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Staff Country Reports

Dominica: Poverty Reduction Strategy Paper—Joint Staff Advisory Note

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper for Dominica, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Paper (PRSP) to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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

DOMINICA

**Medium-Term Growth and Social Protection Strategy (GSPS)
Joint Staff Advisory Note (JSAN)**

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

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I. OVERVIEW

1. **The Government of the Commonwealth of Dominica (GOCD) completed its medium-term Growth and Social Protection Strategy (GSPS) in April 2006.** This strategy is the culmination of an initiative that began with the elaboration of the Interim Poverty Reduction Strategy Paper (I-PRSP), which was submitted to the IMF and the World Bank in November 2003. The GSPS is a much more comprehensive document than its predecessor. It expands considerably the discussion of poverty assessment, investment climate, macroeconomic framework, and public sector reform. The document also advances the social development and poverty reduction agenda in Dominica through sectoral strategies, social safety nets, and a monitoring strategy. The GOCD intends to circulate widely the GSPS in Dominica, and to post it on the internet.
2. **The GSPS has benefited from a broad consultation process that started in mid-2004 and was led by the GOCD.** There were extensive consultations with Cabinet members, officials of the ministry of finance and planning and other ministries, and the rest of the public sector. The consultation process also included discussions with nongovernmental organizations (NGOs) and community based organizations (CBOs) in regional focus groups. Input from the private sector was solicited, and facilitated by presentations made to representatives of the business community and requests for comments on earlier drafts. The authorities also consulted with bilateral and multilateral donors including EU, UNDP, CDB, CIDA, IMF, and the World Bank, including in the context of the donors conference of June 2005.
3. **The GSPS emphasizes the importance of achieving private sector-led growth and maintaining Dominica's social and physical infrastructure, while at the same time**

achieving a smaller and more efficient public sector. Emphasis is given to measures aimed at improving economic growth and job creation since, as the poverty assessment concludes, poverty in Dominica is generally employment-based, rather than due to inadequate access to basic social services. In particular, the GSPS outlines a strategy for improving the investment climate and reducing the cost of doing business in Dominica. It also discusses a strategy to reform the public sector to improve its efficiency, and to speed up the execution of public investment in order to avoid physical infrastructure becoming a bottleneck for private sector growth.

4. This Joint Staff Advisory Note (JSAN) provides Bank and Fund staff's analysis and advice on key priorities for strengthening the GSPS and for ensuring effective implementation. This JSAN comes at a time when Dominica is trying to consolidate the economic recovery following the severe crisis which the country faced between 2001 and 2003. It also comes at a time when Dominica is in the process of completing the stabilization component of its economic strategy and direct its efforts towards growth-enhancing structural reforms.

II. POVERTY ASSESSMENT

5. **The poverty analysis contained in the GSPS builds on a recent comprehensive Country Poverty Assessment (CPA) that was prepared with support from the Caribbean Development Bank (CDB).** The CPA comprised a Survey of Living Conditions, a Participatory Poverty Assessment, and an Institutional Analysis. The CPA provides a very rich quantitative and qualitative basis for assessing the poverty situation in Dominica, covering the many dimensions of poverty including geography, age, education, gender and ethnicity—a dimension of particular importance to Dominica given the significant indigenous Carib population.

6. **The GSPS has made effective use of the available data and information to provide a fairly in-depth assessment of the current situation in Dominica.** This assessment not only serves as a solid basis for the strategic policy prescriptions to address the many dimensions of poverty, but also as a good baseline for measuring progress towards the Millennium Development Goals (MDGs). It is unfortunate that, due to methodological differences, the comprehensive poverty data from the 2002 CPA are not directly comparable with the data from the 1996 poverty assessment. This prevents a useful comparative analysis over time to provide important information on the dynamics of poverty in Dominica. In this regard, staff would urge the authorities to plan for a regular poverty assessment based on a common methodology. Staffs also encourage the use of information from other sources, such as poverty maps generated from the regular household surveys, to enrich the assessment.

7. **The GSPS depicts the level of poverty in Dominica as high, even by Caribbean standards.** According to the 2002 CPA, 29 percent of households and 39 percent of the population were below the poverty line. Moreover, 10 percent of households and 15 percent of the population were indigent. Poverty is largely a rural phenomenon, as three quarters of the poor live in the rural areas. The incidence of poverty is also much higher among the indigenous Carib population, with 70 percent of them falling below the poverty line and

almost half of whom are indigent. Most of the Caribs also live in the rural areas. Poor households in Dominica are characterized by higher unemployment and lower levels of education. However, no strong correlation has been found between poverty and single parenthood, gender, or being elderly.

8. **The GSPS concludes from the poverty diagnosis that poverty in Dominica is largely due to unemployment and underemployment arising from the slow economic growth over the last decade. A strategy to reduce poverty is presented.** The GOCD's poverty reduction strategy details programs and actions built around four pillars. The first pillar is the promotion of economic growth and job creation. The GSPS also emphasizes that this growth would be private sector-led. The second pillar is the human capital development, especially pertaining to skills and health. A third pillar focuses directly on the betterment of the conditions of those who are currently in severe poverty. The final pillar addresses the social problems that could potentially cause future poverty. Staffs consider the four pillars to be appropriate, particularly in light of the deficiencies in past policies and programs. The emphasis in the GSPS on prioritizing programs and actions for poverty reduction is also welcome.

9. **The GSPS also highlights the specific measures to be taken over the medium term to reduce the disparities between the Caribs and other Dominicans.** The intention is to bring the income and poverty indicators for the Caribs in line with the national average by 2010. The specific strategy will focus on: (i) implementing a comprehensive Carib Territory Community Development Program; (ii) integrating the Carib community more fully into the economic life of Dominica, particularly in terms of access to financial services including microcredit; and (iii) promoting the Carib village as an eco-tourism center. Staffs welcome this inclusion of a specific substrategy for reducing poverty among this group as was recommended in the I-PRSP.

III. PRIORITY AREAS FOR POVERTY REDUCTION AND GROWTH

A. Creating an Enabling Environment for Economic Growth

10. **The GSPS attaches great importance to the promotion of economic growth and job creation, given the nature of poverty in Dominica.** Staffs agree that putting emphasis on economic growth is the best way to reduce poverty in Dominica, given the strong link between poverty and unemployment and underemployment. However, to achieve the authorities' ambitious targets of reduction in unemployment and poverty, staffs consider that a deeper understanding is needed regarding how economic growth will translate into poverty reduction, and how the poorest segments of the population will benefit. In this regard, the strategy for economic development of the Carib population is a remarkable first step.

11. **The GSPS also stresses that existing health and education programs are essential to foster growth in the medium and long terms, but further efforts are needed.** Staffs consider that the emphasis on building upon existing health and education systems, which have served Dominica well as reflected in its social indicators, is appropriate. However,

given that it is also important to achieve employment growth and public spending efficiency, there is potential to deepen the discussion of links between this social infrastructure and labor market rigidities. In common with much of the ECCU, these rigidities are reflected in relatively high wages despite high unemployment. For example, there may be scope to sharpen the focus on raising the human resource capacity to address current shortages of skilled medical staff and thus increase public healthcare spending. On education, it might be useful to give a higher priority, and hence develop more specific plans, to improve the supply of vocational and technical training that is relevant to the needs of the private sector. Boosting the number of workers with relevant skills will be critical for employment growth in identified growth sectors such as tourism.

12. **The GOCD acknowledges that private investment must play a leading role in realizing Dominica's growth potential and that the government has a role in improving the investment climate.** There is an appropriate emphasis on streamlining regulations and procedures related to private sector investment. In particular, implementing with World Bank assistance the plans for a one-stop shop for new investors should improve transparency and speed up the investment process. To ensure that private investment sustains the current recovery, it will be necessary to move quickly on implementing these plans. This could also help attract the interest, and facilitate the involvement of the Dominican Diaspora. As mentioned by the GSPS, the Diaspora is a potentially important source of skills and capital.

13. **Staffs think there is scope to widen the discussion about the improvement of the investment climate, in particular regarding the costs of doing business.** On this issue, the GSPS does highlight important input costs such as transport and utilities, and amending the Electricity Supply Act as proposed is a tangible step towards lowering electricity cost over the medium term. However, there is a need to give a higher priority to, and sharpen the focus on, the cost of labor, particularly as employment growth is perceived as the crucial way to reduce poverty. For example, the GSPS could discuss priorities for labor market reform, to include issues such as the ease with which private sector employers can hire workers, for example, on temporary or part-time contracts, and reducing their workforce as needed. Similarly, more emphasis could also be given to the cost of, and access to, capital by local investors. This could be usefully integrated with an enhanced discussion about financial sector reform, since this is a critical sector to the objective of private sector-led growth. Some reform measures to strengthen the financial system and address the incentives of banks and other intermediaries to offer business credits at a lower cost, such as improving the procedures to realize collateral are highlighted in the GSPS. But other measures could be discussed and given a higher priority. These could include raising accounting standards and supporting a region-wide credit bureau to improve the information available on potential borrowers.

14. **Staffs agree with the government's attempt to take steps to speed up the rate of implementation of the public sector's investment program.** Current implementation rates are low and need to be raised to guarantee that the lack of physical infrastructure or suboptimal maintenance of the existing infrastructure do not constrain growth. Staffs recognize that there is limited implementation capacity in small countries such as Dominica, and believe that this makes it even more important to clearly identify how specific projects

will affect growth and poverty reduction, since articulating these linkages would help to prioritize projects.

15. **The potential benefits for Dominica from regional integration and cooperation are high and should be exploited.** Given the small size of the Caribbean economies, and the high fixed costs of providing government and regulatory services, there is tremendous scope to increase the joint provision of selected government services, both to cut costs and achieve efficiencies. It will be important to recognize that this touches on many of the issues addressed in the GSPS, especially growth and poverty reduction strategies. For example, the prospect of increased labor mobility due to the Caribbean Single Market and Economy (CSME) will likely have implications for the labor market reform agenda and also for social safety nets.

B. Social Safety Nets

16. **There is no formal, unified targeted safety net program in Dominica. However, the GOCD operates a number of programs in the context of its overall social protection efforts.** The operation of these programs reflects a lack of established policies and procedures for implementation of social safety net programs, nontransparent targeting of beneficiaries, weak capacity to monitor and evaluate programs, and overlap and duplication of safety net programs. Staffs note the elaboration of plans in the GSPS to strengthen the government's capacity to deliver social safety net programs targeted to poor and vulnerable persons. Staffs welcome the steps that the GOCD is already taking to implement these plans through the preparation of a technical assistance operation to be supported by the World Bank and the European Union.

C. Macroeconomic Framework

17. **The GSPS contains a macroeconomic framework that is consistent with the proposed objectives of poverty reduction.** The macroeconomic framework targets a medium-term rate of growth of 3 percent per year and a gradual reduction of trade imbalances. The public sector's objective is to contribute to the achievement of this target through the maintenance of sound fiscal policy, including a primary surplus of 3 percent of GDP per year for the central government, and prioritized and efficient public sector investment, public sector reform, and price stability.

18. **The growth and fiscal targets envisaged in the macroeconomic framework are also consistent with the objective of maintaining public debt sustainability.** These targets had been previously assessed by staffs as consistent with public debt sustainability in the context of Dominica's fifth review of the PRGF agreement with the IMF. Staffs welcome that the GSPS outlines a plan for putting the social security on a sustainable footing, since, as discussed in the mentioned assessment, addressing the unfunded liabilities of Dominica's Social Security System is essential to guarantee the sustainability of public debt.

19. **Staffs view this macroeconomic framework as achievable and key for the success of the growth and poverty reduction strategy.** In particular:

- While the targeted growth rate of 3 percent per year is higher than the 2 percent envisaged in Dominica's I-PRSP (December, 2003), staffs consider this consistent with developments that occurred in the economy since the I-PRSP was issued (e.g., the debt restructuring program and the rebound of growth observed in 2004 and 2005) and with the government's investment and reform program.
- The objectives in the areas of primary balance and public sector reform are in line with the strategy the central government has followed during the last two years, which has helped it achieve surpluses above the medium-term target and a reduction in the relative size of government. In addition, the GSPS outlines the commitment of the GOCD to bring Dominica's social security system on a sustainable footing, which is key to ensuring sound fiscal finances in the medium to long term.

D. Monitoring Implementation

20. **The GSPS sets out an appropriate approach to the monitoring of its implementation progress because it focuses on a few key objectively verifiable indicators that are at the heart of the strategic goals of the GSPS.** This also explicitly recognizes Dominica's limited statistical capacity, and hence the difficulty of amassing reliable and timely socio-economic data. The performance indicators are expected to track macroeconomic growth, employment and poverty, education and social welfare, health and community development, infrastructure, and the environment. Furthermore, these indicators conform to existing data sources and monitoring systems of relevant line ministries. Staffs recommend that the authorities seek to make use of technical assistance provided by CARTAC, MECOVI and other sources to improve the statistical capacity in key areas related to the monitoring efforts.

21. **The GSPS also attempts to set out the specific institutional framework for monitoring of implementation involving the GOCD, NGOs and the private sector.** The GOCD proposes to incorporate the monitoring of the GSPS into the budget exercise and also proposes a mid-term evaluation in 2007/08 and an end-of-period evaluation in 2009/10. Staffs welcome the authorities' intention to involve other stakeholders in monitoring the implementation of the GSPS, and recommend that the GOCD consider including a member of the Carib community in the Steering Committee responsible for monitoring, which includes senior government officials, a representative from the private sector, and a representative from the NGO sector.

IV. IMPLEMENTATION RISKS

22. **Dominica's economy is subject to large risks, particularly from natural disasters and its heavy reliance on two economic sectors—tourism and bananas.** The country is

also vulnerable to shocks from high energy costs, and to the loss of donor support, since a large part of the public investment program is financed by external grants. The GSPS recognizes these risks, and outlines strategies to mitigate them. In particular, the development of geothermal energy could help Dominica not only reduce its dependency on oil but also create a new exporting sector. Staffs consider that the strategy of fiscal consolidation could also help the GOCD mitigate the risks as well as provide the fiscal space to respond to reconstruction needs.

23. **Staffs recommend that the GOCD also assess the impact of a sudden and substantial reduction of trade preferences in the banana sector.** Staffs recognize that the erosion in trade preferences has been ongoing for more than a decade and that the banana sector now only represents around 2 percent of Dominica's GDP (having declined by more than 10 percentage points during the past 15 years). However, the banana sector is very labor intensive and its share in total employment is still substantially higher than its share in total output. Consequently, a drop in trade preferences to the point of making the sector completely uncompetitive in international markets could create an unemployment problem of large magnitude and exacerbate the poverty situation.

V. CONCLUSIONS AND ISSUES FOR DISCUSSION

24. The GSPS builds on the efforts that Dominica has made in the past three years to achieve sound public finances, stabilize its economy, and stimulate growth. Bank and Fund staffs consider that the GSPS puts the right emphasis on the structural reform agenda that Dominica needs to undertake to consolidate the gains achieved over the past three years.

25. Staffs consider that efficient implementation and monitoring of the GSPS will constitute important challenges for the GOCD, given the limited implementation capacity characteristic of small, medium- and low-income countries. Therefore, efficient execution and prioritization of projects will be essential for the success of the strategies outlined in the GSPS, particularly in the areas related to improving the investment climate and the maintenance and expansion of physical infrastructure. In spite of these difficulties, staffs are encouraged by the close interaction that Dominica is maintaining with donors and the broader international community, in order to receive technical assistance and acquire technical expertise in important areas.

26. Do Directors support the staffs view that the GSPS represents an effective strategy for growth and poverty reduction in Dominica? Do Directors agree on staffs' recommendations to the Government of the Commonwealth of Dominica regarding: (i) the need to prioritize and efficiently implement the government's investment program; (ii) the need to broaden the discussion on the investment climate and the cost of doing business to include financial sector reform; (iii) the importance of maintaining fiscal discipline not only to support macroeconomic stability but also to mitigate risks from potential shocks (e.g., natural disasters); and (iv) the need to be more inclusive in the monitoring and evaluation of results of the implementation of the GSPS.