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

REGIONAL DEVELOPMENT OFFICE/CARIBBEAN

PROJECT PAPER

DOMINICA STRUCTURAL ADJUSTMENT

AID/LAC/P-491
CR P-416

Project Number: 538-0141.02
538-K-604A
538-K-604B

UNCLASSIFIED

CLASSIFICATION

PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: 538-K-604A & 538-K-604B 538-0141.02

2. COUNTRY: Dominica

3. CATEGORY: Cash Transfer

4. DATE: September, 1988

5. TO: James S. Holtaway, Director

6. OYB CHANGE NO.:

7. FROM: David Mutchler, Chief, Program Office

8. OYB INCREASE:

TO BE TAKEN FROM: Economic Support Fund (ESF)

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 1,042,900

10. APPROPRIATION - ALLOTMENT:
72-1181037, LESA-88-35538-KG31, $964,388.00
72-117/81037 LES7-88-35538-KG31 78,512.00

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

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

13. ESTIMATED DELIVERY PERIOD: Sept. 1988-Sept. 1990

14. TRANSACTION ELIGIBILITY DATE: Date of Agreement

15. COMMODITIES FINANCED:

16. PERMITTED SOURCE
U.S. only:
Limited F.W.:
Free World:
Cash: $ 1,042,900

17. ESTIMATED SOURCE
U.S.: $ 1,042,900
Industrialized Countries:
Local:
Other:

18. SUMMARY DESCRIPTION

The grant will be used to support the Government of the Commonwealth of Dominica (GOCD) in its ongoing structural adjustment program. In the long term, Dominica is working toward policies which will expand investment and exports, increase public sector savings, and restrain growth of the public sector. Domestic savings will not be sufficient to support needed private and public infrastructure. IMF and World Bank analysts have concluded that despite the government's best efforts, financing a public sector investment program sufficient to help the economy reach a self-sustaining growth rate will require substantial foreign capital inflows. Dominica is the first OECS country to participate in a Tight Consultative Group structural adjustment program. The Dominica program covers the GOCD fiscal years 1986/87 through 1988/89. Conditionality in this Grant focuses on assuring adequate progress in pursuing a comprehensive structural adjustment program with special emphasis on fiscal targets and incentives to private sector development.

19. CLEARANCES

Clearance	Date
RLA:RJOHNSON	9/26/88
P/E:RJGROHS	9/25/88
PDO:DCHIRIBOGA	9/27/88
A/D/DIR:DEMUTCHLER	9/27/88

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE: James Holtaway DATE: 9/30/88

TITLE: JAMES HOLTAWAY, DIRECTOR

CLASSIFICATION:

PER STATE 321588 & 321584 DATED 9/30/88 FUNDS ARE AVAILABLE UPON SIGNATURE OF AA/LAC OR HIS DESIGNEE FOR TOTAL AMOUNT NOT TO EXCEED $ 1,042,900.

Thomas Fallon, CONT. Date 9/26

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LIST OF ACRONYMS

CGCED	Caribbean Group for Cooperation in Economic Development
EC$	Eastern Caribbean Dollar
ECCB	Eastern Caribbean Central Bank
EFF	IMF Extended Fund Facility
GDP	Gross Domestic Product
GOCD	Government of the Commonwealth of Dominica
IBRD	International Bank for Reconstruction and Development (World Bank)
IMF	International Monetary Fund
OECS	Organization of Eastern Caribbean States
PMPP	Public Management and Policy Planning project
PSIP	Public Sector Investment Program
RDO/C	Regional Development Office/Caribbean
SAC	World Bank Structural Adjustment Credit
SAF	IMF Structural Adjustment Facility
SDR	Special Drawing Rights
TCG	Tight Consultative Group

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I. RECOMMENDATIONS, RATIONALE AND SUMMARY

A. Recommendation

The staff of the AID Regional Development Office/Caribbean recommends that the Mission Director amend Program Assistance Approval Document number 538-0141.02 to authorize a $1,042,900 increase in an Economic Support Fund Grant to the Government of the Commonwealth of Dominica (GOCD), thereby raising the total authorized level of this program assistance to $2,542,900. [NOTE: for convenience of presentation, in this paper general references round the $1.04 million increase to "$1.0 million"]. The funds will be disbursed in one tranche, as soon as the Conditions Precedent are met, but not before January 1, 1989. The January 1 deadline marks the midpoint of the GOCD fiscal year and will enable projections of progress toward fiscal targets for the year.

Grantee

The Grantee will be the Government of the Commonwealth of Dominica, acting through the Ministry of Finance.

B. Purpose of the Amendment

This amendment will enable the Mission to advance the program as originally envisioned. The original PAAD (Attachment A) was written in support of a three-year, $4.5 million, AID contribution to a multi-year structural adjustment program for Dominica. Funding constraints, however, permitted authorization of only $1.5 million in September 1987, leaving the program incompletely funded. This amendment increases the authorization part way toward the intended level for this program.

C. Program Summary

The grant will be used to support the Government of the Commonwealth of Dominica (GOCD) in its ongoing structural adjustment program. In the long term, Dominica is working toward policies which will expand investment and exports, which will increase public sector savings, and which will restrain growth of the public sector. IMF and World Bank analysts have concluded that despite government's best efforts, financing a public sector investment program sufficient to help the economy reach a self-sustaining growth rate of about 4 percent will require substantial foreign capital inflows, since it is unlikely that domestic savings will be sufficient to support private and public infrastructure sufficient to sustain that growth rate. In 1986 Dominica embarked upon a three-year, multi-donor-funded structural adjustment program under the auspices of the "Tight Consultative Group" (TCG).1/

1/ The TCG provides coordinated concessional structural adjustment support from the IMF, the IBRD and other donors (See footnote 1 of the original PAAD, and Annex D to the same document.

Dominica is the first OECS country to participate in a TCG structural adjustment program. The TCG concept has been endorsed by the United States Government at World Bank-led Caribbean Group (CGCED) meetings over an 18-month period in 1986-87.

In 1986 the GOCD reached agreement with the IMF and the World Bank on a Policy Framework Paper (PFP) which sets out the structural adjustment program. The IMF disbursed the first of three annual tranches of its Structural Adjustment Facility (SAF) in December, 1986. In June 1987, an IMF team visited Dominica to assess progress toward agreed-upon targets and to begin negotiations on conditionality for a second disbursement. Under terms of the original TCG program, it was expected that USAID would disburse US$1.5 million of its contribution to the first year of the structural reform effort. However, delays in finalizing the agreement postponed disbursement until after the July 1 start of the GOCD 1987/88 fiscal year.2/

According to the schedule described above, the government of Dominica was to have received both the delayed FY86/87 AID tranche and a scheduled second AID tranche in its 1987/88 fiscal year. RDO/C received no OYB ESF funds in USG FY 1988, thereby preventing obligation of this second tranche. The first World Bank tranche was similarly delayed by negotiation and was carried over to the following GOCD fiscal year. The IMF is expected to disburse its third and final tranche of SDR 0.54 million in September or October, 1988. The IBRD disbursed US$ 1 million during last GOCD fiscal year, and is expected to disburse US$ 2.0 million during GOCD FY88/89. The Caribbean Development Bank disbursed US$ 1.0 last fiscal year and expects to disburse its final $1.0 million in FY88/89. AID anticipated disbursement of three tranches of $1.5 million each, and has so far made only one of these. AID is therefore the only donor which has not yet fully met its intended commitments under the TCG.

The formal Dominica TCG program covers the GOCD fiscal years 1986/87 through 1988/89 (July 1, 1986 - June 30, 1989). The proposed amendment will be AID's second contribution to the program. The policies and targets established under the program, however, will continue into 1990 and beyond. During its May/June 1988 visit to Dominica, the IMF and GOCD established revised fiscal targets through FY1990/91 which include approximately EC$ 30 million each year in external grants, including EC$4.1 million (US$1.5 million) in budgetary foreign grants. The need for external budgetary or balance of payments support will therefore continue for at least one year beyond the formal end of the three-year TCG program, but is in fact supportive of its objectives.

The proposed $1.0 million second tranche of the AID Economic Support Fund grant will be disbursed as soon as possible after January 1, 1989 if the Conditions Precedent to that disbursement are met (the date can be advanced somewhat, by mutual agreement in writing, in case of a cash flow crisis or other emergency need). AID and other donor budget support over the course of the structural adjustment program will enable Dominica to finance a structural adjustment program along the course set by the TCG and as outlined in the Policy Framework Paper and the Public Sector Investment Program (PSIP).

2/ See the original PAAD for a more detailed explanation of these events.

AID's analysis confirms the validity of the performance targets set by the GOCD and the multi-donor agencies. Specific Conditionality requirements in this Grant therefore focus on assuring adequate progress in pursuing a comprehensive structural adjustment program with special focus on incentives to private sector development.

II. PROGRAM RATIONALE

A. Background

[Please refer to the original PAAD, attached].

B. Program Objectives

[Please refer to the original PAAD, attached].

C. Program Setting

[Please refer to the original PAAD, attached].

2. Previous Program Assistance

[Please refer to the original PAAD, attached].

III. PROGRAM DESCRIPTION

A. Introduction

Dominica continues to make very significant progress in macroeconomic and balance of payments performance and in its public finances under the Government of Prime Minister Charles (see Table 1). From 1979/80 until 1984 annual GDP growth averaged nearly 4 percent. This slowed to 1.85 percent in 1985 but returned to a remarkable 6.8 percent in 1986, and a more modest but steady 4.6 percent in 1987, which is likely to be repeated in 1988. The original SAF program projected an average growth rate of 3.6 percent while in fact it has averaged nearly 5.0 percent. The balance of trade deficit has been reduced from 46 percent of GDP in 1981 to an estimated 29 percent in 1985 and about 16 percent in 1987, approximately where it is projected to remain through 1990. The central government's current account deficit moved from an equivalent of 10 percent of GDP in 1980/81 to near balance in 1984 and to a projected surplus (including grants) of about 2.5 percent of GDP in 1986/87 and 4.0 percent in 1987/88. Each of these surpluses exceeded the TCG/SAF target levels for the respective years.

However, Dominica still has a backlog of infrastructure requirements. An ambitious Public Sector Investment Program will be a critical element in supporting private sector growth in future years. Despite a tax effort which increased the tax/GDP ratio from 26 percent in 1981/82 to 27 percent in 1986/87, combined with a reduction in current expenditure from 34 percent to 28 percent of GDP in the same period, government finances continued to be strained through much of the period. In 1983/84, Dominica received US$ 2 million in program support from

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TABLE 1
DOMINICA: ECONOMIC INDICATORS UNDER TCG PROGRAM

	1985	1986	1987	PROGRAM 1/ 1988	1989	1990
(Annual Percentage Changes)						
GDP at constant prices	1.7	6.8	4.6	4.5	4.0	4.0
Inflation (GDP deflator)	8.3	6.2	4.5	4.0	3.5	3.5
Exports (US$ million)	11.3	55.1	4.1	16.5	11.2	8.4
Imports (US$ million)	2.5	-2.6	19.0	10.6	12.4	5.5
(Percent of GDP)						
BALANCE OF PAYMENTS						
Current account deficit						
before grants	-20.7	-3.4	-8.9	-8.4	-9.8	-8.4
after grants	-5.0	4.2	0.7	0.0	-1.0	0.6
External debt	47.9	47.1	51.0	51.2	51.3	49.9
Debt service as pct. of exports, serv., priv. transf.	9.4	7.9	9.4	8.8	7.7	6.5
CENTRAL GOVERNMENT OPERATIONS						
Current revenue	29.3	28.8	30.2	28.5	28.4	28.3
Current expenditure	28.3	26.4	26.2	25.0	24.2	23.5
Current balance	1.1	2.5	4.0	3.5	4.2	4.8
Capital exp. & net lending	15.9	9.7	12.5	14.9	14.9	14.3
Overall balance						
before grants	-14.9	-7.3	-8.5	-11.4	-10.7	-9.5
after grants	-2.2	-1.9	-0.4	-4.1	-2.6	-2.0
External grants	12.7	5.4	8.1	7.3	8.1	7.5
External concessionary loans (net, incl. IMF SAF)	1.8	2.7	4.4	6.7	3.7	2.8
Nonconcessionary financing	0.4	-0.8	-4.0	-2.6	-1.1	-0.8

SOURCE: IMF

1/ TCG/SAF Program beginning July 1, 1986

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AID. In 1984/85 the government borrowed on nonconcessionary terms, and in each of the fiscal years 1985/86 and 1986/87 it received US$ 1.5 million in AID program support to help close its financing gaps.

B. Performance to Date Under the TCG Program 3/

In addition to exceeding the TCG balance of payments and government savings targets, as noted above, the IMF and GOCD report that numerous other changes have been implemented or are well in train, including:

- Discontinuation of automatic merit pay increases for civil servants, that amounted to 2.5 percent of the wage bill;
- restructuring the central government's domestic debt to contain the growth of the debt burden;
- with AID assistance, improving the efficiency of the Inland Revenue department;
- a 10 percent increase in electricity tariffs, to bring them into line with costs;
- reorganization of the Central Water Authority to reduce operating costs;
- divestment of the Dominica Electricity Services Ltd., through sale of 60 percent of equity shares;
- strengthened the government's economic development unit to increase the government's capacity for Public Sector Investment Program formulation and monitoring;
- removed price controls on livestock and poultry products to improve resource allocation;
- formulated a tourism development strategy to encourage tourism and thereby economic diversification;
- removed all taxes on local commercial bank deposits to encourage savings and investment;
- reduced the public sector's indebtedness to local commercial banks to facilitate growth of bank credit to the private sector;
- reduced the company tax for manufacturers to encourage investment in manufacturing;
- initially reduced, and in FY 1988/89 eliminated, the foreign exchange purchase levy to encourage foreign private investment;

3/ Information supplied by Government of Dominica, will appear in forthcoming update of Policy Framework Paper.

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- simplified the investment application procedures to encourage private sector investment;
- removed the export tax and stamp tax on export sales to encourage exports;
- implemented a tax reform with lower rates and a broader base to reduce disincentives to production and exports;
- improved the sales tax system to reduce the cascading effects of the sales tax;
- continued to work on the Organization and Management exercise for the civil service to rationalize the civil service and to restrain the growth of the wage bill;
- integrated the Industrial Development Corporation (IDC) and the Tourist Board to streamline the institution and to improve the IDC's capacity to offer assistance to prospective investors;

In addition, the following are included among activities for the third year of the program:

- new wage legislation for the public sector to make wage bargaining less disruptive and to implement a uniform wage policy in the public sector;
- implementation of the results of the O & M study to rationalize the civil service and to restrain the growth of the wage bill;
- annual review of the PSIP to ensure that public investments are appropriate in size, composition and financing;
- complete reorganization of the water authority to improve water supply and the financial position of the NWS;
- extension of coverage of the Social Security scheme to the self-employed, to widen the coverage of the system and to increase the contribution of the SS scheme to national savings;
- exercise limitations on the Central Government's use of nonconcessional financing to keep the debt burden within manageable limits;
- construction of 65,000 square feet of factory space by the Agricultural Industrial Development Bank to encourage private sector investment in manufacturing;
- substitution of tariffs for quotas to improve resource allocation.

C. The Need for Budgetary Assistance

The Public Sector Investment Program is key to moving toward a sustainable 4 percent growth path in the medium term. The overall deficit of the Central

Government, before grants, is projected to widen in FY1988/89 due to outlays for infrastructure. The government's current account surplus is expected to decline in FY1988/89, in part a lagged effect of the tax reform enacted last year. This surplus is however expected to increase through 1991. The program worked out with the TCG provides for funding of the PSIP, but with sufficient external funding to permit a reduction in the liabilities which the government built up during the cash flow crisis that preceded the structural adjustment program. Reduction in the government's liabilities also permits accumulation of a reserve of future borrowing capacity which can be used in the event of adverse external shocks. This is particularly important for Dominica, which constantly faces the threat of tropical storms and which now faces the possibility that its banana market might be seriously curtailed after 1992. Dominica's external financing requirements are related mainly to the PSIP, which is in turn aimed at infrastructure and other government activities directly supportive of directly productive activities, such as hydroelectric power, airport improvements, feeder roads, farm access roads, and improvements in water and sewerage systems. Approximately 88 percent of the external financing requirement will be project related. As designed by the TCG program, Dominica will need program assistance of U.S.$7.7 million over the three-year period, beginning in mid-1988. Of this, the IMF will furnish SDR 0.54 million with its final tranche, IBRD will disburse approximately US$ 2 million, and CDB US$ 2 million.

The program thus leaves an unfinanced gap of US$ 3 million with no specified donor. That gap will be partially filled by the proposed AID grant. Without the AID financing, the gap must be closed by either (1) reducing expenditure on the PSIP, and jeopardizing the medium-term growth objectives established by the reform, or (2) reducing the rate at which the GOCD repays its nonconcessionary loan financing, thereby failing to meet targets established with the IMF. Given the choice, it is likely that the GOCD would feel compelled to absorb some of the reduction by reducing its capital expenditures. The AID grant therefore permits the GOCD to simultaneously meet its investment and debt reduction targets, although only in part.

For the long term, Dominica is working toward policies which will expand investment and exports, which will increase public sector savings, and which will restrain growth of the public sector. TCG analysts have concluded that despite government's best efforts, financing a public sector investment program sufficient to help the economy reach a self-sustaining growth rate will require substantial foreign capital inflows.

D. Update on the Balance of Payments Situation

Dominica does not face an imminent balance of payments crisis in the usual sense that its international reserves are threatened by its external balance. It does, however, require balance of payments support to free budgetary resources for developmental needs. U.S. dollars are required to service much of its external debt. One of the objectives of the structural adjustment program is to reduce, or at least prevent substantial increases in, the debt/GDP ratio. Without external balance of payments support, the Government must use its budgetary resources to purchase U.S. dollars from the regional central bank (the ECCB). This purchase reduces the amount of local resources available to support the development program crafted

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Table 2
Dominica Balance of Payments 1/
(US$ Million)

	1984	1985	1986	Prel. 1987	-------Projections----- 1988	1989	1990	1991
CURRENT ACCOUNT BALANCE (before grants)	-18.5	-20.6	-3.8	-11.1	-11.3	-14.3	-13.1	-12.8
Trade Balance	-30.2	-28.7	-11.5	-20.3	-19.7	-22.8	-22.3	-23.8
Exports, f.o.b.	25.6	28.5	44.2	46.0	53.6	59.6	64.6	69.1
Imports, c.i.f.	-55.8	-57.2	-55.7	-66.3	-73.3	-82.4	-86.9	-92.9
Travel (net)	8.5	7.3	7.5	8.3	9.1	9.8	10.5	11.7
Interest Payments (net)	-2.0	-2.0	-2.0	-1.9	-1.8	-2.0	-2.1	-2.2
Other services (net)	-1.1	-3.7	-4.3	-4.0	-5.5	-6.0	-6.0	-5.5
Private Transfers (net)	6.3	6.5	6.5	6.8	6.6	6.7	6.8	7.0
CAPITAL ACCOUNT	24.7	19.7	9.0	19.8	12.5	17.2	16.7	16.1
Official grants 2/	11.0	15.6	8.6	11.4	7.2	11.4	14.1	12.5
Public sector borrowing 2/	4.8	4.5	4.1	3.9	7.8	7.8	4.8	3.3
Commercial banks	3.0	-0.8	-2.9	-12.7	-6.0	-5.5	-5.7	-3.2
Direct investment	2.3	3.0	6.1	6.0	3.5	3.5	3.5	3.5
Short-term capital (incl. errors & omissions)	3.6	-2.6	-6.9	11.2	0.0	0.0	0.0	0.0
SDR ALLOCATION	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OVERALL SURPLUS OR DEFICIT(-)	6.2	-0.9	5.2	8.7	1.2	2.9	3.6	3.3
FINANCING	-6.2	0.9	-5.2	-8.7	-1.2	-2.9	-3.6	-3.3
Change in official reserves 3/ 4/	-6.1	2.7	-4.2	-8.1	-2.7	-1.5	-1.6	-1.7
Change in for. assets	0.2	-0.3	-0.3	-0.2	3.6	0.9	-0.6	-0.7
Net credit from IMF 5/	-0.3	-1.5	-0.6	-0.4	-2.1	-2.3	-1.3	-0.9

SOURCE: IMF AND GOVERNMENT OF DOMINICA

1/Based on partial data from Government of Dominica. There are no complete official balance of payments statistics.

2/IMF data adjusted to coincide with assumptions in Table 3C, below. Beyond 1988 sources of official grants and concessional borrowing have not yet been identified.

3/Refers to change in Dominica's imputed share in international reserves held by ECCB. These are not freely available to Dominica.

4/"Change in official reserves" data for 1985-87 are distorted as the result of underreporting of currency in circulation in 1985-86 on which Dominica's imputed share of ECCB international reserves is based.

5/Includes actual and projected disbursements under the IMF Structural Adjustment Facility.

under the TCG. Balance of payments support is therefore directly linked to the government's capacity to program its development projects while at the same time meeting debt/GDP objectives.

The IMF projections shown in in Table 2 indicate that despite sharply higher export earnings (led by the banana sector) the higher imports required to sustain the PSIP will continue to produce trade deficits in coming years. Interest payments and net service imports will add to this, so that the current account will remain in deficit throughout the period. Even so, the country could experience continued surpluses in its overall balance of payments, including grants, until 1991. This scenario, however, hinges critically on the ability of Dominica to upgrade agricultural and manufacturing export production, to attract continuous official grant support or increasing flows of private investment, and to maintain prudent public sector policies.

It is unlikely that domestic savings will be sufficient to support needed private and public infrastructure. Concessional foreign capital inflows will be required to supplement domestic savings. In order to keep this dependence on foreign capital at a manageable level, attention must be focused on expanding exports and on restraining the growth of imports, especially of consumer goods. Export growth must center on agriculture and on light manufacturing. Agriculture was the engine of growth and the major foreign exchange earner in 1986 and 1987, but heavy reliance on banana-financed growth and foreign exchange generation represents a precarious base. The prospects beyond 1992 are worrisome, with exports likely to level or decline in the face of a potential elimination or reduction in sales under the preferential banana accord with the U.K. Both banana and non-banana agriculture must therefore be prepared to compete more openly in international markets. In order for agriculture to compete, continued productivity increases will be required in traditional products, and diversification efforts must aim at reducing dependence on established markets.

Recent performance of the traditional agriculture subsectors has been strong. Improved price incentives, banana marketing and farmer efficiency have led to three years of rapid growth in banana exports. Other sectors are performing relatively less well but hold promise for the near future. The accompanying projections assume that Dominica will be able to increase its exports of bananas from more than 60,000 tons in 1987 to over 80,000 tons by 1989, with continued increases thereafter. To achieve this, prices to growers must be sustained to maintain production incentives. While the local currency banana prices are now high, a significant appreciation of the U.S. dollar, to which the EC dollar is tied, could lower the effective price of bananas below the breakeven point for the Banana Marketing Association, and also reduce the net price to farmers. Improved use of fertilizer and pesticides and better management techniques still need to be introduced. Coconut production has been restored to pre-hurricane levels. Further expansion will require new access roads and technical assistance. Dominica hoped to make further inroads into regional and extra-regional citrus markets, but faces severe extra-regional competition in both areas. Passion fruit, carambolla and other tropical fruits hold some promise for the future, and USAID is assisting in the development of these products through HIAMP.

Industrial sector performance has been generally disappointing, though there have been indications of quite active investor interest in 1987-88 that could

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bring new vitality to the sector. As reported above, the government has taken several actions to improve Dominica's investment climate and continues to explore other ways to energize the private sector without unnecessarily eroding its own long-term revenue base. The Public Sector Investment Program is carefully tailored to meet the infrastructure needs of the private sector.

E. Central Government Finances, 1987/88

The Government of Dominica's stated goal is to improve public sector performance aimed at generating sufficient budgetary savings to service its external debt and to contribute to the capital development program. A full description of Dominica's recent fiscal history is contained in the original PAAD. The fiscal situation has improved under the first two years of the structural adjustment program. During the initial year the government abolished its system of automatic pay raises for civil servants. Customs administration was improved, electricity tariffs were increased, export taxes were abolished and measures were begun to improve the functioning of the water authority. The main feature of the second year of the program was the introduction of the fiscal reform program, as described above. Agriculture was brought onto the tax roles at a time when agricultural revenues were booming.

During the first two years of the program, the overall deficit of the central government, before foreign grants, was reduced from 15 percent of GDP to 7 percent. Stronger public finances have increased the liquidity of the domestic banking system, reducing the "crowding out" that threatened during the 1985/86 fiscal crunch.

Table 3A presents comparative data on the Government of Dominica's fiscal performance since 1984 and includes preliminary estimates for FY 88/89, under the IMF assumptions of a fully-funded TCG program, as outlined in the Policy Framework Paper (PFP). The fiscal situation continued to improve in Fiscal Year 1987/88, which ended June 30, 1988. Tax revenues increased by 11.7 percent over the previous year, and despite a potentially revenue-negative tax reform, exceeded TCG target program levels for the year. Much of the 1987/88 increase reflected collections from the newly-enacted banana excise tax. There was an overall deficit before grants but a surplus after grants, partly a result of the "bunching" of foreign grants in that fiscal year.

Current expenditures increased by 8.2 percent, compared to 4.2 percent the previous year. Wage and salary expenditures are notably the largest item, and continued to rise (by 7.3%), reflecting the built-in effects of the three-year wage agreement reached in 1985. With interest payments, retirements, and transfers representing mainly obligatory expenditures, and with 85 percent of the capital budget financed from outside sources, wages and salaries and goods and services represent virtually the only opportunities to exercise discretionary control over its current expenditures.

The government experienced a significant increase in its current account surplus, and was able to increase its contribution to capital expenditures from EC$ 5.1 million to EC$ 10.7 million.

Short-term resources available to the government include borrowing from the Eastern Caribbean Central Bank. [Please see original PAAD for a description of the government's use of this facility during the fiscal crunch]. During

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the first two years of the structural adjustment program, it has begun to repay the accumulated overdrafts, repaying EC$ 2.7 million in 1986/87 and EC$ 1.9 million in 1987/88.

In addition, the government has commercial bank overdraft ceilings which reached their effective limit in the liquidity crunch of 1985/86. Again, repayments have been made and as of June, 1988 overdrafts with the commercial banks have been cleared, partly through a debt rescheduling and issuance of debentures.

Between 1981 and 1983, GOCD drew nearly US$11 million from Fund facilities. From FY84/85 to FY87/88, GOCD made net repayments to the Fund, amounting to EC$ 18.7 (US$ 6.9) million. Payments are to continue through 1993/94, with EC$ 7.4 (US$ 2.7) million scheduled for 1988/89 and EC$ 5.2 (US$ 1.9) million for 1989/90.

F. <u>Government Finances and the Structural Adjustment Program</u>

[Please refer to original PAAD, attached]

G. <u>Government's Tax Reform</u>

[Please see original PAAD].

H. <u>Closing the fiscal Gap</u>

Table 3A presents central government fiscal operations for the three-year term of the structural reform program (FY 1986/87-1988/89) and beyond. Dual columns for some years compare TCG program targets with actual or projected performance.

The PSIP guides the capital expenditure line item in the budget. As in the past, the capital budget will be largely financed through foreign grants and concessionary loans. As envisioned in a fully-funded program, foreign grants for FY 88/89 and FY89/90 would include $EC 8.2 (US$ 3.0) million in budget support grants. The proposed amendment will cover one-third of that two-year gap.

Zeros in the Residual row indicate a fully-financed program for a given year. The original program identified a EC$ 6.8 million financing gap which was to be covered by an equal amount of budget support grants from AID "and other donors." As noted earlier, with AID unable to disburse before June 30, the 1986/87 gap was temporarily financed by a large increase in "other domestic" borrowing in anticipation of a later AID disbursement

Following the recent tax reform, the IMF projects moderate revenue growth, including increases in tax revenues of 2.3 percent in 1988/89 and 7.6 percent in 1989/90. From this revenue base, GOCD must finance a small portion of the capital budget in addition to current expenditures and debt repayments. The program calls for increased public savings. The current account surplus therefore is targeted to increase from EC$13.4 million in FY88/89 to EC$21.1 million in 1990/91. This is to be accomplished through particular emphasis on the control of recurrent expenditures. In Dominica, this necessarily

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TABLE 3A
DOMINICA
CENTRAL GOVERNMENT OPERATIONS
FULLY FUNDED TCG PROGRAM
(EC$ million)

	1984/85	1985/86	Prog. 1986/87	1986/87	Prog. 1987/88	Prel. 1987/88	Prog. 1988/89	Proj. 1989/90	Proj. 1990/91
Revenue and grants	110.6	121.5	114.6	112.4	127.4	140.5	138.7	150.8	158.7
Current revenue	74.6	84.7	90.4	92.9	94.1	106.2	108.4	116.2	124.6
Tax revenue	65.9	76.3	81.1	84.8	85.5	95.5	97.7	105.1	113.2
Nontax revenue	8.7	8.4	9.3	8.1	8.6	10.7	10.7	11.1	11.4
Capital receipts	0.1	0.1	0.0	2.0	1.2	5.9	2.5	1.5	1.0
Foreign grants	35.9	36.7	24.2	17.5	32.1	28.4	27.8	33.1	33.1
Of which: budgetary grants /1/	0.0	4.1	6.8	0.0	9.5	4.1	4.1	4.1	0.0
Total expenditure	125.7	127.5	125.5	116.2	141.0	135.9	151.8	160.1	166.3
Current expenditure	74.5	81.6	85.9	85.0	90.7	92.1	95.0	99.0	103.5
Of which: wage bill	42.3	47.1	49.4	49.1	52.8	52.7	54.3	55.9	57.6
Capital expenditure and net lending	51.2	45.9	39.6	31.2	50.3	43.8	56.8	61.1	62.8
Of which: local	4.7	6.6	9.1	5.1	0.9	10.7	14.8	10.2	14.5
Current account balance	0.1	3.1	4.5	7.9	3.4	14.1	13.4	17.2	21.1
Overall balance before grants	-51.1	-42.7	-35.1	-21.3	-45.7	-23.8	-40.9	-42.4	-40.7
Overall balance	-15.1	-6.0	-10.9	-3.8	-13.6	4.6	-13.1	-9.3	-7.6
Concessionary foreign borrowing	9.2	5.1	7.7	8.7	20.2	15.4	25.6	15.3	12.5
of which: SAF	0.0	0.0	2.4	2.6	4.1	4.2	2.0	0.0	0.0
Nonconcessionary financing	5.9	0.9	3.2	-4.9	-6.6	-20.0	-12.5	-6.0	-4.9
Reserve-type transactions	-0.2	-0.6	1.9	-8.3	-3.5	-10.3	-5.5	-2.7	0.0
IMF (net purchases)	-2.1	-4.6	-4.2	-4.7	-7.2	-7.4	-7.4	-5.2	0.0
Change in government foreign assets(increase: -)	-8.4	-0.8	-0.7	-0.9	-3.0	-1.0	-1.1	-1.5	0.0
Other foreign	0.2	0.0	0.1	0.0	9.0	0.0	3.0	4.0	0.0
ECCB borrowing	2.1	4.8	-1.3	-2.7	-2.3	-1.9	0.0	0.0	0.0
Commercial banks	3.5	-1.0	1.3	-1.1	-3.1	-19.2	-7.0	-3.3	-0.3
Statutory bodies	2.0	4.7	0.0	4.0	0.0	10.5	0.0	0.0	0.0
Other domestic	0.0	0.1	0.0	1.1	0.0	0.1	0.0	0.0	0.0
Residual	0.7	-2.4	0.0	-0.6	0.0	-1.1	0.0	0.0	-4.6

SOURCE: IMF AND GOVERNMENT OF DOMINICA

/1/ 1988-89 from [illegible]. 1989/90 Programmed by IMF but source not identified

TABLE 3B
DOMINICA
CENTRAL GOVERNMENT OPERATIONS
WITH NO FUTURE BUDGET SUPPORT
(EC$ million)

	1984/85	1985/86	Prog. 1986/87	1986/87	Prog. 1987/88	Prel. 1987/88	Prog. 1988/89	Proj. 1989/90	Proj. 1990/91
Revenue and grants	110.6	121.5	114.6	112.4	127.4	140.5	134.6	146.7	158.7
Current revenue	74.6	84.7	90.4	92.9	94.1	106.2	108.4	116.2	124.6
Tax revenue	65.9	76.3	81.1	84.8	85.5	95.5	97.7	105.1	113.2
Nontax revenue	8.7	8.4	9.3	8.1	8.6	10.7	10.7	11.1	11.4
Capital receipts	0.1	0.1	0.0	2.0	1.2	5.9	2.5	1.5	1.0
Foreign grants	35.9	36.7	24.2	17.5	32.1	28.4	23.7	29.0	33.1
Of which: budgetary grants	0.0	4.1	6.8	0.0	9.5	4.1	0.0	0.0	0.0
Total expenditure	125.7	127.5	125.5	116.2	141.0	135.9	151.8	160.1	166.3
Current expenditure	74.5	81.6	85.9	85.0	90.7	92.1	95.0	99.0	103.5
Of which: wage bill	42.3	47.1	49.4	49.1	52.8	52.7	54.3	55.9	57.6
Capital expenditure and net lending	51.2	45.9	39.6	31.2	50.3	43.8	56.8	61.1	62.8
Of which: local	4.7	6.6	9.1	5.1	8.9	10.7	14.8	10.2	14.5
Current account balance	0.1	3.1	4.5	7.9	3.4	14.1	13.4	17.2	21.1
Overall balance before grants	-51.1	-42.7	-35.1	-21.3	-45.7	-23.8	-40.9	-42.4	-40.7
Overall balance	-15.1	-6.0	-10.9	-3.8	-13.6	4.6	-17.2	-13.4	-7.6
Concessionary foreign borrowing	9.2	5.1	7.7	8.7	20.2	15.4	25.6	15.3	12.5
of which: SAF	0.0	0.0	2.4	2.6	4.1	4.2	2.0	0.0	0.0
Nonconcessionary financing	5.9	0.9	3.2	-4.9	-6.6	-20.0	-8.4	-1.9	-4.9
Reserve-type transactions	-0.2	-0.5	1.9	-8.3	-3.5	-10.3	-5.5	-2.7	0.0
IMF (net purchases)	-2.1	-4.5	-4.2	-4.7	-7.2	-7.4	-7.4	-5.2	0.0
Change in government foreign assets(increase: -)	-0.4	-0.8	-0.7	-0.9	-3.0	-1.0	-1.1	-1.5	0.0
Other foreign	0.2	0.8	8.1	0.0	9.0	0.0	3.0	4.0	0.0
ECCB borrowing	2.1	4.8	-1.3	-2.7	-2.3	-1.9	0.0	0.0	0.0
Commercial banks	3.5	-1.0	1.3	-1.1	-3.1	-19.2	-7.0	-3.3	-0.3
Statutory bodies	2.0	4.7	0.0	4.0	0.0	10.5	0.0	0.0	0.0
Other domestic	0.0	0.1	0.0	1.1	0.0	0.1	0.0	0.0	0.0
Residual	0.7	-2.4	0.0	-0.6	0.0	-1.1	4.1	4.1	-4.6

SOURCE: IMF AND GOVERNMENT OF DOMINICA

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TABLE 3C
DOMINICA
CENTRAL GOVERNMENT OPERATIONS
WITH PARTIAL BUDGET SUPPORT
(EC$ million)

	1984/85	1985/86	Prog. 1986/87	1986/87	Prog. 1987/88	Prel. 1987/88	Prog. 1988/89	Proj. 1989/90	Proj. 1990/91
Revenue and grants	110.6	121.5	114.6	112.4	127.4	140.5	137.3	150.8	158.7
Current revenue	74.6	84.7	90.4	92.9	94.1	106.2	108.4	116.2	124.6
Tax revenue	65.9	76.3	81.1	84.8	85.5	95.5	97.7	105.1	113.2
Nontax revenue	8.7	8.4	9.3	8.1	8.6	10.7	10.7	11.1	11.4
Capital receipts	0.1	0.1	0.0	2.0	1.2	5.9	2.5	1.5	1.0
Foreign grants	35.9	36.7	24.2	17.5	32.1	28.4	26.4	33.1	33.1
Of which: budgetary grants /1/	0.0	4.1	6.8	0.0	9.5	4.1	2.7	4.1	0.0
Total expenditure	125.7	127.5	125.5	116.2	141.0	135.9	151.8	160.1	166.3
Current expenditure	74.5	81.6	85.9	85.0	90.7	92.1	95.0	99.0	103.5
Of which: wage bill	42.3	47.1	49.4	49.1	52.8	52.7	54.3	55.9	57.6
Capital expenditure and net lending	51.2	45.9	39.6	31.2	50.3	43.8	56.8	61.1	62.8
Of which: local	4.7	6.6	9.1	5.1	8.9	10.7	14.8	10.2	14.5
Current account balance	0.1	3.1	4.5	7.9	3.4	14.1	13.4	17.2	21.1
Overall balance before grants	-51.1	-42.7	-35.1	-21.3	-45.7	-23.8	-40.9	-42.4	-40.7
Overall balance	-15.1	-6.0	-10.9	-3.8	-13.6	4.6	-14.5	-9.3	-7.6
Concessionary foreign borrowing	9.2	5.1	7.7	8.7	20.2	15.4	25.6	15.3	12.5
of which: SAF	0.0	0.0	2.4	2.6	4.1	4.2	2.0	0.0	0.0
Nonconcessionary financing	5.9	0.9	3.2	-4.9	-6.6	-20.0	-11.1	-6.0	-4.3
Reserve-type transactions	-0.2	-0.5	1.9	-8.3	-3.5	-10.3	-5.5	-2.7	0.0
IMF (net purchases)	-2.1	-4.5	-4.2	-4.7	-7.2	-7.4	-7.4	-5.2	0.0
Change in government foreign assets(increase: -)	-0.4	-0.8	-0.7	-0.9	-3.0	-1.0	-1.1	-1.5	0.0
Other foreign	0.2	0.0	8.1	0.0	9.0	0.0	3.0	4.0	0.0
ECCB borrowing	2.1	4.8	-1.3	-2.7	-2.3	-1.9	0.0	0.0	0.0
Commercial banks	3.5	-1.0	1.3	-1.1	-3.1	-19.2	-7.0	-3.3	-0.3
Statutory bodies	2.0	4.7	0.0	4.0	0.0	10.5	0.0	0.0	0.0
Other domestic	0.0	0.1	0.0	1.1	0.0	0.1	0.0	0.0	0.0
Residual	0.7	-2.4	0.0	-0.6	0.0	-1.1	1.4	0.0	-4.6

SOURCE: IMF AND GOVERNMENT OF DOMINICA

/1/ 1988-89 from AID. 1989/90 Programmed by IMF but source not identified involves controlling the wage bill. Wage and salary expenditures increased rather sharply between the first and second years of the TCG program, reflecting contractual obligations made in 1985. The program calls for moderate increases in the future, and for a reduction in the share of wages in the budget. In addition to increased public savings, the program is designed to improve the government's debt position through reduction in debt obligations. It therefore includes substantial repayments of nonconcessional external debt as well as of obligations to domestic commercial banks. (Table 3A). Under this program, the IMF identifies financing gaps of EC$4.1 million for 1988/89 and 1989/90. Table 3B illustrates the impact of failure to secure any budgetary support grants. Table 3C illustrates the impact of the lower than anticipated level of AID support 1989/90, as provided in the present proposed grant, but retains the assumption that funding from unidentified sources (including potential future AID funds) will be forthcoming in FY 1989/90. For presentational purposes, the effect of reduced budgetary support in tables 3B and 3C is shown as an increase in the residual (or "unfinanced gap"). However, the mission anticipates that the impact of reduced budgetary support grants will in fact be absorbed by a combination of reduced capital expenditure and slower repayment of nonconcessionary debt (or indeed even by the need to resort to nonconcessionary borrowing).

I. Future Financing Requirements

Program assistance will help Dominica pursue its structural adjustment program while enabling it to effect some reductions in its nonconcessional financing obligations. Every effort should be made to assure that such financing is kept to manageable levels. Prolonged resort to costly financing will place an onerous debt burden on government finances, will interfere with the Public Sector Investment Program, and ultimately will forestall sustained economic growth.

Under the TCG, further efforts will be made to improve the underlying structure of Dominica's government finances, including increasing the efficiency of the revenue collection system, maintaining restraint in government current expenditures, and attempting to maintain or increase government's contribution to national savings. For at least the rest of this decade, and probably for some time beyond, Dominica will require sustained and significant levels of external assistance. Its external assistance requirements are related mainly to the public sector investment program which is designed to foster the economic objectives of the structural adjustment program. The focus of the PSIP is support for the directly productive sectors and for economic infrastructure. Public investments are to be directed at meeting the infrastructure requirements of a growth-oriented economy.

At the discussions of the CGCED subgroup meeting in St. Lucia in March, 1986 (at which time GOCD indicated its willingness to be the first country to attempt a structural reform program under the Tight Consultative Group) it was indicated that the structural reform program would require substantial budgetary support assistance. Even with the aid of significant structural adjustment assistance, it is unlikely that the economy will generate sufficient domestic savings to fully finance its capital needs.

J. Policy Issues

[Please refer to original PAAD, attached]

IV. Program Elements

A. Use of U.S. Dollar Resources

Depending on the existing foreign exchange regime in a recipient country, AID/W guidance (State 325792, 10/20/87) on programming of U.S. dollar resources offers three choices, in descending order of preference: imports from the U.S., auction of foreign exchange, and debt service payments. The first of these is the most appropriate for the proposed program assistance.

The U.S. dollars will be deposited in a separate interest-bearing account at a U.S. commercial bank that is normally a correspondent bank of a commercial bank in Dominica (probably Irving Trust) in the name of the National Commercial Bank (NCB) of Dominica. This will be a new account to be used exclusively for disbursements under the proposed grant. Conditionality under the Grant Agreement will specify that no other funds can be commingled with the ESF grant funds in this account. The funds deposited in Irving Trust will be used, over the ensuing twelve-month period, to cover payments that Dominican residents make for their importation of eligible merchandise from the U.S.

The GOCD will instruct the NCB to draw down the special account for payments for U.S. exports to Dominica, unless the specific transaction in question involves Dominican imports of goods for which the use of special account funds is ineligible. The GOCD will be mindful of the necessity of liquidating funds in the account within one year of their deposit. Accrued interest in the account shall be used in the same manner as the principal.

B. Use of Local Currency

Local currency will be generated by the National Commercial Bank's depositing into a special Government of Dominica account in a specified bank an amount of local currency equivalent to the Grant's US dollar proceeds. That local currency account will be available for the Government of Dominica (in the framework of the Tighter Consultative Group) to program. Accrued interest, if any, in the account shall be used in the same manner as the principal. (Note. It is not anticipated that the local currency account will be interest-bearing. The account will be a current account and local regulations permit interest to be paid only on term accounts. However, establishment of a term account could delay the GOCD's access to the funds by weeks or months and thereby run counter to the purposes of the grant).

Here, again, AID/W (State 224820, 7/13/88) offers three choices to Missions on the programming of local currency. The three general categories are: general budgetary support, sectoral or subsectoral budgetary support, or direct project support. The Mission selects the first of these, since a direct linkage exists between programming for general budgetary support and the development goals of the USG-funded assistance.

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Bureau guidance (State 224820) concerning general budgetary support states that, "the existence of a sound fiscal program embodied in an IMF or IBRD agreement could be a possible means of linking general budget support to achieve development objectives." Dominica's program fully meets that criterion. Indeed, the Tighter Consultative Group (the joint funding of program assistance to OECS countries, designed to encourage the development of sound fiscal and other economic policies) is the essence of linkage between external support and sound development policies. As a participant in the TCG, AID's budgetary support is a therefore carefully crafted element of a coordinated multi-donor structural adjustment program.

Guidance on the programming of local currency also states that it must be "additional," rather than permitting the recipient to not spend funds in light of AID's provision of funding. Were AID not to provide the proposed funding under this program, the Government of Dominica would be forced either to cut back on repayments to creditors or to reduce expenditures on critical public sector investment items. Inasmuch as the former option could immediately halt other (read IMF) support, given quantitative performance targets on the level of commercial debt exposure, the Government of Dominica would likely opt, at least in part, for the latter. However, without the investment spending outlined in the Government's current three-year program, attaining balanced growth would be difficult. Therefore, the funds proposed under AID's program would in fact be additional to those the Government of Dominica would otherwise spend.

C. <u>Cash Transfer versus Commodity Import Program (CIP)</u>

In designing the program, the Mission weighed the merits of a Cash Transfer versus a CIP and the experience with both in other countries in the Caribbean Basin and elsewhere. Based on an analysis of the advantages and disadvantages of both approaches, the Mission concluded that the Cash Transfer mechanism was the best means to achieve the objectives of this $1.5 million program. The problem facing Dominica is not fundamentally a shortage of foreign exchange with which to import commodities. It is a shortage of resources necessary to implement its public sector investment program and the structural adjustment program while simultaneously reducing its accumulated debt obligations. The procedures and controls required to implement a CIP would impose a degree of public sector intervention and control over the allocation and use of foreign exchange which would be contrary to both Dominica's and USG's policy of relying on the market mechanism. The Cash Transfer approach will also require less staff time to administer, both on the part of Dominica and the Mission. The GOCD's manpower base is already stretched to the limit, and a heavy demand exists on Mission staff to implement the RDO/C assistance program. Under terms of the amended agreement (see below) the U.S. dollar proceeds of the proposed disbursement will be programmed for Dominica's purchase of eligible merchandise from the U.S.

D. Grant versus Loan Funding of the Program Support

The issue of grant versus loan was addressed in connection with the original PAAD (Bridgetown 06527, 8/06/87). The details of the argument can be found in Reftel, but the reasons outlined there are essentially the following:

(1) If USAID provides loan rather than grant assistance in this case, it will undercut the TCG program as structured by the IMF and World Bank. Since RDO/C and AID/W have been strong advocates of the TCG concept from its inception, the mission did not think it advisable to undermine the process in its first application. When mission staff raised the issue with IMF staff the response was that it would damage the program. The reason is that the IMF Board will not accept a higher ratio of loans to GDP than is already included in the program, which assumes that U.S. assistance will be grant funded. In making this determination, the IMF uses two ratios: (a) the debt/GDP ratio and (b) the debt service ratio. One could make the argument that the debt service ratio would not increase substantially with a concessional loan, but this argument was already made to the IMF Board in connection with the earlier phase of the program and was rejected. The reason was that the loan/GDP ratio would be increased from a level that is already very high, in the Fund's view. The denominator of this ratio is subject to sharp changes. A hurricane could reduce GDP by 25 or 30 percent, driving the debt/GDP ratio to intolerable levels overnight. A sudden shift in the terms of trade against Dominica would have the same effect. The mission is persuaded by this argument, and feels that reducing the debt/GDP ratio in the shortest manageable time period is a high priority for the the structural adjustment program.

(2) The second reason that the mission proposes grant funding is that the OECS states have a special status for the time being. While they are being "graduated" from IDA, they will be eligible for IDA funding under IDA VIII, using a mix of IDA and regular IBRD resources. This decision reflects the World Bank's recognition that although relatively high per capita GDP levels would exclude several of the islands from the most concessional assistance terms, small island states have special problems of high cost due to small scale that mitigate against the simple application of the per capita GDP rule for determining terms. AID/W recognized this in discussing two previous budget support grants to Dominica.

E. Reports

The Government of Dominica will be required in the Grant Agreement to present reports to AID to enable AID to conclude that the U.S. dollar and local currency resources have been expended in accordance with their programming.

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In the case of the U.S. dollar resources, the National Commercial Bank of Dominica will be required to present, on a quarterly basis, to AID (a) the disbursement orders it has communicated to its U.S. correspondent bank to release funds from the special dollar account, and (b) copies of the statements of the latter account, verifying that the funds have been appropriately released.

In the case of the local currency, the Government of Dominica will be required to report that funds from the special local currency account have been released to the Development Account of the Government of Dominica. This reporting will occur at least quarterly, beginning ninety days after disbursement of the U.S. dollar resources, until funds in the special local currency account have been liquidated.

F. Importation of U.S. Commodities

It is expected that Dominica will be able to import commodities from the United States in value at least equal to that of the Grant. Dominica's imports from the U.S. were US$ 13.3 million in 1982, 10.9 million in 1983, 14.8 million in 1984 and 13.6 million in 1985. They should therefore far exceed the requirements noted below in Covenants. Under project 538-0157, disbursed in June, 1986, Dominica reported approximately US$ 6 million in imports from the U.S. in the two quarters (June-December, 1986) following disbursement. After eliminating ineligible imports, US$ 3.7 million remained for half a year. On an annual basis, therefore, Dominica is not expected to have difficulty in importing at least $US 1.0 million in commodities from the U.S. under the present grant.

V. Conditionality Under the Present Cash Transfer

A. Incremental Nature of the Program

The proposed grant will be the second AID disbursement under the three-year structural adjustment program. The Grant will be disbursed in one tranche, in accordance with the Conditions Precedent to the disbursement, as specified below. The tranche will be disbursed immediately upon satisfaction of the Conditions Precedent, but not before January 1, 1989, unless the parties otherwise agree in writing.

B. Proposed Grant Agreement provisions

The Grant Agreement will contain conditions precedent to disbursement, covenants and other requirements essentially as follows:

SECTION 2.1 Conditions Precedent to the Disbursement

Prior to the disbursement of the Grant, or any part thereof, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

(a) An opinion of the Attorney General of the Grantee stating that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, the Grantee, and that it constitutes a valid and legally binding obligation of the Grantee in accordance with all of its terms.

(b) A statement of the names of the persons holding or acting in the office of the Grantee specified in Section 7.2 and a specimen signature of each person specified in such statement.

(c) Evidence that the Grantee has established, or has caused to be established, a separate, interest-bearing U.S. dollar account with a designated U.S. correspondent bank, to be used solely for the disbursements of the U.S. dollar proceeds of this Grant, and evidence that adequate accounting procedures are in place to accurately track the sources of deposits into, and the uses of withdrawals from, this account. Procedural guidance will be provided by A.I.D. to the Grantee in the form of an Implementation Letter.

(d) Evidence that the Grantee has established, or has caused to be established, a separate local currency account to be used solely for the deposit of local currency specified in Section 5.3 of this Agreement, and evidence that adequate accounting procedures are in place to accurately track the sources of deposits into, and the uses of withdrawals from, this account. Procedural guidance will be provided by A.I.D. to the Grantee in the form of an Implementation Letter.

(e) Evidence that the Grantee is making satisfactory progress in implementing the Civil Service Reform program in cooperation with the Organization, Methods and Manpower technical assistance team, and in keeping with the objective of restraining increases in the government's wage and salary expenditures.

(f) Evidence that the Grantee is making satisfactory progress toward attaining the targets for wage and salary expenditures, as stated in Section 5.8 (a), below.

(g) Evidence that the Grantee is making satisfactory progress toward attaining the targets for public sector savings, as measured by the balance on recurrent account in the revenue and expenditure accounts of the Government of Dominica, as stated in Section 5.8 (b), below.

SECTION 2.2. <u>Notification</u>

When A.I.D. has determined that the conditions precedent to disbursement specified in Section 2.1 have been met, it will promptly notify the Grantee.

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SECTION 2.3. Terminal Date for Conditions Precedent

If the conditions precedent to disbursement as set forth in Section 2.1 have not been met by January 31, 1989, or such later date as A.I.D. may agree to in writing, A.I.D., at its option, may terminate this Agreement by written notice to the Grantee.

Article III. Disbursement

SECTION 3.1. Deposit of Disbursed Funds

After satisfaction of the conditions precedent, at the written request of the Grantee, A.I.D. will arrange for deposit of the proceeds of the Grant in the designated U.S. correspondent bank for the account of the Grantee or its designated, jointly approved agent.

SECTION 3.2. Date of Disbursement

Disbursement by A.I.D. will be deemed to occur on the date(s) the proceeds of the Grant are deposited in the bank or banks designated pursuant to Section 3.1.

SECTION 3.3. Terminal Date for Requesting Disbursement

Except as A.I.D. may otherwise agree in writing, the terminal date for the Grantee to request disbursement of the Grant proceeds shall be nine months from the date of this Agreement. After such date, A.I.D. may deobligate funds from this Grant without further notice to the Grantee.

Article IV. Uses of Funds

SECTION 4.1. Uses of U.S. Dollar Grant Proceeds.

The Grantee agrees that the Grant proceeds disbursed into the separate account specified in Sections 2.1(c) and 5.2 will be used to finance, during a period of one year following the first disbursement under this Grant and in accordance with procedures to be described in Implementation Letters, imports from the United States of raw materials, intermediate and capital goods, essential consumer goods, and such other classes of commodities or imports that may be agreed to by A.I.D. It is expressly understood and agreed that the Grant proceeds will not be used to finance military or paramilitary equipment or services, surveillance equipment, police or other law enforcement equipment or services, abortion equipment or services, luxury goods or gambling equipment, weather modification equipment, or pesticides which are not registered by the U.S. Environmental Protection Agency without restriction. The Grantee further agrees to redeposit in the said separate account any amounts, as directed by A.I.D., representing funds applied to a disallowed use, and to reprogram such funds to a permitted use.

SECTION 4.2. Uses of Deposited Local Currency.

The Grantee agrees that the Eastern Caribbean dollars deposited in the account specified in Sections 2.1(d) and 5.3 will be used only for support of the Grantee's Development Account in accordance with procedures to be described in Implementation Letters. It is anticipated that funds in the local currency account will be fully disbursed during the 24-month period immediately following the disbursement of this Grant. It is expressly understood and agreed that funds in the account will not be used to finance police training or for military orparamilitary purposes. The Grantee further agrees to redeposit in the said separate account any amounts, as directed by A.I.D., representing funds applied to a disallowed use, and to reprogram such funds to a permitted use.

Article V. Covenants

The Grantee covenants that:

SECTION 5.1. Records

It will maintain, or cause to be maintained, financial records, in accordance with generally accepted accounting principles, to assure compliance with this Agreement, such records to be maintained for at least three years after the date of the last disbursement hereunder and to be made available upon request for examination at any reasonable time by authorized representatives of A.I.D.

SECTION 5.2. U.S. Dollars

The U.S. dollar proceeds of the Grant will be deposited and maintained in the separate account established in accordance with 2.1(c) above until use as authorized by this Agreement. The Grantee further covenants that the U.S. dollars in such account will not be commingled with funds from any source other than disbursements under this Grant.

SECTION 5.3. Local Currency

Using the highest rate of exchange which is not unlawful existing at the date of the local currency deposit, the Grantee will immediately upon each disbursement of the Grant deposit, or cause to be deposited, an amount of Eastern Caribbean Dollars equivalent to the Grant into a separate government account at the National Commercial Bank of Dominica (NCB), and the Grantee shall, within 45 days of each disbursement under this Agreement, provide evidence satisfactory to A.I.D. that such a deposit has occurred. The Grantee further covenants that the local currency deposited in the separate account will not be commingled with funds from any other source and will be expended only for purposes approved under this Agreement.

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SECTION 5.4. Reports

(a) The Grantee will present to A.I.D., on a quarterly basis, itemized documentation of the disbursements from the separate U.S. dollar account at the designated U.S. correspondent bank for purposes authorized by this Agreement. This documentation shall include: (1) the disbursement orders that the Grantee or its designated, jointly approved agent has communicated to the designated U.S. correspondent bank to release funds from the special dollar account, and (2) copies of the statements of the special dollar account, verifying that the funds have been appropriately released.

(b) The Grantee will provide, beginning ninety days after disbursement of the U.S. dollar resources, and until funds in the special local currency account have been liquidated, quarterly reports documenting that funds from the special local currency account have been released to the Development Account of the Government of Dominica.

Further specification of the content and timing of the Grantee's reporting requirements will be contained in an Implementation Letter.

SECTION 5.5. Publicity

The Grantee will give appropriate publicity to the Grant.

SECTION 5.6. Execution of Program

The Grantee will carry out the Program or cause it to be carried out with due diligence and efficiency.

SECTION 5.7. Consultation

The Grantee will meet at regular intervals with A.I.D. in order to consult concerning the effectiveness of the activities undertaken through the Agreement. The Grantee will provide to A.I.D. such information relating to the economic and financial situation of Dominica as may be reasonably requested by A.I.D.

SECTION 5.8. Miscellaneous Financial and Program Covenants

(a) The Grantee shall make every effort to restrict increases in the public sector wage bill to no more than three percent per year between Government of Dominica's Fiscal Years 1987/88 and 1988/89, and between 1988/89 and 1989/90. The Grantee further covenants that civil service wage and salary payments will equal no more than 53 percent of recurrent revenue in Fiscal Year 1987/88 and that every effort will be made to reduce civil service wage and salary payments to a level not to exceed 50 percent of recurrent revenue by Fiscal Year 1989/90. Government further covenants to make every effort to ensure that civil service wages and salaries will not exceed 57 percent of current expenditure in Fiscal Years 1988/89 and 1989/90. The Grantee further covenants to provide to A.I.D., at the request of A.I.D., expenditure data demonstrating the progress that the Grantee is making toward attaining the targets for wage and salary expenditures, such data to be used in determining satisfaction of the Conditions Precedent to the disbursements under this Grant.

Mindful that A.I.D.'s request will occur before the end of the Grantee's fiscal year, the Grantee will be prepared to present its most currently available actual performance data along with full 1988/89 fiscal year projections before January 1, 1989.

(b) The Grantee shall make every effort to contribute to public sector savings by taking actions necessary to produce a surplus in the recurrent account of the Government budget equal to at least 11 percent of current revenue in Fiscal Years 1988/89 and 1989/90. The Grantee further covenants to provide to A.I.D., at the request of A.I.D., revenue and expenditure data demonstrating the progress that that the Grantee is making toward attaining the targets for current account surpluses, such data to be used in determining satisfaction of the Conditions Precedent to the disbursements under this Grant. Mindful that A.I.D.'s request will occur before the end of the Grantee's fiscal year, the Grantee will be prepared to present its most currently available actual performance data along with full 1988/89 fiscal year projections before January 1, 1989.

(c) The Grantee shall provide to A.I.D., prior to January 1, 1989, except as the parties may otherwise agree in writing, in form and substance satisfactory to A.I.D. a report on further measures taken or planned by the Grantee to remove fiscal, regulatory, or other disincentives to private investment in Dominica.

(d) The Grantee shall provide to A.I.D., prior to January 1, 1989, except as the parties may otherwise agree in writing, in form and substance satisfactory to A.I.D. an implementation timetable for further privatization of state-owned enterprises.

(e) The Grantee shall increase the Government of Dominica's budget for road and infrastructure maintenance by at least 10 percent each year between its Fiscal Year 1988/89 and Fiscal Year 1989/90.

Article VI. <u>Refunds</u>

If the failure of Grantee to comply with any of its obligations under this Agreement has the result that the Grant is not used effectively in accordance with this Agreement, A.I.D. may require the Grantee to refund all or any part of the amount of the disbursements under this Agreement in U.S. dollars to A.I.D. within sixty (60) days after receipt of a request therefor. Such right to require refund of any disbursement will continue, notwithstanding any other provision of this Agreement, for three years from the date of the last disbursement under this Agreement.

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Article VII. Miscellaneous

SECTION 7.1. Communications

Any notice, request, documents, or other communication submitted by either party to the other under this Agreement will be in writing or by telegram or cable, and will be deemed duly given or sent when delivered to such party at the following address:

To the Grantee: Prime Minister and Minister of Finance

Mail Address: Government Headquarters
Roseau, Dominica

Cable Address: Telex No. 8613 DOM EXTERNAL

To A.I.D.: Director, Regional Development Office/Caribbean

Mail Address: USAID/Bridgetown
Box 302, U.S. Embassy
Bridgetown, Barbados

All such communications will be in English. Other addresses mav be substituted for the above upon the giving of notice.

SECTION 7.2. Representatives

For all purposes relevant to this Agreement, the Grantee will be represented by the individual holding or acting in the position of Minister of Finance, Government of the Commonwealth of Dominica and A.I.D. will be represented by the individual holding or acting in the position of the A.I.D. Director, Regional Development Office for the Caribbean, in Barbados, each of whom, by written notice, may designate additional representatives. The names of the representatives of the Grantee, with specimen signatures, will be provided to A.I.D., which may accept as duly authorized an instrument signed by such representatives in implementation of this Agreement, until receipt of written notice of revocation of their authority.

IN WITNESS WHEREOF, the Commonwealth of Dominica and the United States of America, each acting through its duly authorized representative, have caused this Agreement to be signed in their names and delivered as of the date and year first above written.

COMMONWEALTH OF DOMINICA	UNITED STATES OF AMERICA
By: ______________________ Hon. Charles A. Maynard	By: ______________________ James S. Holtaway
Title: Acting Prime Minister and Minister of Finance	Title: Director, RDO/C

ANNEX A

1987 Dominica PAAD

In order to limit the physical size of the present document, Annex A is not attached here. The original document can be found on file under project number 538-0141.02 at the Regional Development Office/Caribbean (RDO/C) in Bridgetown, Barbados.