANCING GAPS DURING 1988 CLEARLY HAS PRIORITY OVER COMPREHENSIVE TAX REFORM. IT IS NOW UNDERSTOOD THAT A MAJOR CAUSE OF RECENT INSTABILITY OF FINANCIAL STRUCTURES HAS BEEN INADEQUATE FISCAL BALANCE. MEASURES IMPLEMENTED OR PROPOSED IN RECENT WEEKS ARE EXPECTED TO PROVIDE AN ADDITIONAL RDS66 MILLION OF REVENUES THIS YEAR, AND RDS1.07 BILLION NEXT YEAR. EVEN IF THE EXCHANGE COMMISSION ON SUGAR AND MINERAL EXPORTS IS SOON RESCINDED, AND PESSURE IS INTENSIFYING TO DO SO, INCREASED REVENUES FROM THE NEW MEASURES COULD BE SOME RDS835 MILLION.

THE GOVERNMENT HAS PROJECTED THAT APPLYING ONLY RDS560 MILLION OF THE POTENTIAL RDS1.07 BILLION ASSOCIATED WITH THE NEW MEASURES TO CENTRAL GOVERNMENT ACTIVITIES AND SUBSIDIES TO PARASTATALS COULD RESULT IN REDUCING THE CONSOLIDATED PUBLIC SECTOR DEFICIT TO A MERE ONE PERCENT OF GDP IN 1988. SINCE THE GOVERNMENT PROJECTS NET EXTERNAL FINANCING EQUIVALENT TO 1.6 PERCENT OF GDP, THIS WOULD PERMIT A REDUCTION IN DOMESTIC FINANCING OF

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INCOMING
TELEGRAM

PAGE #1 SANTO 12692 06 OF 07 0421022 2441 076337 AID0540
ACTION AID-00

SANTO 12692 05 OF 07 0421022 2441 076337 AID0
THIS MECHANISM FROM VENEZUELA AND MEXICO SINCE 1980.

INFO TELE-01 /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AA.A-01 LACO-01 LADP-04 LADR-02 FVA-01 PPE-02
GC-01 GCLA-02 PDC-01 PPF-01 GCM-02 APPC-02 PPR-01
PVC-02 RELO-01 JO-01 PRE-06 /038 A4 305

INFO LOG-00 COPY-01 CIAE-00 EB-00 D005-00 ARA-00 /001 W
-----342375 0421082 /70 37

O 042043Z DEC 87
FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 8773

UNCLAS SECTION 05 OF 07 SANTO DOMINGO 12692

AIDAC

PASS TO ARA/CAR

E.O. 12355: N/A

SUBJECT: USAID/DR FY 1987 ESF PAAD UPDATE

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

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

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

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

8. PLANNED DOLLAR USES AND TRACKING SYSTEM

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

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

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

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

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58

Department of State

INCOMING TELEGRAM

PAGE 01 SANTO 12692 07 OF 07 042102Z 2459 076338 AID0545
ACTION AID-00

SANTO 12692 07 OF 07 042102Z 2459 076338 AID
ESTIMATE THE TOTAL AMOUNT OF COUNTERPARTY TO BE PROVIDED
UNDER THE GRANT AGREEMENT. KILDAY

INFO TELE-01 /001 A6

ACTION OFFICE LACA-03

INFO FPA-02 AALA-01 LACO-01 LADP-04 LADR-03 FVA-01 PPPB-02
GC-01 GCLA-03 PPDC-01 PPMF-01 GCOM-02 APPC-02 PPR-01
PVC-02 RELO-01 DD-01 PRE-05 /038 A4 385

INFO LOG-00 COPY-01 CIAE-02 EB-02 DODE-03 ARA-00 /001 W
-----342430 042113Z /65 36

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FM AMEMBASSY SANTO DOMINGO
TO SECSTATE WASHDC IMMEDIATE 0774

UNCLAS SECTION 07 OF 07 SANTO DOMINGO 12692

AIDAC

PASS TO ARA/CAR

E.O. 12356: N/A

SUBJECT: USAID/DF FY 1987 ESF PAAD UPDATE

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

9. LOCAL CURRENCY PROGRAM

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

PROPOSED USE	ESTIMATED AMOUNT RDS MILLION (S)
I. INCREASING INDUSTRIAL PRODUCTION	
- THROUGH PRIVATIZATION AND DEBT	
- EQUITY CONVERSION	25.0
II. ENHANCING AGRICULTURAL DIVERSIFICATION	
- THROUGH AGRIBUSINESS CREDIT	15.0
III. SUPPORTING PUBLIC INFRASTRUCTURE	
- IMPROVEMENTS (ROADS, HIGHWAYS,	
- IRRIGATION)	10.0
IV. OTHER	
- NGO/PVO PROGRAMS	3.1
- AID TRUST FUND	2.0
- COORDINATING UNIT	1.0
- TOTAL	62.1

(S) EXCHANGE RATE OF RDS4.50 TO US\$1.00 WAS USED TO

UNCLASSIFIED