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BANCO CENTRAL DE LA REPUBLICA DOMINICANA
REPORT TO THE MONETARY BOARD: AUGUST 1982

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REPORT TO THE MONETARY BOARD: AUGUST 1982

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BANCO CENTRAL DE LA REPUBLICA DOMINICANA
REPORT TO THE MONETARY BOARD: AUGUST 1982

Introduction

1. The purpose of this report is to give a brief account to the Monetary Board of progress in carrying out the programme of work which we are undertaking in collaboration with officials from the Banco Central under the agreement between the Banco Central and Samuel Montagu & Co. Ltd. The report also mentions some of the subjects which we hope to discuss at the Banco Central during our regular visit to Santo Domingo in the working week beginning 23 August.

Financial report

2. The financial report on the Dominican Republic that we have prepared was checked with the Banco Central during our visit to Santo Domingo in May. With the agreement of the Banco Central it was subsequently circulated in June to a target list of foreign banks outside North America (Appendix 1). Copies have also been despatched to the Banco Central for circulation to the Banco Central's traditional foreign bank counterparties in North America and to other financial institutions. We hope to discuss during our visit in the working week beginning 23 August ways in which we can assist the Banco Central in following up the report by contacting the foreign banks concerned.

Foreign exchange budget

3. A revised format for the short term foreign exchange budget was agreed during our visit in May. A copy of the format and a note that we prepared at the time explaining the new format are included as Appendix 2. The format is used for internal management purposes and for the weekly telexes that are exchanged between the Banco Central and Samuel Montagu. We hope to review the format with the Banco Central during our visit in the working week beginning 23 August.

International Monetary Fund

4. At the Banco Central's request, we made a special visit to Santo Domingo at the end of June to discuss the question of opening negotiations with the IMF. A paper that we prepared on the subject for the Governor strongly recommended an approach to the Fund. A copy of this paper is included as Appendix 3. We have subsequently received a telex from the Governor indicating that the Monetary Board has unanimously decided to recommend to the President of the Republic that an approach should be made to the Fund. While the Banco Central is well prepared for any negotiations that take place, we hope to discuss during our visit

ways in which we may be able to assist the Banco Central, in particular on questions affecting relations with foreign banks that may arise while the negotiations with the Fund are taking place. Two such questions are how to prevent arrears arising on foreign debt payments in the next few months, as far as possible, and how best to renew the 'commercial bank agreements'.

Special assignments

5. Since our May visit we have at the Banco Central's request prepared a number of papers on financial questions of concern to the Banco Central. These comprise:

(a) 'the case for a Public Debt Office': this paper was despatched by courier to the Banco Central earlier in August; (a copy is attached as Appendix 4);

(b) 'comparative study of the IMF Extended Fund Facility': this paper was despatched to the Banco Central at the beginning of June; (a copy is attached as Appendix 5);

(c) 'foreign exchange market practice in the industrial countries': this paper was despatched to the Banco Central at the beginning of June; (a copy is attached as Appendix 6);

(d) 'prospects for gold sales by the Dominican Republic': a copy of this paper is attached as Appendix 7.

Seminars and training

6. During our visit in May, we conducted two seminars for officials from the Banco Central on opportunities for the Dominican Republic in international financial markets. We would be prepared to conduct further seminars during our visit in the working week beginning 23 August. We also hope to discuss the training of Banco Central officials in financial market techniques in London. When the Governor visited Samuel Montagu in London in May, we offered in addition to give any assistance we could in relation to the training of officials for the new Dominican gold refinery.

Financial assessments

7. On our May visit, we made financial assessments on a number of financial proposals submitted by foreign banks and broking houses on behalf of the Banco Central. We hope to discuss during our visit the assessment of any new proposals that have been received since our May visit.

OPR/lmm.

16 August 1982

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THE DOMINICAN REPUBLIC:
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Line
A. Foreign receipts (+)
Foreign debt payments (-)
Oil payments (-)
Commercial bank payments (-)
Other payments (-)	.....	.....	.....	.....	.....	.....
B. Balance for financing (-)	.....	.....	.....	.....	.....	.....
Use of reserves (+)	.....	.....	.....	.....	.....	.....
New borrowing (+)	.....	.....	.....	.....	.....	.....
Accumulation of arrears (+)	.....	.....	.....	.....	.....	.....
C. Net reserves	.....	.....	.....	.....	.....	.....
Sight deposits	.....	.....	.....	.....	.....	.....
Arrears outstanding	.....	.....	.....	.....	.....	.....
Letters of credit outstanding	.....	.....	.....	.....	.....	.....

NOTES:- SECTION A: shows foreign receipts (line a) and foreign payments (lines b-e) falling due in the period ending on the date at the head of the column concerned.

SECTION B: shows the balance for financing (line f) and the source of financing, whether through the use by the Banco Central of foreign reserves (line g), net new foreign borrowing by the Banco Central (line h), or the accumulation of arrears (line j) in respect of payments falling due in the period but not paid.

SECTION C: shows the level of net reserves of the Banco Central (line k), the level of sight deposits of the Banco Central (line l), the volume of arrears outstanding (line m) and the volume of letters of credit outstanding (line n) at the end of the period ending on the date at the head of the column concerned. Net reserves (line k) are calculated according to Article 45 of the Central Bank law. Sight deposits (line l) consist of free balances of the Banco Central with foreign banks and balances managed by the Federal Reserve Bank of New York. Arrears outstanding (line m) consist of arrears (not covered by the agreement with the commercial banks) at the beginning of the period plus the accumulation of arrears during the period (line j) Letters of credit outstanding (line n) consist of the volume of letters of credit approved at the beginning of the period, less payments by the Banco Central to commercial banks during the period in respect of letters of credit falling due, plus new issues of letters of credit approved by the Banco Central during the period.

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BANCO CENTRAL DE LA REPUBLICA DOMINICANA:
REPORT ON MAY VISIT AND PROGRAMME OF WORK BY SAMUEL MONTAGU
BETWEEN MAY VISIT AND JULY VISIT

Introduction

1. This report gives an account of the work on which we have been engaged during our visit to Santo Domingo in the working week beginning 3 May, and an outline of the programme of work that we are due to undertake prior to our next regular visit to Santo Domingo in July. This programme of work is flexible. We can adjust it to meet the Banco Central's changing requirements from time to time.

Report to the international financial community

2. During the course of our visit, we have discussed with officials from the Banco Central the contents of the draft report on the Dominican Republic we have prepared for distribution to the international financial community. The text of the report has been approved and the statistics in the report have been updated. The report will now be printed in London and circulated with a covering letter from the Banco Central to a target list of banks in Europe, the Middle East and the Far East, and to selected official institutions such as export credit agencies. We will handle the circulation of the report in Europe, the Middle East and the Far East. But we will also send copies to Santo Domingo for distribution by the Banco Central to interested institutions, such as the Central Bank of Trinidad & Tobago.

Presentations to the international financial community

3. Once the report has been circulated, we will initially contact the banks on the target list on an informal basis. That is, we will take the opportunity of meetings in London to discuss the financial position and prospects of the Dominican Republic with them on an individual basis. Similar opportunities will arise when our representatives visit target banks overseas. However, we consider that formal presentations should also be held in London or other financial centres on the model that we used in Cartagena when officials from the Banco Central are free to attend them and participate with us. We understand that the Banco Central will let us know as far as possible in advance of convenient dates.

Short term foreign exchange budget

4. In collaboration with officials from the Banco Central, we have reviewed the format for the short term foreign exchange budget that is prepared weekly for the month ahead and suggested a revised format. This shows 'above the line' the value of foreign receipts and foreign payments falling due in each week covered by the budget, and 'below the line' the resulting deficit to be financed and the anticipated method of financing, whether by the use of the Banco Central's foreign reserves, by new borrowing by the Banco Central, or by the accumulation of arrears.

5. There is a separate section in the revised format of the short term foreign exchange budget that is designed to show a number of critical financial variables at the end of each week. These are: the level of net reserves of the Banco Central, as calculated under Article 45 of the Central Bank Law; the level of gross sight deposits of the Banco Central with foreign banks and the Federal Reserve Bank of New York; the volume of letters of credit outstanding under the Banco Central's agreement with the foreign commercial banks (and the national commercial banks with their foreign correspondents); and the level of arrears outstanding not covered by the commercial bank agreements.

6. In the case of the volume of letters of credit outstanding, the revised short term foreign exchange budget format will demonstrate whether or not the ceiling of \$260m prescribed in the commercial bank agreements has been breached. In the case of the arrears, the revised format will show the overall amount overdue and not covered by the commercial bank agreements. We have suggested that a separate schedule should be prepared each week for the internal purposes of the Banco Central. This schedule should itemise the different categories of arrears, distinguishing where relevant between foreign debt payments overdue, letters of credit and 'cobranzas', and distinguishing between arrears for which the Banco Central has received the equivalent in pesos and those for which pesos are due but have not been received.

7. Apart from providing additional management information in the Banco Central, the revised format for the short term foreign exchange budget will be telexed each week to us in London along with a summarised statement of the foreign reserve position. This will enable us to continue to provide weekly recommendations to the Banco Central on the financing of the foreign exchange budget and the investment of the foreign reserves.

Medium term foreign exchange budget

8. The weekly telex which we send to the Banco Central will continue to enable us to make short term recommendations on financing for the month ahead. But we have also had the opportunity to collect towards the end of this visit the latest version of the foreign exchange budget for the rest of 1982. We will be taking this document back to London with us so that we can study it in detail and make suggestions about the financing of the foreign borrowing requirement for the rest of 1982 in writing in due course. When we do so, we will pay particular attention to the problems raised by the need to eliminate arrears outstanding and to keep within the terms of the commercial bank agreements.

Foreign currency financing options

9. During the course of our visit, we have had the opportunity to review a number of proposals submitted to and generated by the Banco Central so that we can give our recommendations. These recommendations are given in outline below. Where appropriate, separate notes have been prepared for the Banco Central. We hope that, when the Banco Central receives proposals from financial institutions overseas in future, it will send them to us by telex or airmail for our comments when we can be of assistance.

(a) CCC financing

10. We have reviewed a proposal submitted by Salomon Brothers whereby US\$100m import finance, guaranteed by CCC, would be available for 3 years at a margin over US Treasury bill rate, plus fees and expenses. We have recommended that the fees and expenses are reasonable, and that the difference between the effective Treasury bill rate and prime rate (on which CCC facilities are normally based) offers a potential saving in terms of interest, costs and fees, of 0.5%-0.8% per annum.

(b) US commercial paper

11. We have reviewed an information package submitted by Merrill Lynch on the issue of US commercial paper. Although the information package is addressed to the Banco Central, we understand that, if an entity from the Dominican Republic is going to use the commercial paper market, it will be a corporation rather than the Banco Central or any other Government-owned institution. We have concluded that a commercial paper facility of the kind proposed is only likely to be viable for a Dominican issuer if a suitable prime financial institution in the US can be identified to give a 'rating' to the issuer by effectively guaranteeing the paper issued, and underwrite the placement of the paper, thereby ensuring that funds are available to the issuer regardless of placement success. We have drafted a reply to Merrill Lynch asking for their suggestions in this respect.

(c) Rate protection programme

12. We have reviewed an offer from Merrill Lynch of a facility (covering up to US\$100m) whereby, for a fee of 1% per annum payable in advance, the Banco Central can be protected against a rise in prime rate above a certain level (to be determined at the time). A facility of this kind may be useful in respect of the credit, for up to 30 days, which Mexico grants the Banco Central on oil payments, on which interest is charged at prime rate. We have produced a separate note on the subject. This concludes that the facility seems a reasonable method of obtaining protection against significant rises in prime rate, when and if they are anticipated.

(d) Net reserves

13. Given that foreign currency liabilities of the Banco Central carry a 100% weighting in the calculation of net reserves under the Central Bank Law if their maturity is less than 30 days, we have suggested that pressure on the net reserves would be eased if a way could be found of documenting foreign currency credit lines to the Banco Central so that their effective maturity never reaches less than 30 days. We have suggested that a lending bank which grants a 90 day line to the Banco Central could be requested after, say, 55 days to agree that the line should be extended on maturity for a further period. If the bank agrees in advance, then in effect the maturity of the line of credit is deferred until the end of the following period: i.e. 125 days instead of 35 days. If this pattern is repeated subsequently, the maturity of the line will never fall below 30 days. The Banco Central's Legal Department is going to examine whether this procedure would satisfy the criteria provided in the definition of net reserves.

(e) Federal Reserve Bank

14. We have reviewed a letter that will be sent by the Banco Central to the Federal Reserve Bank of New York giving revised instructions for the management of the Banco Central's account. The revised instructions stipulate a minimum balance of US\$25,000 on the account, with the excess up to US\$5m to be invested by the Federal Reserve Bank on the Banco Central's behalf in repurchase agreements, and the excess over US\$5m to be invested either in repurchase agreements or in Treasury bills with not more than 3 months' maturity.

(f) Cheques in transit

15. We have discussed the procedure for collecting foreign exchange receipts with a view to determining whether or not the Banco Central is losing income on the foreign reserves. We understand that the procedure is as follows:

(i) Foreign exchange receipts are paid direct to the Banco Central in respect of gold and some sugar exports. In these cases, the proceeds are paid into the Banco Central's account at the Federal Reserve Bank of New York or one of its other bank accounts.

(ii) Other foreign exchange receipts are paid initially into accounts of the commercial banks. The commercial banks are required to pay the amounts concerned to the Banco Central immediately on receipt, and the Banco Central puts pressure on them to do so.

(iii) The commercial banks make cheques out to the Banco Central. These generally take one day to process, and the Banco Central receives good value on the second day.

(iv) In the case of Banco de Reservas, its overdraft with foreign correspondents cannot always be increased sufficiently to honour the cheques it pays to the Banco Central immediately.

(v) Foreign receipts are included in the foreign reserves of the Banco Central when the cheques paid by the commercial banks are received by the Banco Central. Initially, the cheques are included in the reserves as 'cheques in transit'. When they have been cashed, they are included as cash and generally held in the form of sight deposits.

(vi) In the case of Banco de Reservas, the proportion of cheques paid to the Banco Central which are not honoured in foreign exchange is sometimes used by the Banco Central to reduce commercial arrears to the Banco de Reservas in lieu of payment. In these circumstances, the value of cheques in transit in the reserves, which initially rises when the Banco Central receives the cheques, subsequently falls by more than sight deposits rise, because of the associated reduction that occurs in arrears.

On the evidence available from this analysis of the procedure for collecting foreign exchange receipts, we do not consider that the Banco Central is losing income on the foreign reserves unnecessarily.

Special assignments

16. From time to time, we are asked to undertake special assignments for the Banco Central which we submit for consideration by the Banco Central in written form. Before our next visit, we will be undertaking three such assignments, the first to be submitted by the end of May, and the other two to be brought with us when we return to Santo Domingo in July:

(i) We will prepare a paper incorporating recommendations about the establishment within the Banco Central of a system for monitoring foreign loan documentation to be signed by public entities in the Dominican Republic following approval of the loans in principle by the Monetary Board.

(ii) We will prepare a comparative study of the terms obtained by other relevant countries from the IMF under the Extended Fund facility.

(iii) We will examine the promotional value and potential profitability of selling Dominican gold coins outside the Dominican Republic.

Seminars and training

17. We have, during the course of this visit, conducted two half-day seminars for officials from the Banco Central on opportunities for the Banco Central in international financial markets. We will be pleased to conduct more seminars of this kind on future visits, if requested by the Banco Central to do so.

18. As a separate exercise, we are prepared to assist the Banco Central in the process of locating potential training assignments for officials which the Banco Central nominate with foreign financial institutions. In order to perform this task effectively, it will be helpful if we can be given advance notice and background details of the individual or individuals concerned. We understand that training assistance may initially be required in relation to the gold market.

Governor's visit to London

19. We are looking forward at Samuel Montagu to receiving the visit of the Governor of the Banco Central, the Head of the Foreign Exchange Department and the Dominican Ambassador to the United Kingdom at 11 a.m. on Monday 10 May. A programme has been arranged to enable the visitors to meet the heads of the different divisions of Samuel Montagu, and will be followed by a lunch for the visitors in the Governor's honour.

Next visit to Santo Domingo

20. Our next regular visit to Santo Domingo is due in July, and has provisionally been fixed for the working week beginning Monday, 12 July. We will confirm whether these dates are convenient for the Banco Central in due course. If a special visit is needed before our next regular visit, the Banco Central will let us know.

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Strictly confidential

THE DOMINICAN REPUBLIC: FINANCING THE FOREIGN EXCHANGE BUDGET

Introduction

1. The shortage of foreign exchange in the country at present has two consequences. First, it is difficult to meet foreign debts and other foreign liabilities falling due for repayment. Secondly, it is difficult to finance the continuing current account deficit on the balance of payments. The requirements for foreign exchange for these two purposes are likely to become critical in the next few months.

2. There appear to be two possible courses of action available to the financial authorities. The first is to make an application to the International Monetary Fund under an Extended Fund arrangement or a standby facility. The second is to attempt to renegotiate debts to foreign creditors without making an application to the International Monetary Fund. In view of the continuing shortage of foreign exchange, it is imperative that the financial authorities decide on a course of action as soon as possible.

Renegotiation of foreign debt

3. The first policy option is to renegotiate debts and other foreign liabilities falling due for repayment over a specified period ahead, either on a comprehensive or on a selective basis, without making an application to the International Monetary Fund. If adopted, this course of action would avoid the need to explain an application to the International Monetary Fund to the electorate. But it would raise two important problems.

4. First, based on recent experience in a number of other countries, it is very unlikely that foreign banks or other foreign creditors would agree to a renegotiation of their claims on the Dominican Republic on the scale required without the negotiation of an agreement with the International Monetary Fund. Since their experience of Peru several years ago, when foreign banks found it impracticable to impose policy conditions on a sovereign government, foreign banks involved in debt renegotiations have nearly always urged the countries concerned to negotiate an agreement with the Fund, and the successful outcome of the debt renegotiations has generally depended on the successful conclusion of a Fund agreement.

5. Secondly, even if a debt renegotiation with foreign banks and other foreign creditors was successful, without an agreement with the International Monetary Fund, it would fail to solve the foreign exchange problem facing the country. This is not simply a matter of deferring foreign debt maturities falling due. It is also a matter of raising new foreign currency finance to meet the ongoing current account deficit on the balance of payments. In the absence of an agreement with the Fund to provide balance of payments support, neither official foreign creditors nor foreign banks would provide the foreign currency funds necessary to finance the imports that the Dominican Republic requires.

International Monetary Fund

6. The second policy option is to make an application to the International Monetary Fund under an Extended Fund arrangement or a standby facility. The conclusion of an agreement with the International Monetary Fund would not preclude a decision to renegotiate debt falling due to foreign banks and other foreign creditors. It would make any such decision more likely to achieve the objective intended, which is not only to relieve the foreign exchange pressure arising from the maturity of foreign debts, but also to continue to obtain balance of payments support. There are two reasons for this.

7. First, the International Monetary Fund would be able to provide a very substantial volume of balance of payments support directly itself, on relatively concessionary terms (compared with the cost of funds in international financial markets). The Fund used to be criticised for imposing policy conditions on member countries in exchange for amounts of foreign currency that were not sufficiently large in relation to member countries' foreign exchange requirements to justify them. In view of the recent increases in member countries' quotas in the Fund and the increase in their drawing rights as a proportion of quotas, this criticism is no longer valid.

8. Secondly, the conclusion of an agreement with the International Monetary Fund would have an indirect effect in raising additional foreign currency funds, because it would increase the confidence of the international financial community in the Dominican Republic. The successful conclusion of an agreement with the Fund would make it easier for the Government to obtain new commitments from official foreign creditors and foreign banks. It would also be easier if necessary to negotiate the deferment of foreign debts falling due for repayment. The new Government in Jamaica used a Fund agreement to secure assistance from foreign official institutions and foreign banks last year, and the new Government in Costa Rica has recently announced to its foreign creditors that it intends to reach a new agreement with the Fund.

9. Despite these obvious financial advantages, the International Monetary Fund has sometimes been criticised in the past for imposing unacceptable political conditions on member countries in exchange for balance of payments support. The Fund appears to have learnt from its experience in the past (for example, in Peru). Recent cases have shown that the Fund is prepared to be much more flexible in imposing policy conditions on member countries than it used to be. (For example, devaluation is not a precondition for a Fund agreement). The policies imposed are policies that prudent financial authorities would wish to adopt anyway in the circumstances, whether or not a Fund agreement was requested.

10. These considerations enabled the new Jamaican Prime Minister to present the agreement reached between Jamaica and the Fund last year as a political victory rather than a defeat. He argued that the Fund agreement represented a great opportunity to help restore the prosperity of his country. In fact, since the agreement was reached, there has been a significant revival in the Jamaican economy, despite the effect of the world recession. Equivalent benefits could be achieved by the Dominican Republic from an agreement with the Fund.

Recommendations

11. For the reasons given, we recommend that an application should be made by the Dominican Republic to the International Monetary Fund as soon as possible. The application should preferably be made under an Extended Fund arrangement which would provide up to 450% of the Dominican Republic's quota in the Fund of SDR82.5m over a three year period (the equivalent of US\$471m at exchange rates prevailing at the end of May). A little more than 150% of quota might be available in the first year of the arrangement, owing to 'front-end loading'. In addition, we understand that the compensatory financing facility has been drawn only up to 50% of quota. In certain circumstances, the Fund allows member countries to draw up to 125% of quota in respect of export shortfalls and cereal imports.

12. The negotiations with the International Monetary Fund would probably last from three to four months. While the negotiations with the Fund were taking place, preparations would be made for negotiations with foreign official institutions (defined as friendly foreign governments and international development agencies), and with foreign banks and suppliers. These would begin as soon as it could be shown that the negotiations with the Fund would come to a successful conclusion, the negotiations with foreign official institutions taking place under the auspices of the Caribbean Group for Cooperation and Economic Development or an equivalent body, and the negotiations with banks and suppliers separately, possibly through a Steering Committee.

13. The preparations for negotiations with foreign official institutions and with foreign banks and suppliers would be concerned with answering two questions. The first is what new financial commitments would be required from foreign creditors, once the Fund agreement was concluded. The second is whether it would be necessary to ask foreign creditors to defer repayment of selected debts and liabilities falling due. These could be categorised in three main blocks:

(a) the official foreign debts with payments in arrears or falling due for repayment in the period ahead (as defined for the purposes of the exercise);

(b) the renewal of the agreement with foreign banks and with local and mixed banks for the payment of letters of credit falling due and overdue;

(c) arrears on payments to foreign suppliers and arrears on selected service payments.

14. Special consideration would need to be given to the financing of the foreign exchange budget during the period before new commitments could be negotiated from the International Monetary Fund under an Extended Fund arrangement, or from foreign official institutions and foreign banks. If it was impossible to meet all foreign payments on time, priorities would have to be decided for the allocation of the foreign exchange budget. Subsequent negotiations with foreign creditors would be easier to conclude successfully, if it was possible to meet official foreign debt payments on time in the interim.

15. It might be possible either to bring forward the completion of negotiations with the International Monetary Fund on the compensatory financing facility or to obtain temporary bridging finance from friendly foreign governments or foreign banks pending the outcome of negotiations with the Fund under the Extended arrangements. In discussions with foreign creditors on financing plans, it would be advantageous to mention progress on the negotiations with the Fund, and disadvantageous even to discuss the possibility of attempting to renegotiate foreign debts without an application to the Fund.

Assistance

16. In the context of our agreement with the Banco Central, the assistance that we could provide in this exercise would be of three main kinds:

(a) assistance in preparing and presenting the Dominican Republic's case to the Fund, either 'visibly' at the negotiating table or 'invisibly' behind the scenes, making use of our knowledge of what other countries have been able to achieve with the Fund, and with the intention of making the negotiations as speedy as possible;

(b) assistance in preparing the case and negotiating with foreign official institutions and foreign banks and suppliers to obtain new financial commitments, and, if necessary, to refinance existing obligations; and

(c) assistance in keeping foreign banks informed of progress in the development of the Dominican economy and in negotiations with the Fund (e.g. through updates of the report that we have already prepared on the Dominican Republic for the international financial community).

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29 June 1982

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BANCO CENTRAL DE LA REPUBLICA DOMINICANA: THE CASE FOR A PUBLIC DEBT OFFICE

Introduction

1. The purpose of this paper is to set out the disadvantages of the present systems within the Dominican Republic of approving foreign currency borrowings and to recommend how these disadvantages may be overcome by the establishment of a Public Debt Office. The advice which we give is based partly upon the experience we have gained in dealing with similar offices in other Latin American countries.

2. This paper is divided into six main sections:

(a) The first section sets out our understanding of the present systems whereby public and private borrowers in the Dominican Republic obtain the necessary permissions to enable them to borrow in foreign currency.

(b) The second section describes how in practice we understand that these permissions are obtained and which organisations and bodies are responsible for approving the terms and conditions of the borrowings.

(c) The third section comments on the Office of the Director General of Public Credit.

(d) Following on from the first three sections, the fourth section lists the disadvantages which we see in the present systems.

(e) The fifth section describes how these disadvantages could be overcome by the establishment of a Public Debt Office and suggests how this office may be established within the framework of existing institutions in the Dominican Republic.

(f) The last section briefly suggests how the Public Debt Office should be set up and under whose authority it should operate.

The present system of approvals

3. We understand that four different chains of approval exist at present for borrowing foreign currency, dependent upon the status of the borrower. These four systems are described below.

4. Central Government, including ministries, require Congressional approval before borrowing foreign currency, but do not require the approval of the Monetary Board. In the loan documentation for such borrowers, Congressional approval has usually been a condition precedent; that is to say, before drawdown is permitted by the lenders such approval must have been obtained by the borrower. In practice, Congressional approval has not always been given and so certain loans, although negotiated and documented, have never been drawn down.

5. Autonomous Government entities (e.g. the State sugar company CEA, the State holding company CORDE and other companies owned by the State), with the exception of the Banco Central, require permissions from:

- (a) their own board;
- (b) the board of a State holding company, if the borrower is a subsidiary of such a company:
- (c) the Presidency of the Republic, and this approval usually requires a law or decree to be issued by the President; and
- (d) the Monetary Board.

It is only once all these approvals have been obtained that a borrower may sign the loan document. Thus it is not possible to include such approvals as conditions precedent to drawdown in any loan agreement.

6. The Banco Central, if it borrows for periods of under one year, requires no approvals whatsoever other than its own internal ones. If the Banco Central borrows for over one year, then it requires the approval of the Monetary Board and of Congress. Again, only once such approvals have been obtained is the Banco Central in a position to sign the loan agreement. Thus the approvals cannot be made conditions precedent to drawdown within such agreements.

7. The private sector is not required to obtain any approvals to borrow foreign currency and no controls are exercised over their borrowings or upon the terms of those borrowings. To repay funds due under such borrowings, private sector borrowers need to obtain the appropriate foreign exchange from the Banco Central, at which point the Banco Central will become aware of the existence of the borrowings. The question of private sector borrowings is not addressed by this paper which concentrates solely upon public sector borrowings. Without changing formal exchange controls and appropriate legislation, it is difficult to see how future borrowings by the private sector can be regulated in the way that we contemplate regulations being imposed upon the public sector.

The present system for negotiating terms and conditions

8. In a similar way that different types of borrower need different types of approvals, we understand that the system of negotiating foreign currency borrowings varies from one type of borrower to another. These different systems are considered below.

9. When negotiations take place with the World Bank and other international agencies (excluding IFC) who lend directly to the Government or to a State entity against a Government guarantee, then such negotiations are conducted by the borrower and by the Banco Central even if the Banco Central is not an obligor or a guarantor. The Ministry of Finance and the Technical Secretariat of the Presidency may also be involved in the negotiations. Quite often, however, the Ministry of Finance and the Technical Secretariat are not parties to the negotiations and rely upon the Banco Central to achieve the best terms and conditions available to the borrower.

10. If, however, the Central Government borrows from commercial institutions, then no institution other than the Ministry of Finance is involved in the negotiations. In particular, the Banco Central has no role to play when such borrowings occur.

11. Autonomous Government entities when borrowing without a State guarantee negotiate directly with the lenders and neither the Banco Central nor the Ministry of Finance participate in those negotiations. The agreed loan documentation is not filed either with the Banco Central or the Ministry of Finance and the Banco Central only becomes aware of the terms and conditions of such borrowings through the Monetary Board and through the requests received by the Banco Central from the entities concerned for foreign currency to service the loan.

12. Autonomous Government entities when borrowing with a State guarantee enter into negotiations with the lenders with a representative of the Ministry of Finance. No representative of the Banco Central is present. Again, it is difficult for the Banco Central to establish the terms and conditions agreed upon at those negotiations.

13. The Banco Central negotiates its own borrowings without participation from any other government body.

14. The private sector negotiates directly with potential lenders without the need of any governmental participation. Private sector borrowers are not required to file information regarding their borrowings with any public authority.

The Office of Director General of Public Credit

15. In many Latin American countries the type of unit which this paper concludes by proposing is called the Office of the Director General of Public Credit. There currently exists in the Dominican Republic an official reporting to the Ministry of Finance called the Director General of Public Credit but, as far as we understand, the office concerned merely fulfils the role of collecting the details of loan arrangements entered into by public sector borrowers and of producing statistics in respect of them.

16. Despite the coincidence of name (and for the reasons set out in paragraph 22 below) we do not consider on the information available to us that the Director General of Public Credit, or indeed the Ministry of Finance to which the office concerned reports, would be suitable for fulfilling the functions of a Public Debt Office as proposed in this paper.

Disadvantages of the present systems

17. There are several major disadvantages in the present systems whereby public sector entities borrow foreign currency. To overcome the disadvantages, we recommend the establishment of a Public Debt Office in the Banco Central as a Secretariat to the Monetary Board.

18. First, when facilities are being negotiated by public sector borrowers, there is no common unit involved in the negotiations. Because of this lack of a common unit, there is an apparent absence of a means for enforcing any common consensus on the terms and conditions of the loan agreements. That is to say there is no common policy within the Dominican Republic regarding the maturity of the loan, the margin over LIBOR payable on loans, etc.

19. Secondly, when negotiations occur on the documentation of loans, there is no common unit to ensure consistency of the conditions upon which the loans are made. There is a large number of clauses that need to be considered carefully within any loan document, including those concerning covenants, events of default, definition of LIBOR and waiver of sovereign immunity. For example, it is important to avoid cross default clauses in documentation which could result in an event of default being called in relation to a major Central Government borrowing because of a small default by a minor State-owned entity.

20. The third disadvantage in the present systems relates to the Office of the Director General of Public Credit. It is our understanding that the Director General may not have all the figures relating to public sector obligations (e.g. the Director General is unlikely to have all the statistics relating to Banco Central borrowings) and thus there is no one institution within the Dominican Republic which has complete knowledge of the amount of the present public sector foreign currency debt or of the maturity profile of that debt.

Proposed Public Debt Office

21. We recommend that the above disadvantages in the present systems could be remedied by the establishment of a Public Debt Office.

22. For three main reasons we believe that this Public Debt Office should be established as a Secretariat in the Banco Central reporting to the Monetary Board. These reasons are as follows:

(a) A review of the first section of this paper highlights the fact that the Monetary Board is required to give its approval for most public sector borrowings. The two main types of borrowing falling outside the jurisdiction of the Monetary Board are (i) direct borrowing by the Central Government and (ii) short term borrowings by the Banco Central. In the case of borrowings of the Central Government, the Banco Central is generally involved in negotiations unless the Government is borrowing directly from commercial institutions. We do not view the Banco Central's ability to borrow for under one year without approval as being an important deficiency in our proposals.

(b) The Monetary Board is located within the Banco Central and takes advantage of the administration and information systems of the Banco Central. A Technical Secretariat responsible to the Monetary Board would thus naturally work in close co-operation with the Banco Central with mutual advantage to both.

(c) The Monetary Board is composed of the Governor of the Banco Central and representatives from the Government and from the private sector. The Board is thus a representative body and is a natural focus for such a monitoring role, in the same way as the Banco Central (as the custodian of the foreign exchange reserves of the State) is responsible for disbursing foreign exchange to meet all foreign currency debts falling due.

23. The Monetary Board should refer all submissions that come to it for approval to the Public Debt Office for checking. The Public Debt Office will be able to examine each submission in much greater detail than is possible by members of the Monetary Board and will be able to apply to each submission those general principles on terms and conditions that the Board will have previously established. The Board should only give its approval for a foreign currency borrowing after the Public Debt Office has indicated that the terms and conditions of the borrowing are consistent with the Board's policy.

24. We have stated above that the Central Government can borrow foreign currency commercially without the approval of the Monetary Board. However, Central Government does require Congressional approval and we believe that Congress would be more sympathetic in giving that approval if it knew that the Public Debt Office had approved all the terms and conditions negotiated by the Government. Naturally, the Public Debt Office cannot ensure that Congress would not withhold its approval on political grounds, but nevertheless the fact that there has been a prior examination by the Public Debt Office should help in obtaining the necessary approval.

25. We further believe that the Public Debt Office should be present during all negotiations conducted by public sector entities concerning foreign currency borrowings. We believe that public sector entities themselves would wish this to occur because they will be aware that in almost all cases Public Debt Office approval will eventually be needed as to the terms and conditions negotiated.

26. We believe that the above proposals will not require any legislation to be passed or decrees to be issued. Once it is seen that the Public Debt Office's approval is important, then potential public sector borrowers will wish to involve the Office at an early stage to ensure the easiest possible passage for their proposed borrowings.

The formation of the Public Debt Office

27. We recommend that the Public Debt Office should be a Secretariat of the Monetary Board. In this way it will effectively operate as a sub-committee of that Board operating under the latter's control. The Public Debt Office should be headed by a person who has extensive knowledge of international eurocurrency loan markets and who has been responsible for both negotiating and documenting foreign currency borrowings, preferably with experience of the lender's point of view. This person will be directly responsible to the Monetary Board and will need a small staff to assist him.

28. The Public Debt Office will operate within strict guidelines laid down by the Monetary Board. The terms and conditions upon which foreign currency is borrowed should be determined by the Monetary Board acting upon the advice given by the Public Debt Office. Given constantly changing market conditions, these guidelines will need constant revision, which will be a function of the Public Debt Office.

29. In summary, the functions of the Public Debt Office will be fourfold:

(a) to suggest from time to time to the Monetary Board guidelines as to the terms and conditions for foreign currency borrowings by the public sector;

(b) to approve foreign currency borrowings by the public sector, within such guidelines as to terms and conditions as are established from time to time by the Monetary Board;

(c) to assist borrowers in negotiating such foreign currency borrowings; and

(d) to collect statistics on all foreign currency borrowings in order that a correct position can be determined on the Dominican Republic's total foreign indebtedness.

BANCO CENTRAL DE LA REPUBLICA DOMINICANA
COMPARATIVE STUDY OF THE IMF EXTENDED FUND FACILITY

INTRODUCTION

1. The purpose of this paper is to provide a comparative study of the use by the IMF of the Extended Fund facility to provide financial support for member countries in the region, so that the Banco Central de la Republica Dominicana can draw conclusions about the potential relevance of the facility to the Dominican Republic. The first part of the paper covers the terms on which the facility can be provided. The second part gives recent examples of Extended Fund arrangements with member countries in the region, with particular reference to Jamaica. The third part summarises points that may be relevant to the Dominican Republic.

THE EXTENDED FUND FACILITY (EFF)

Purpose

2. The Extended Fund facility (EFF) was established in September 1974 to enable the IMF to provide financial assistance to member countries for longer periods and in amounts larger in relation to quotas than available under other facilities so as to enable them to overcome structural problems in their balance of payments. A member country is most likely to apply to the IMF under the EFF in circumstances in which:

(a) the country is running a persistent balance of payments deficit on current account and its net international reserve position is being depleted by the absence of sufficient non-monetary capital inflows to finance the current account deficit;

(b) the financial authorities in the country intend to implement a comprehensive set of economic and financial policies intended to adjust the balance of payments over a period of two to three years.

Conditions

3. When it seeks an arrangement with the IMF under the EFF, a member country is expected to present a programme setting out its objectives for the whole period of the extended arrangement, together with a detailed statement of the policies that it intends to follow in the first year of the arrangement so as to meet the objectives of the programme. New statements are required in each subsequent year. Purchases of foreign currency by the member country from the IMF under the EFF are phased over a three year period, and can only be drawn so long as the performance criteria set in advance for each year of the agreement are met.

Amount

4. Under the EFF, a member country can expect to purchase foreign currency from the IMF up to 150% of quota every year for three years, provided that the IMF's holdings of the member country's currency accumulated in exchange for its purchases of foreign currency do not exceed 600% of quota. This ceiling on the IMF's holdings of a member country's currency is calculated net of repurchases made by the member country in repayment of drawings and excludes the member country's drawings under IMF facilities for oil, compensatory financing and buffer stock financing, all of which carry a low level of policy conditions. Given the Dominican Republic's current quota of SDR82.5m, the full drawing of foreign currency available under the EFF over a three year period would amount to SDR371.3m, or the equivalent of US\$471.3m at the US dollar exchange rate for the SDR prevailing at the end of May.

Cost

5. The provision of the EFF is financed by the IMF out of its ordinary and borrowed resources. Ordinary resources are available to member countries at concessionary rates and borrowed resources at a margin over the cost of funds to the IMF, which is normally related to market rates. Access to ordinary resources is limited to a maximum of 140% of quota. The excess consequently has to be financed out of borrowed resources. The maximum repayment period under the EFF is limited to 10 years. The facility is denominated in SDRs as a unit of account, which gives rise to a potential exchange risk in terms of the Dominican peso, since the peso is tied to the US dollar.

RECENT EXAMPLES OF EFF ARRANGEMENTS

General observations

6. The IMF has approved an increasing number of EFF arrangements in its last two financial years, all with developing countries. Eleven arrangements were approved in 1980/81 (ending April 1981) and a similar number in 1981/82. There appear to be three main reasons why member countries have applied in increasing numbers to make use of the EFF:

(a) The current account of the balance of payments of all non-oil developing countries has been severely affected by the increase in oil prices of 1979/80. Their creditworthiness has not always been sufficiently strong to enable them to raise substantial sums in balance of payments support on international financial markets, where in any case the cost of funds has been very expensive, owing to the rise in US dollar interest rates. Meanwhile, the source of funds made available by the IMF in the form of the oil facility after the first increase in oil prices in 1973/74 has not been repeated on the present occasion.

(b) The volume of funds available under the EFF has increased substantially, as a result of the increase in member countries' quotas under the 7th review (effective November 1980), the increase to 450% in the percentage of quotas that member countries are eligible to draw under the EFF (effective January 1981), and the experience in some member countries that an agreement with the IMF unlocks funds that may not otherwise be available from international financial markets. In addition, the long average maturity of the EFF compares favourably with the short maturity available under the ordinary credit tranches, and the average cost compares favourably with the cost of funds in international financial markets.

(c) The conditions imposed by the IMF, which have sometimes been criticised in the past for causing political disturbances (e.g. in Peru), have recently been more flexibly applied by the IMF to take account of the local conditions in the country concerned. Having said this, some countries (such as Brazil) have chosen not to make use of IMF facilities, and others (such as Costa Rica) have proved unable to meet the performance criteria imposed under the arrangements with the IMF, leading to a suspension of new drawings.

The Jamaican example

7. The best recent example of an effective EFF arrangement between the IMF and a country in the region is the arrangement made in April 1981 by the new Government in Jamaica, five months after it was elected to office. The EFF arrangement will provide Jamaica with the equivalent of SDR478m (430% of Jamaica's quota of SDR111m) over the three year period to the end of its fiscal year 1983/84 (31 March 1984) from the IMF's ordinary and borrowed resources. Of the total, SDR178m was provided in the first year of the arrangement. SDR150m will be available in the second year and SDR150m in the third year. A slightly larger proportion was made available in the first year to provide front-end loading.

8. Besides the resources available under the EFF, Jamaica was also able in fiscal 1981/82 to purchase the balance of SDR22m available from its first credit tranche at the IMF. After taking account of purchases made by the previous Government under the EFF, the oil facility and the compensatory financing facility, the total value of Jamaica's drawings from the IMF at the end of fiscal 1981/82 amounted to SDR528m (476% of quota). Net of repurchases to be made in respect of repayments falling due, drawings outstanding are expected to rise to SDR646m (582% of quota) at the end of fiscal 1982/83 and SDR754m (679% of quota) at the end of fiscal 1983/84. A separate structural adjustment loan has also been obtained from the World Bank in support of Jamaica's medium term recovery programme.

9. Jamaica has so far met all the performance criteria set under the EFF. In particular, arrears on current international payments, which amounted to J\$106m at the end of fiscal 1980/81 were eliminated by the end of fiscal 1981/82, nine months ahead of schedule. The other performance criteria can be divided into five categories:

(a) There is a limit on net bank credit to the public sector from the domestic banking system. This is intended to ensure that a sufficient share of domestic credit is available for the productive sector of the economy.

(b) There is a limit on the net domestic assets of the Bank of Jamaica, which is intended to control the extent of inflationary credit creation by the Bank of Jamaica.

(c) Targets have been set for the level of the net international reserves of the Bank of Jamaica. These are designed to ensure an improvement in Jamaica's overall balance of payments, taking the current account and non-monetary capital flows combined.

(d) There is a limit on new external borrowing by the Government, both direct and guaranteed. For fiscal 1981/82, there was a limit of US\$60m for loans with maturities of between one and five years and US\$130m for loans with maturities of between one and twelve years. There is no limit for loans with maturities longer than twelve years. In addition, the ceilings do not apply to loans from foreign governments and their agencies or from multilateral lending institutions. Loans to refinance existing foreign debt obligations are also excluded from the ceiling.

(e) Finally, there is an obligation on Jamaica not to introduce multiple currency practices or new restrictions on payments and transfers for current international transactions.

10. There was a substantial turnaround in the performance of the Jamaican economy during the first year of the EFF arrangement (fiscal 1981/82):

(a) Despite the recession in the world economy, real GDP is estimated to have increased by 1.9% in fiscal 1981/82, compared with an aggregate decline of 19% in the preceding seven years.

(b) Inflation, measured by the consumer price index, was reduced to 4.7% in the year to the end of calendar 1981, compared with 28% in 1980.

(c) The overall balance of payments, taking current and capital account together, was in surplus by US\$43m in fiscal 1981/82, compared with a deficit of US\$161m in fiscal 1980/81.

Other examples

11. Besides Jamaica, EFF arrangements have been negotiated by a number of other countries in the region since the facility was introduced. They comprise Dominica, Guyana, Haiti, Honduras and Mexico. However, only two of these (Dominica and a new arrangement with Guyana) have been negotiated since the funds available under the EFF were substantially increased in 1980/81. The case of Dominica is not relevant, because of its small size. So far the new arrangement in Guyana does not appear to have worked as successfully as Jamaica, possibly because the Government there has not found it as easy to agree with the IMF on mutually acceptable policies or to implement them.

CONCLUSION

12. In weighing up the relevance of an EFF arrangement to the Dominican Republic, there are a number of important technical factors which should be taken into account:

(a) The amount of foreign currency finance potentially available to the Dominican Republic under an EFF arrangement would be larger than any alternative source of balance of payments support (as opposed to finance provided for specific development projects). The EFF is also available on relatively attractive financial terms.

(b) Although policy conditions would have to be agreed in advance, the Jamaican example shows that these conditions do not need to be particularly onerous and can produce relatively quick economic and financial results. It is quite possible that the Banco Central would wish to keep within financial targets of the kind that would be imposed by the IMF, even if no EFF arrangement was being sought.

(c) It is important that, if an EFF arrangement is agreed, the performance criteria are met. However, provided that this is the case, the existence of an EFF arrangement with the IMF could have a significant effect in maintaining and increasing the confidence of the international financial community in the prospects for the Dominican economy.

OPR/lmm.

1 June 1982

BANCO CENTRAL DE LA REPUBLICA DOMINICANA
FOREIGN EXCHANGE MARKET PRACTICE IN THE INDUSTRIAL COUNTRIES

INTRODUCTION

1. The purpose of this paper is to summarise the evolution of foreign exchange market intervention practice by central banks in the main industrial countries (taken, for the purposes of the paper, as the United States, Japan and Western Europe), and to assess the relevance of their experience to the Dominican Republic.

PRACTICE IN THE INDUSTRIAL COUNTRIES

2. Foreign exchange market intervention practice by central banks in the main industrial countries can best be described historically in two distinct periods: the period of fixed exchange rates up till early 1973; and the period of 'managed' floating since early 1973.

Fixed exchange rates

3. In the period up till early 1973, the central banks in most of the main industrial countries intervened in the exchange market between their own currencies ('domestic currency') and foreign currency (generally US dollars) to ensure fixed exchange rates within a 2% intervention band. They ensured this by being prepared:

(a) to sell foreign currency from their international reserves so as to purchase domestic currency from the banking system in unlimited amounts whenever the exchange rate threatened to fall beneath their lower intervention margin (generally 1% below the central exchange rate); and

(b) to sell domestic currency so as to purchase foreign currency from the banking system for their international reserves in unlimited amounts whenever the exchange rate threatened to rise above their upper intervention margin (generally 1% above the central exchange rate).

4. The fixed exchange rate regime gave the central banks in question the option whether to intervene in the exchange market between the upper and lower intervention margins, but gave them no discretion whenever the intervention margins were reached. In these circumstances, a current account deficit (or surplus) in the main industrial countries which was not financed by private capital inflows (or outflows), was always financed by a reduction (or increase) in the central bank's foreign reserves.

5. There were periodic changes in fixed exchange rates in the period up till early 1973 by means of devaluation or revaluation in terms of the US dollar. But persistent pressures developed in the foreign exchange market between the US dollar and some of the currencies of the other main industrial countries (particularly the Deutsche mark), reflecting the overall balance of payments imbalance between the United States and the other main industrial countries. This imbalance was financed mainly by the accumulation of US dollar claims by central banks outside the United States on the United States.

Managed floating

6. In early 1973, the joint decision was taken to attempt to relieve the pressure that had developed in the exchange market at fixed exchange rates by allowing the currencies of the main industrial countries to 'float' one against the other. The idea in theory was that, if central banks withdrew from the foreign exchange market by refusing to intervene at predetermined fixed rates, the exchange market would find an equilibrium level at which current account and private capital flows would balance.

7. In practice, central banks in the main industrial countries have found by experience since 1973 that a floating exchange rate regime is not as simple as this, for two main reasons. First, a country in current account deficit whose central bank allows its exchange rate to depreciate in order to improve its external trading competitiveness with the objective of eliminating the current account deficit may find that, in the absence of supplementary changes to fiscal and monetary policy, the depreciation in the exchange rate leads to an increase in inflation instead of an increase in competitiveness. In these circumstances, the underlying rate of inflation in the country is likely to increase and the current account deficit will not be eliminated.

8. Secondly, short term private capital flows which are responsive to changes in interest rates between the major industrial countries have an effect on their exchange rates which does not necessarily coincide with the effect required to bring the current account back into balance. High and rising interest rates will tend to raise the exchange rate of the country concerned by attracting private capital inflows, even if the current account is in deficit. Low and falling interest rates will have the reverse effect, even if the current account is in surplus.

9. In other words, the experience of central banks in the main industrial countries since early 1973 is that the foreign exchange market cannot be left entirely to its own devices. Central banks have had to be prepared to intervene in the exchange market in some circumstances. Initially, they hoped that it would only be necessary to intervene in the exchange market to 'even out erratic fluctuations' in exchange rates. It was hoped that the trend in exchange rates would still be determined by the market rather than by central banks.

10. But central banks have had difficulty in distinguishing between 'erratic fluctuations' in exchange rates and the evolution of fundamental trends. In practice, they have decided to intervene in the exchange market to a greater extent than they initially intended. As a result, the current exchange market regime in the industrial countries is as close to a fixed exchange regime as to 'free' floating. It is best described as a regime of 'managed' floating in which central banks are prepared to intervene to keep their exchange rates within wide and fluctuating intervention bands.

RELEVANCE TO THE DOMINICAN REPUBLIC

11. The official exchange market in the Dominican Republic is like the fixed exchange rate regime used to be in the industrial countries. For exports channelled through the official system and for imports eligible to receive official exchange, the Banco Central de la Republica Dominicana purchases and sells US dollars at the fixed exchange rate of RD\$1 = US\$1. The parallel market in the Dominican Republic in which the Banco Central does not apparently intervene at present is like a freely floating exchange market in the industrial countries would be, if the central banks in the industrial countries were prepared to withdraw from the exchange market entirely. As has been shown, in practice the central banks in the industrial countries have not been prepared to do this, except in selected cases for short periods.

12. The exchange problem that has arisen in the Dominican Republic is a reflection of the shortage of official exchange. In circumstances in which there is pressure on the Banco Central's foreign reserves, it is possible to relieve the pressure by reallocating imports from the official market to the parallel market. This has the effect of driving up the premium on the parallel market rate for the Dominican peso over the official rate, which in turn makes it more attractive for Dominican exporters, tourists to the Dominican Republic and Dominican workers abroad who remit their for-

foreign currency earnings, to use the parallel market rather than the official market. If this situation continues indefinitely, then there is a possibility that the Banco Central will lose control over the demand and supply for foreign exchange.

13. In current conditions, and taking no account of the important political considerations involved, there appear to be three main technical options available to the Banco Central:

(a) The first option is to persist with the current policy by maintaining the official exchange rate at parity (i.e. RD\$1 = US\$1), and attempting to narrow the differential between the official market rate and the parallel market rate by increasing the availability of foreign exchange in the official market (e.g. by borrowing foreign currency from the IMF).

(b) The second option is to devalue the official exchange rate for the Dominican peso, either into line with the parallel market rate, or some of the way towards the parallel market rate. That would have the effect of directing a larger proportion of exchange flows (both receipts and payments) which currently go through the parallel market back through official channels. However, it would tend to raise the inflation rate in the Dominican Republic, and it would not necessarily increase external trading competitiveness, as the prices of most Dominican exports are determined by the world market price rather than by prices in the Dominican Republic.

(c) The third option is for the Banco Central to start intervening on a selective basis in the parallel market in order to help support the parallel market rate. This could be done whether or not the official rate is devalued, though as the use of official exchange would be involved, it would be easier to implement the policy in circumstances in which there was an increase in the supply of official exchange either as a result of new borrowing (e.g. from the IMF) or as a result of the direction of a greater proportion of parallel market flows back into the official market through a devaluation. Selective intervention in the parallel market would be equivalent to the 'managed' floating that is currently practiced by central banks in the industrial countries.

OPR/lmm.

1 June 1982

PROSPECTS FOR GOLD SALES BY THE DOMINICAN REPUBLICIntroduction

1. The purpose of this paper is to outline the ways in which the Dominican Republic could maximise its foreign exchange income from the sale of its gold output on the international market. In doing so, we have paid particular attention to the prospects of the Dominican Republic making further gold coin issues whilst also stressing the importance of timing as far as bullion sales are concerned.

2. The contents of this report have been compiled following detailed discussions with the Royal Mint in London.

Gold coin issues

3. The aim of such issues would be twofold, namely to assist the country in generating additional foreign exchange income, and to enhance the country's prestige by promoting the Dominican Republic both as a Caribbean tourist resort, and as an issuer of collectors' gold coins.

4. There are effectively two major types of coins which are sold worldwide, and these are described in greater detail below.

(a) Bullion coins

5. Bullion coins are coins which are minted in large quantities and essentially represent an investment in gold bullion since they sell at a relatively small premium (3%-5%) over their gold content.

6. The total of gold coins sold during 1981 was 10% lower than in 1980 and it is estimated that about 7m ounces were purchased by the market in 1981. Of this total, more than half were in the form of Krugerrands (over 3.5m ounces) which carry a premium of 2%-3% over their gold content.

7. Other bullion coins carrying similar premiums to the Krugerrand are the Canadian Maple Leaf (2%-3%) and New Sovereigns (4%-5%).

(b) Collectors' coins

8. Collectors' coins are usually minted in limited quantities and are issued to commemorate specific events or occasions (independence celebrations, visit by a prominent Head of State, etc.) Because of the limited size of an issue and its numismatic value to collectors, these coins usually carry a substantial premium (120%-140%) over their gold content.

9. Collectors' coins are usually issued in two forms, namely 'proof' and 'uncirculated'. 'Proof' coins are the coins most prized by collectors since they require further processing by the producer to attain a high quality finish (i.e. additional polishing etc.) 'Uncirculated' coins are coins issued in mint condition but which can be circulated since they are legal tender. Generally speaking, 'proof' coins carry a 20% premium over 'uncirculated' coins and are issued in a 3:1 ratio.

Relative merits of each type of coin for the Dominican Republic

10. As mentioned in paragraph 5 above, bullion coin issues require a large level of turnover in order to be profitable, and since there are quite a few well known coins already in circulation (Krugerrands, Maple Leafs, etc.) it is unlikely that an issue by the Dominican Republic would prove to be a marketable proposition without a substantial marketing effort and the related costs thereof. The alternative is thus for the Dominican Republic to issue collectors' coins, since the revenue from 10,000 collectors' coins sold on the Royal Mint's terms (outlined in 13 below) would yield as much revenue to the Dominican Republic as 60,000 coins sold on a bullion basis.

11. One should however qualify the above by emphasising the following points:

(a) The market for collectors' coins is going through a lean period at present partly owing to the excessive number of recent coin issues.

(b) Coin issues have been abused by many small countries as a source of extra revenue in that some countries have issued commemorative issues with no bearing whatsoever on the country's own history (e.g. Cayman Islands' recent issue on the World Cup) and this has dampened collectors' interest in new issues.

(c) Although collectors' coins are less sensitive to movements in the price of gold than bullion coins, the present low price of gold on world markets has not enhanced the sale of gold coins.

(d) International investors looking to buy gold coins will normally prefer an issue which is being marketed in the issuer's own country since this will enhance the resale value of the coins in the secondary market. Thus, if there is a small domestic market, international investors may adopt a somewhat lukewarm approach to an issue.

Issue and marketing costs

12. By far the largest cost associated with a coin issue is the price of gold itself.

13. The Royal Mint offers its customers an all-in package whereby once it has agreed to work on a coin issue, it assumes all risks associated with such an issue and deals with both the minting and marketing aspects. The issuing country/client would normally receive a royalty payment from the Royal Mint equal to 15% of the selling price of each coin sold. Payments are normally disbursed quarterly in arrears.

14. The Royal Mint has a mailing list for clients in the UK, the US and Canada. Elsewhere, however, it markets coins through an established dealer network.

Timing

15. Should an issue be undertaken by the Royal Mint, they would require a minimum of six months' notice in order to fit the issue into their programme. Sales would normally proceed for one year.

Recent issues

16. During 1981, the Royal Mint was responsible for minting 5,000 proof Ba \$500 coins commemorating the British Royal Wedding on behalf of the Bahamas. A similar issue of 435 proof Ber \$250 coins was made on behalf of Bermuda. Finally, the Royal Mint also issued a set of 10,000 proof coins depicting the Royal Wedding for the Cayman Islands.

Gold sales

17. In view of the limited prospects for future gold coin issues, it might therefore be more profitable for the Dominican Republic to pay greater attention to the timing of its gold sales on the international market. Thus, even assuming that the Dominican Republic could sell 10,000 collectors' coins in a year and assuming moreover that the coins weighed an ounce each, this would give the gold content value, at a price of US\$350 per ounce, as US\$350 per piece. Allowing for a 100% premium to get a selling price of US\$700 per coin and working on the basis of a 15% return to the Dominican Republic, this would result in an income of US\$1.05m which is only the equivalent of US\$2.50 per ounce of gold on the Dominican Republic's annual production of just over 400,000 ounces.

18. Bearing in mind, however, that the price of gold dropped during 1981 from US\$600 per ounce to US\$430 per ounce (i.e. by some 28%), with significant variations in price occurring throughout the year, it is clear that significant gains can

be made by keeping in close touch with the market and by forecasting market trends. Thus, despite the overall fall in the price of gold during 1981 (see attached graph) owing to the stability of the US dollar in the face of rising interest rates, events in Poland, the continuing war between Iraq and Iran and the advent of M. Mitterand to the French Presidency all contributed to producing sharp rallies in the price of gold. These rallies caused the price of gold to rise by over US\$30 per ounce on some occasions, i.e. substantially above the US\$2.50 per ounce generated by the gold coin issue outlined above.

Conclusions

19. From the above comments it would appear unlikely that the issue of a bullion coin by the Dominican Republic would meet with much demand on the international investors' market.

20. The issue of a collectors' coin would however appear to be a feasible proposition provided such an issue was relevant in illustrating a significant historical event or occasion associated with the Dominican Republic (for instance, the discovery of Hispaniola by Columbus in 1492). Such an issue would thus be on an 'ad hoc' basis and should not be followed by another issue without a reasonable gap thereby enhancing the scarcity value of each issue. Whilst these coins might appeal to some overseas Dominican Republic citizens, it is felt that the price and type of coins issued should really be aimed at serious numismatic collectors.

21. The major advantages for the Dominican Republic of such an issue would comprise:

(a) a guaranteed royalty on each coin sold in the case of an issue being entrusted to the Royal Mint: in this context, it is worthwhile noting that the Mint will only undertake a commission if it feels the issue has a reasonably good chance of being successful;

(b) the prestige attached to such a coin which, if well designed and minted, would attract prime collectors;

(c) the ability of the Dominican Republic to use its own raw materials which it would furthermore be able to process in its own refinery. Samuel Montagu would be prepared to assist the Dominican Republic in this field by helping to place people for training purposes whilst following up queries which might arise in the Dominican Republic.

22. In view of the variations in the price of gold over a period of time, substantial gains can clearly be made by monitoring market trends and taking advantage of short-term price fluctuations.

RS-M/lmm.
18 August 1982

Gold Prices 1978-1981

(Based on Monthly Average Prices London Market Fixings)

