

INTERNATIONAL MONETARY FUND



Staff Country Reports

Dominica: Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper

The attached Joint Staff Assessment (JSA) of the Interim Poverty Reduction Strategy Paper for **Dominica**, prepared by the staffs of both the World Bank and IMF, was submitted with the member country's Poverty Reduction Strategy Paper (PRSP) or Interim PRSP (IPRSP) to the Executive Boards of the two institutions. A JSA evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP or IPRSP provides a sound basis for concessional assistance from the Bank and Fund, as well as for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative. The Boards then decide whether the poverty reduction strategy merits such support.

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**INTERNATIONAL MONETARY FUND
AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION**

DOMINICA

Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper

Prepared by the Staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

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I. INTRODUCTION

1. This document represents the joint assessment of the staffs of the Bank and the Fund of the interim poverty reduction strategy paper (I-PRSP) prepared by the Government of the Commonwealth of Dominica and submitted to the Bank and the Fund on December 1, 2003. The preparation of this I-PRSP, and the later full PRSP, is intended to provide a framework for assistance under the Poverty Reduction and Growth Facility. The authorities have consented to the publication of both the I-PRSP and the joint staff assessment (JSA).

II. COUNTRY OVERVIEW

2. **After performing reasonably well over the 1980s, Dominica experienced a secular slowdown during the 1990s followed by an unprecedented decline in output and a marked deterioration of its fiscal position in the new millennium.** Dominica's economy performed reasonably well over the 1980s with growth rates averaging 4.6 percent per year, fueled by a preferential trading regime, and favorable exchange rate movements. During this period, the country undertook significant trade and tax reforms and public finances strengthened considerably. The country then suffered a slowdown during the 1990s brought on by steady appreciation of the real exchange rate since 1996, declining preferential market access for its banana exports and increased incidence of weather-related shocks. The impact was felt in declining exports and flat tourism receipts. Delayed fiscal adjustment to the secular decline in growth, combined with a lack of expenditure control and a sharp increase in commercial borrowing to finance poorly planned and unproductive public investments, resulted in a deterioration of public finances. Then in 2001, Dominica was further hit by the impact of a severe drought, the events of September 11, 2001 and the global economic slowdown. The economy contracted by 9 percent between 2001 and 2002, further

exacerbating the fiscal difficulties. The central government deficit reached 11 percent of GDP in FY00/01, domestic arrears mounted to around 10 percent of GDP by FY01/02 and public debt reached 106 percent of GDP in 2002.

3. The Government is taking steps to address the macroeconomic situation. In August 2002, the Government embarked on a stabilization program supported by a Stand-By Arrangement with the IMF to address the fiscal imbalances and halt the macroeconomic deterioration. Although important progress was made during FY02/03, implementation delays and inadequate control of the wage bill caused the program to go off track. In mid-2003, the Government negotiated an extension of the Stand-By Arrangement through end-2003, and has implemented a package of politically difficult fiscal measures of around 2.5 percent of GDP, including a 5 percent public sector wage cut. The overall public sector deficit has declined to a projected 5.6 percent in FY03/04. However, the debt-to-GDP ratio is estimated at 111 percent of GDP in mid-2003.

4. Dominica is not the only economy in the Eastern Caribbean Currency Union facing difficulties. The pattern of economic slowdown due to a worsening external environment and subsequent fiscal weakness is a sub-regional phenomenon. So too is the incidence of poorly conceived public investments financed by commercial borrowing that have not yielded the expected impact on growth and diversification, and have saddled the OECS (Organization of Eastern Caribbean States) countries with increased debt burdens. The widespread deterioration in public finances, with the consequent pressures on domestic banking systems, poses a serious challenge to the management of the currency union.

III. THE INTERIM PRSP

5. The staffs concur with the Government's concern that the recent slowdown in growth, particularly the retrenchment in the banana sector, and the current fiscal crisis have increased already high poverty levels in Dominica. The staffs also welcome the Government's decision to adapt their ongoing development planning processes to the formulation of a poverty reduction strategy. This I-PRSP has three main strengths: (i) an up-to-date and thorough assessment of the existing poverty situation in Dominica based on sound poverty measurement and diagnostics; (ii) a candid description of the current macroeconomic situation, its antecedents and potential solutions; and (iii) a comprehensive review of Dominica's current social safety net.

6. The Government's poverty reduction strategy is to implement a comprehensive program to foster economic growth and private sector employment and at the same time maximize the effectiveness of government spending on pro-poor programs and social protection while the economy undergoes adjustment. Given the nature of poverty in Dominica, the staffs believe that this approach is appropriate, but also that much remains to be done to fully specify the mechanisms by which the strategy is to be achieved. The staffs also welcome the focus on maintenance of the basic services that have yielded Dominica's relatively good social indicators and as well as the focus on the potential causes of impoverishment. In this regard, the staffs have encouraged the authorities to adapt the Millennium Development Goals to specific medium term targets for poverty reduction relevant to the situation in Dominica.

A. Poverty Analysis

7. **The I-PRSP contains a sound analysis of the nature and causes of poverty in Dominica** based on an excellent Country Poverty Assessment (CPA) recently completed by the Government with support from the Caribbean Development Bank (CDB) and the UK Department for International Development (DFID). Extracting from the CPA, which was based on a household consumption survey and a participatory poverty assessment conducted by the authorities, the I-PRSP provides useful and robust information about the scale of poverty which remains high both at a population and household level, and geographical and demographic characteristics, including specific treatment of the particular position of the indigenous population – the Caribs - and the gender profile. Notably, the data enables the authorities to differentiate between the relative importance of key determinants of poverty and vulnerability as a basis for focusing their interventions. This analysis of these determinants should be strengthened in the full PRSP.
8. **The staffs agree with the broad conclusions of the analysis that poverty in Dominica is generally income/employment-based, rather than based on inadequate access to basic services and social capital.** Decades of investment in human and social capital have yielded relatively good social indicators in Dominica that are not significantly different for the poor and the non-poor except in secondary education attainment and unemployment. As such, the I-PRSP rightly concludes that poverty reduction will require a focus on increasing employment and income-generating opportunities for the poor. The staffs would also encourage particular attention to the expansion of access to, and improvement of the quality of, secondary education, to enable the poor to build the human capital necessary to take advantage of those opportunities. At the same time, care will have to be taken to maintain the delivery of quality basic services to ensure that social gains are not reversed as a result of the current fiscal difficulties.
9. **The staffs also note the special situation of the indigenous Carib population,** which faces notably lower access to basic amenities, yielding less admirable social indicators, and have encouraged the authorities to include a specific sub-strategy for reducing poverty among this group in the full PRSP.
10. **The staffs feel that the full PRSP would benefit from a specific focus on Dominica's efforts to stem the spread of HIV/AIDS, as a potential cause for future impoverishment,** in particular given the very high prevalence rates in the Caribbean.
11. **The full PRSP should also use the detailed poverty data to sharpen the focus of sector strategies** and corporate plans at the line ministry level as well as the overall Public Sector Investment Program (PSIP) on specific and targeted poverty-reducing interventions. In this regard, the staffs welcome the Dominican authorities' initiative to translate the information from the household and labor force surveys and a recent census into a poverty map for use in improving targeting mechanisms for social service delivery and social assistance spending. The Bank will provide technical assistance for this effort which is also being supported by the Caribbean Development Bank.

12. Finally, the current poverty data is limited with respect to establishing precise trends because of a lack of comparability with previous surveys. However, the anecdotal evidence provided by the participatory assessment clearly confirms that poverty has been on the rise over the last few years. **The full PRSP should contain plans to continue the routine measurement of poverty through the use of periodic household consumption surveys.** In that respect, the staffs have urged the authorities to take full advantage of the Bank's recently-approved Institutional Development Fund grant to support the improvement of joint sub-regional capacity for poverty monitoring and measurement with other OECS member countries.

B. Macroeconomic Framework

13. The staffs commend the authorities for the strong emphasis in the I-PRSP on the appropriate macroeconomic framework. Indeed, the medium-term program and targets presented in the I-PRSP reflect a three-year framework for which the government is seeking IMF support under the Poverty Reduction and Growth Facility (PRGF). The authorities have targeted a growth rate of 2 percent per year which the staffs feel is reasonable given the external outlook for Dominica. Moreover, with negligible population growth due to migration, this growth rate should provide sufficient impetus for reducing poverty. More work would need to be done in the full PRSP to ascertain the rate of poverty reduction that could be expected from this growth target.

14. *Debt reduction.* The staffs agree with the I-PRSP assessment that achieving the macroeconomic stability necessary for growth will require a reduction of public sector debt through debt restructuring and maintenance of adequate primary surpluses to service the lower debt. The authorities have targeted a reduced level of debt, and a primary surplus of 3 percent of GDP to be achieved over a three-year horizon. The staffs feel that the strategy is appropriate.

15. The staffs agree with the authorities' strategy to reverse fiscal imbalances by emphasizing expenditure reduction, while simultaneously removing distortions in the tax regime and avoiding undue increases in the already high tax burden on the economy. This approach should minimize the risk of the fiscal adjustment catalyzing a further contraction of the economy. However, the commitments and targets for outer years will need to be revised in the full PRSP, in particular in line with the outcome of the debt restructuring exercise. Moreover, the establishment and strict implementation of a well-designed fiscal responsibility law and medium-term expenditure framework should help to improve investor confidence. Among others, this will also require further advances in expenditure management and control systems.

16. Given the structure of public expenditure in Dominica, the staffs concur with the I-PRSP strategy to focus on the reduction of public employment through a program to systematically reform public service delivery without jeopardizing quality and coverage, and believe that the reductions targeted under the macroeconomic framework are achievable. The plan to adjust fiscal targets to exclude the cost of retrenchment, as necessary, is also appropriate. However, care should be taken to ensure that appropriate safety nets are put in place for retrenched employees. In this regard, the staffs recommend that, early on, the

authorities establish a tracking survey to monitor the poverty and social impact on retrenched employees over time. The Bank has offered to support this effort with a Poverty and Social Impact Assessment of the reform program.

C. Structural Reform

17. The I-PRSP is very short on the analysis of the structural problems facing Dominica, with the exception of a need to strengthen the financial sector and improve external competitiveness. Moreover, it does not outline any approaches for addressing these areas. The I-PRSP aims to reduce the current account deficit by 50 percent over the next few years, but does not specify how this target is to be achieved. A number of measures are proposed in the structural matrix but without any additional explanation. In the full PRSP, the Government should include a more detailed description of the structural reforms aimed at improving external competitiveness and promoting both domestic and foreign investment. The ongoing World Bank study on growth and competitiveness issues in the OECS countries will provide to the authorities analytical input on these issues.

D. Social Safety Nets

18. The staffs welcome the comprehensive description of Dominica's current social safety net and proposals to strengthen it through a reallocation of resources to more effectively targeted programs. These recommendations are fully consistent with the findings of the Bank's recent Social Protection Review for Dominica. However, the full PRSP should also include a more detailed description of the sources of vulnerability for Dominica's households, as well as their formal and informal mechanisms for dealing with the effects of macroeconomic volatility as well as idiosyncratic shocks, as an input into the reform of the safety net.

IV. PARTICIPATION AND OWNERSHIP

19. **The Government of Dominica has established a good track record of consultation and participation, which is expected to yield full ownership of the PRSP among the population at large.** Since the onset of the stabilization program in 2002, the Government has followed an approach of openness and consultation with a broad cross-section of Dominicans. The Government has undertaken extensive consultations with trade unions, private sector organizations and political groups in order to increase understanding of the difficult challenges facing the country and build support for the stabilization and structural reform agenda for 2003 and beyond. Regular quarterly meetings were held with an Economic Stabilization Consultation Group (ESCG) comprising trade unions, private sector and civil society. Earlier this year, there was widespread and open public debate of the proposed fiscal measures leading up to the June presentation of the Government's budget to Parliament. The Government has also undertaken a "Change Management" program within the public sector to sensitize officials to the need for reform. The ESCG has now been replaced by the establishment of an Independent Monitoring Group made up of civil society representatives, including religious organizations, which receive monthly reports on the stabilization and structural reform program and publish their own analysis of the Government's performance.

V. PREPARATION OF THE FULL PRSP

20. The authorities have presented a plan, including a consultation process, to complete a full PRSP by end December 2004. The staffs find the proposed institutional arrangements and consultation process satisfactory and are confident that the authorities will continue the approach of participation and openness (described in para. 19) and that it will yield the necessary ownership of the full PRSP strategy among the population at large. The staffs have also recommended that the authorities explore ways to involve the Dominican diaspora overseas in the proposed consultations and to include formal interactions with the donor community and regional partners as part of the preparation of the PRSP.

21. *Timetable.* While the detailed calendar of activities needs to be refined over time, the staffs consider that this plan is realistic. The target date is achievable and allows sufficient time for the work described above. However, the staffs recognized that, with the proposed timetable, work on the full PRSP would not be sufficiently advanced to allow a full reflection of its broadly agreed priorities and actions in the FY04/05 budget and have recommended that the authorities explicitly target FY05/06 as the budget year in which the national budget would be fully aligned with the PRSP.

22. *Additional work.* Targets under the macroeconomic framework will need to be adjusted in line with the outcome of the debt restructuring exercise. In addition, it is the staffs' view that more work is needed to: (a) adapt the Millennium Development Goals to Dominica's specific situation and develop appropriate indicators and targets; (b) identify specific policy priorities in order to refine and expand the structural reform agenda, in particular with respect to reviving growth; (c) formulate more detailed and focused sector strategies based on the rich poverty analysis available in the Country Poverty Assessment; (d) indicate what are the priority expenditures for execution of the strategy in the government's budget and the 3-year rolling public sector investment program; and (e) establish a clear set of monitorable indicators and a participatory monitoring and evaluation system.

23. *Technical assistance.* A group of donors and regional partners, including the World Bank and the International Monetary Fund, the Caribbean Technical Assistance Center (CARTAC), CDB, CIDA, DFID, the EU, the Government of Barbados, and UNDP have been providing a coordinated net of technical assistance to the Government of Dominica under the stabilization and adjustment program, in areas such as financial and public expenditure management including the PSIP, tax reform, public sector reform, power sector, and private sector development including the formulation of a tourism strategy. The Bank has supported these efforts through the preparation of a Country Financial Accountability Assessment, a Country Procurement Assessment Review, a Social Protection Review and with technical assistance on the petroleum and electricity sectors. The Fund continues to support the authorities with technical assistance on expenditure management, tax reform and macroeconomic programming. The staffs expect that this assistance will continue through the development and implementation of the full PRSP. The Bank will also support Dominica's proposed application for a grant from the multi-donor PRSP Trust Fund for the development and implementation of the full PRSP.

VI. WORLD BANK AND IMF PLANNED ACTIVITIES

24. The authorities envision that a full PRSP would be completed by end-December 2004. In the interim, the Bank is preparing an Economic Recovery Support Operation for Dominica, scheduled for presentation to the Bank's Board in January 2004. The IMF will also present a PRGF-supported program for Dominica to its Board on December 17, 2003.

VII. RISKS AND CHALLENGES

25. **The staffs have identified significant risks to the implementation of the poverty reduction strategy as laid out in the I-PRSP.** A first set of risks is related to the macroeconomic framework, namely (i) potential difficulties in executing the debt strategy; (ii) Dominica's continued macroeconomic vulnerability to external shocks and natural disasters; and (iii) the risk of slower recovery in growth and private investment. A second set of risks is related to political uncertainties including: (iv) potential reform fatigue on the part of the population; and (v) upcoming general elections in early 2005. Finally, as a small state, Dominica remains susceptible to (vi) deeper than expected capacity constraints in the public sector that may slow implementation of the strategy.

26. As mentioned above, the authorities' debt strategy is an ambitious one. Difficulties or delays in concluding negotiations with creditors could lead to additional fiscal adjustment as part of the macroeconomic program and may jeopardize social spending. At the same time, a slower than expected recovery of growth and private investment would delay the needed employment generation that is crucial for poverty reduction. Moreover, although the current projections for the external environment are positive, Dominica remains vulnerable to frequent and costly natural disasters associated with its location in the hurricane belt.

27. On the political side, **there is a significant risk that the upcoming general election in 2005 could weaken political momentum and commitment** to fiscal discipline and the reform agenda. However, since its decision to request the Stand-By Arrangement in mid 2002, the Government has worked steadily through extensive public consultation (see para. 19) to garner political support for the agreed stabilization measures and structural reforms, evidenced by its ability to undertake a 5 percent public sector wage cut in July 2003 with little or no civil unrest. A related risk, however, is that reform fatigue on the part of the population may jeopardize the Government's ability to correct price distortions that are necessary to strengthen Dominica's external competitiveness and attract foreign investment.

28. Finally, **Dominica remains susceptible to public sector capacity constraints – common in small states – that may delay the pace of reform and strategy implementation** and, consequently, the reduction of poverty levels. Moreover, the implementation of the needed public sector reform program may initially constrain the pace of implementation of the poverty reduction strategy as new organizational structures are put in place and become fully operational.

VIII. CONCLUSIONS

29. The staffs of the World Bank and IMF consider that this I-PRSP provides a sound basis for the development of a fully participatory PRSP and for Bank-Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.