RNM/OECS COUNTRY STUDIES TO INFORM TRADE NEGOTIATIONS: DOMINICA

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DOMINICA

INTRODUCTION

The Economy of Dominica is heavily dependent on the banana industry and is likely to be the country most affected by the developments in the banana regime. Although Dominica has reduced its dependence on agriculture in recent years, it still retains pride of place in the economy accounting for approximately 19% of GDP in 1998. This is an 11 percentage points reduction from the 30% contribution in 1986. Of the 19% of GDP contributed by the Agricultural sector in 1998, 46% of this contribution is attributable to banana production. In addition banana exports account for 60% of the merchandise exports of the country. Such a heavy dependence on this crop means that the international developments in the banana regime take on critical importance. The next largest sector is Government services which contributes 17%. The Distributive sector and Banks/Insurance round out the top four contributors - each contributing 12% of GDP. Transport and communications each account for approximately 10% of GDP while the contribution of the manufacturing sector averages about 7% of GDP. The tourism sector is a small but growing sector that contributes approximately 3% of GDP.

The performance of the economy follows a similar pattern to the rest of the OECS countries with growth rates in excess of 6% being recorded during the period 1986 to 1990 and then a period of slower growth during the 1990's. Although the growth rates in Dominica did not fall off until 1991, for comparability with the other OECS countries three sub-periods are used, 1986-89 - a period of high growth, 1990-1994 - the low growth period and 1995-1999 - a period of variable growth as the economy adjusts to a variety of external shocks and natural disasters.

The high growth period, which began in the early 1980's continued into the later years of the decade. Growth rates in Dominica exceed 6% every year except for 1989 when the economy was beset by hurricane and the economy recorded a decline of -1.12%. The average growth rate for that period was 4.5%. Abstracting from the decline in 1989 the average was over 6%. Growth during this period was led by the agricultural sector which recorded a growth rate of 16% in 1986 and after adjusting for the effects of the hurricane in 1989 grew at an average well over 6% during the period. The passage of hurricane Hugo resulted in a 14.5% decline in the agricultural sector in 1989. The communications sector also expanded at a rapid rate and growth in this sector was uninterrupted in 1989 - growing by 13.5%. The average growth rate for the period was 24.1%. However the sector was growing from a relatively small base, accounting for only 4.4% of GDP in 1986 and rising to 6.7% in 1989. The tourism sector as measured by the contribution of Hotels and Restaurants also exhibited robust growth from a small base. The sector grew at an average rate of 11% annually over the period but in 1989 only contributed 1.6% of GDP.

The balance of payments of Dominica improved during this period except for a small overall deficit in 1988. Revenue from merchandise exports increased significantly mirroring the performance of the banana industry. The current account balance narrowed to 6% of GDP in 1987 but deteriorated drastically in 1989 in the aftermath of the hurricane. The current account widened to 35% of GDP as imports increased significantly to effect the reconstruction of the economy. The deficit on the current account was financed by significant inflows on the capital and financial account. In 1989 capital transfers amounted to $36m, and direct investment $46m, in a capital and financial account balance of $123m. Direct investment inflows were strong throughout the period accounting for an average of 9% of GDP.

The period after 1990 was marked by a period of slow growth consequent on the uncertainty of the banana regime. Moreover, as the British Pound fell out of the European Union exchange rate mechanism in the fall of 1991, the EC dollar value of the Green Market price of Bananas tumbled and the levels achieved in 1991 have not been attained since that time. Thus in 1990 the economy recorded a growth rate of 6.3% following the decline of 1.2% in 1989. This was partially related to the recovery after the hurricane and since then real growth rates have remained below 3% until the 3.45% achieved in 1998. Growth is estimated at around 1% in 1999. The growth of the economy has largely tracked the performance of the agricultural sector with some offsetting changes in tourism construction and communications. The contribution of the tourism sector grew from 1.6% in 1990 to 2.6% in 1998, while that of communications grew from 6.4% to10.1% over the same period. The manufacturing sector has experienced erratic growth alternating between high growth and significant decline. For example, the sector grew by 10.1% and 6% in 1988 and 1992 respectively but declined by 9.6% and 10% respectively in 1994 and 1997.

During this period favourable inflows on the capital and financial account resulted in a deficit on the current account of the balance of payments. Foreign Direct Investment (FDI) averaged 9% of GDP in the period 1990-94 and 11% of GDP in the period 1995-98. Capital transfers averaged about 6% of GDP during this period and government undertook foreign borrowing to finance the PSIP. All of these precipitated a rise in imports since almost all capital goods and construction material have to be imported. Even though the current account deteriorated during the period on account of the rise in imports and the poor performance of merchandise, the balance of payments recorded an overall surplus in each year except 1994 when a deficit of approximately 2% of GDP was recorded. This was partly due to export receipts from tourism services offsetting the decline in banana revenues and favourable inflows on the capital account. Visitor expenditure averaged EC$70m during the period 1990-94 and EC$100m during the period 1995-98. The latter exceeded the average export receipts from bananas during that period.

RECENT FISCAL PERFORMANCE

Fiscal performance in Dominica has been dominated by the fortunes of the banana industry as the largest contributor to and most effective distributor of personal incomes. Until recently the government has followed a prudent approach to fiscal management which was assisted by a structural adjustment programme in which a number of important measures were taken to strengthen fiscal management, improve tax buoyancy, rationalize the incentive framework and the allocation of revenue resources. These measures are discussed further below. Since 1995, the government has followed a more aggressive and expansionary approach to economic management that has put some pressure on the fiscal account.

Fiscal performance was relatively strong during the period 1986 to 1989. The current account balance improved from a deficit of 2.3% of GDP to a surplus of 6.9% of GDP by 1989; but this gain declined to 3.1% of GDP by 1990 following devastation of the economy by two major hurricanes in 1989 and 1990. Thereafter the current account declined steadily to a deficit of 3.7% of GDP by 1994 following a trend of negative growth in the banana industry. At the end of 1998 the current account was again positive at 1.4% of GDP as growth strengthened in the manufacturing sector (soap exports), tourism and non-tourism services sectors reflecting significant gains in government's diversification programme.

Although the overall fiscal balance declined between 1993 and 1998, grants and concessional loans also declined, thus necessitating increased use of domestic and non-concessional financing. Domestic payment arrears also increased during this period.

Tax buoyancy showed mixed results with an average rate of 1.3 during 1984 to 1989 declining to 0.9 during 1990 to 1998. Taxes on international trade were less buoyant at 1.2 during the earlier period declining to 0.6 during the latter period. The high tax buoyancy rates during 1984 to 1989 are attributable to the stimulating effect of the comprehensive tax reform programme that took effect during that period as well as the distributive effect of the considerable growth in banana earnings. On the other hand, performance during the 1990 to 1998 period suffered from the impact of hurricane damage, declining growth in the banana sub-sector and a more liberal application of tax incentives and concessions.

Recurrent revenue as a per cent of GDP increased from 32.4 in 1984 to 34.2 at the end of 1998. Domestic taxes and non-tax revenue accounted for most of this gain. The ratio of domestic taxes to GDP increased from 10.3 in 1984 to 13.3 in 1998, while similar ratios for non-tax revenue increased from 4.1 in 1984 to 5.1 in 1998. The ratio of taxes on international trade, however, declined from 18.0 to 15.8 during the same period.

Recurrent expenditure as a per cent of GDP grew from 31.6 in 1984 to 32.7 in 1998. Overall recurrent expenditure grew at an average annual rate of 8.3%. In absolute terms, growth in wages and salaries was faster than in other economic classifications, although the average annual rate of increase was moderate at 7.4% as compared to goods and services at 6.3%, interest payments at 12.4% and transfers at 14.0%. Interest payments increased sharply in 1990 as the stock of government's debts, both concessional and non-concessional, rose in response to demands for financing to rehabilitate damaged infrastructure after three successive hurricanes and to support the structural adjustment programme. Sectoral allocation of recurrent expenditure showed a significant shift from general administration towards social and economic services. Education's share of recurrent expenditure increased from 16.9% to 17.3%. Allocations to health increased from 13.7% to 14.2%. Expenditure on economic services moved from 14.6% to 15.8%. Allocations to general services, on the other hand, decreased from 38.6% to 33.7%.

The external debt increased from $143.6 million in 1986 to $278.19 in 1995; but declined to $242.17 by 1998 principally due to debt forgiveness by the UK. Domestic debt also rose from 14.5% of GDP in 1991 to 33.6% of GDP in 1998. The stock of public debt (excluding guarantees) rose to over 40.5% of GDP by the end of 1998. Interest payments as a per cent of recurrent expenditure increased from 5.5 in 1994 to 8.5 by 1998. This increase was due to the increasing use of non-concessional borrowing, especially from domestic sources. Arrears to the Social Security and traders increased to more than 10% of recurrent expenditure by the end of 1998. An analysis of the disbursed outstanding debt by sector showed that the highest proportion of debt was borne by the water and power sector (utilities) followed by agriculture and industry. The average annual growth of agriculture and industry has been negative from 1991 thus generating insufficient revenues to service the sectors' share of debt.

STRUCTURE OF REVENUES

Dominica reduced its dependence on taxes on international trade from 18.0% of GDP in 1984 to 15.5% of GDP by 1998. Domestic taxes and other revenues on the other hand increased from 14.4% of GDP in 1984 to 18.9% of GDP by 1998. Taxes on income and profits constituted the largest share of domestic taxes; but its distribution was very uneven with by far the highest share being borne by the services sector. In 1998 the ratio of taxes on income and profit to each sector's share of GDP was as follows:

- Agriculture 0.02
- Manufacturing 4.60
- Construction 1.10
- Utilities 14.10
- Hotels & Restaurants 3.20
- Banking & Insurance 8.80
- Commerce 21.90
- Government (PAYE) 9.90

Dominica undertook a major comprehensive tax reform programme in 1986 in which a number of minor taxes were abolished and the principal taxes (income tax and consumption tax) were simplified and restructured. In 1998 the structure of the tax system was as follows:

Direct Taxes

- personal income tax with a three band rate structure from 20 to 40%, the lowest rate after a threshold of $12,000 and the highest rate applying at an annual income over $60,000. Incomes from agriculture and interest are exempt;

- corporate tax of 30% of net income;

- development levy on the income of banana farmers at 1 cent per pound of bananas sold whenever the price paid to the grower exceeds 55 cents per pound.

- withholding taxes on royalties, rents, public entertainment charges and dividends to non-residents at rates ranging from 15 to 30%;

- stamp duty on land sales at 4% of value.

Taxes on Domestic Goods and Services –

- sales tax at the rate of 3% of retail sales (including restaurant sales);
- consumption tax on locally produced goods at 25% of ex-factory price;
- hotel occupancy tax at 5% of room rate;
- entertainment tax at rates varying from $10.00 to $60.00 per performance and on ticket sales at cinemas at rates varying from 33% to 14%;
- various licenses including trade, professional and vehicle;
- an aliens land holding license at 10% of land value.

Taxes on International Trade and Transactions –

- consumption tax at 25% of landed cost (including import duty paid) with exemptions for live animals, milk products, paper and paper products, tools, equipment and machinery; specific rates are applied to alcoholic beverages and tobacco products;
- a surcharge of 15% on luxury items including motor vehicles;
- environmental surcharge of 5% on appliances and television receivers;
- a petroleum surcharge at $2.00 and $2.80 on diesel and gas imports;
- import duties generally ranging from 5 to 35% with special rate of 40% on selected agricultural imports;
- customs service charge of 1% on all imports;
- embarkation tax of $25.00 on all departing passengers over twelve years;
- security tax of $5.00 on airport passengers;
- environmental levy at $13.50 per head on all cruise ship passengers;

Dominica's tax structure appears to be generally in conformity with WTO standards and consistent with MFN principles. The customs service charge has been lowered to the permissible level of cost recovery. Stamp duty on customs documents was removed in the 1986 tax reform. However, there are restrictions on the ownership of land by non-nationals and a license fee of 10.0% of land value is imposed on transactions involving land purchases by non-nationals. Recent high demand for residential land by nationals residing overseas has brought land prices beyond the reach of lower and middle-income earners. The authorities are concerned about the social effects of deregulating land transactions and the possible alienation of nationals from land ownership in an environment where poverty levels are high and basic shelter remains a critical problem in both urban and rural communities. Liberalization in this area will have to be approached with caution. Consideration should be given to devising social safety schemes for ensuring land availability for basic shelter and rural settlements particularly respecting food security. In the circumstances, deregulation of land transactions should be phased over a period of transition.

Recent Tax Changes

After the major tax reform during 1986, discrete changes were made to the income tax threshold to adjust for fiscal drag. It was also announced that interest income and dividends as well as royalties, rents and insurance settlements due to non-residents would be exempt; but legislative action to give effect to these measures were delayed. A cruise ship passenger tax and an environmental levy were introduced. Minor adjustments were made to import duties on alcoholic beverages, embarkation tax, and a number of license fees including insurance, trade and professional. In an attempt to broaden the tax base the government introduced a programme for the development of offshore services as an additional source of revenue and employment. The programme includes international business companies, Internet gaming, offshore banking, exempt trust and insurance companies and economic citizenship.

MEDIUM TERM ECONOMIC PROSPECTS

The Medium-term economic prospects for Dominica are tied up with the fortunes of the banana industry, which is the major economic activity. While one part of the picture will be painted by the developments in the World Trade Organization (WTO), the prospects for the industry depends to a large measure on the success of the adjustment measures that are implemented in the local industry. The emphasis of domestic product is being shifted to production for supermarkets or targeted segments of the market that offer better prices. At the same time concerted efforts are directed to the improvement of farm management practices and the overall quality of fruit under the Certified Growers Programme. The programme is aimed at reducing cost by improving labour productivity and increasing yields per acre through improved management and infrastructure. In recent times Dominica farmers have maintained the highest standard of fruit quality in the Windward Islands.

With no significant policy adjustment the economy of Dominica is expected to perform worse than it did in the 1990s (growth averaging about 2%) and significantly worse than the latter half of the 1980s when real growth rates averaged about 6%. In particular fiscal adjustment is necessary to reverse weak performance of the Central Government and consolidated public sector. The fiscal performance will be further complicated by the weaknesses in the export sectors given the high dependence of the economy on trade taxes and the strong link between the performance of the export sectors and economic activity.

The current account deficit is projected to deteriorate further and the overall balance would remain negative given the heavy dependence of the economy on external financing for the Public Sector investment programme.

There is some uncertainty about the future course of the economy in the medium term since the newly elected government had campaigned on a platform to reverse some of the major capital projects which was the main plank in the economic strategy of the former administration. In particular they pledged not to continue with the building of an international airport at a cost in excess US$100m.

FISCAL PROSPECTS

Slow growth in the economy and a weakening of fiscal management resulted in a further deterioration of the fiscal account during 1998. It is projected that by the end of fiscal 2001 central government savings will fall further to a deficit equivalent to –2.4% of GDP. Lack of government savings and a declining trend in grants and concessional financing will result in increasing use of non-concessional borrowing as well as growth in external and domestic arrears. It is important, therefore, that government take immediate measures to improve the current account on a sustainable basis.

A number of initiatives have already been taken to increase revenues, control expenditure and generally strengthen fiscal management. These include:

- improving the capacity of the Inland Revenue, including computerization (SIGTAS), to assess and collect direct taxes and licenses and to report on revenue trends;

- strengthening Customs administration and reporting (ASYCUDA);

- an IMF study to examine the feasibility and revenue potential of VAT;

- budget reform (programme and performance budgeting) to rationalize revenue resource allocation and improve accountability for public expenditure;

- enhancing the payment, accounting and financial reporting functions of government (SIGFIS).

However, there are a number of critical issues to be addressed if the fiscal account is to be stabilized and the savings ratio improved.

The first concerns the capacity of the economy to generate revenues and the strength of the administration to mobilize them. As indicated above the tax buoyancy ratio is relatively low at 0.9. Although Dominica implemented a major reform of its tax system in 1986 with significant modifications in 1990, the tax system is still inefficient. The tax burden is not distributed equitably. As shown above with respect to the income tax, agriculture bears a proportion of only 0.02, construction 1.1, hotels and restaurants 3.2, and manufacturing 4.6, while utilities, banking and insurance, commerce and government services bear 14.1, 8.8, 21.9 and 9.9 respectively. This inequality in tax distribution results in high rates in some sectors and lower rates in the preferred sectors, a situation which distorts the allocative efficiency of the system and serves to shift investment to sectors where rents in the form of tax incentives are more readily available. The tax incentive framework itself was designed to foster investment in import substitute goods and support an emerging hotel industry. Recent pronouncements regarding the need to diversify the economy and a growing recognition of the importance of the services sector brings into question the appropriateness of the current policy on fiscal incentives.

Further, the lack of equity in the distribution of the tax burden discourages compliance. This, compounded by a weakness in the tax administration to enforce tax laws, results in increasing arrears. Complexities and loopholes in tax laws and a lack of legal support to pursue tax cases in court weaken the authority of the tax departments.

A similar situation exists with respect to customs revenue. A high incidence of smuggling and undervaluation of imports erodes the revenue potential of international trade. The emerging importance of e-commerce has posed a further challenge to customs administration in a situation where customs officers for the most part have received only basic training in customs procedure. The introduction of the ASYCUDA programme has helped to strengthen audit and accounting; but the programme has been found deficient in its capacity to support analysis and reporting of customs data. In addition, investment incentives, exemptions and ad hoc concessions have further eroded potential revenues. A significant amount of potential revenue from international trade is forgone. In this area, too, concessions are weighted towards preferred sectors, traditionally agriculture, manufacturing and tourism.

The incentives scheme lacks transparency and consistency and the recipients of concessions are not made accountable for benefits received by them, a situation which undermines the authority of the customs and inland revenue administrations. Moreover, customs administration has to cope with the additional burden of preventive work, which has become a critical element in the more challenging area of surveillance against drug importation and transhipment, which further weakens the capacity of the administration to manage its revenue functions.

An examination of the revenue estimates reveals a vast number of taxes, licenses and charges that have to be administered in the main by the two principal revenue departments – inland revenue and customs. Some of these revenue items are low yielding and clearly not cost effective to administer. Although the 1986 tax reform went a long way to simplify the tax system, a further review is required to eliminate inefficient taxes and charges, reduce the tax handles to a manageable number of broad based taxes. The policy regarding tax exemptions and concessions should also be reviewed so as to recognize the importance of all sectors and rationalize the granting of incentives.

Recurrent expenditure at the end of 1998 was as high as 32.7% of GDP. Most of this (55.3%) went to wages and salaries. Overall the share of recurrent expenditure allocated to general administrative services was 33.7% compared to 17.3% to education. 14.2% to health. 15.8% to economic services and 10.4% to social services and welfare. The government has recognized the need to rationalize the use of revenues to support recurrent expenditure and has been pursuing two important initiatives to this end: public sector reform and budget reform.

Public sector reform has been directed to improving the efficiency of the public services; but has tended to focus narrowly on administrative structures, salary gradings and performance measurement criteria. In a limited way this has helped to justify present levels of expenditure on wages and salaries within the traditional organizational framework; but it has not addressed the persistent problems of distribution and utilization of manpower, inadequate management, technical skills and wage setting.. With regard to wages and salaries, the policy followed for wage setting and adjustments have been inward looking which has led to serious distortions in wage relativities between grades as well as anomalies in the comparison of civil service salaries with private sector comparators. Whereas in general lower level staff salaries are much above market values prevailing in the private sector, management salaries are much below.

A strategic approach is required to determine what government should be doing, what it needs to do it and the appropriate organizational and regulatory framework for conducting its business. This approach should also indicate the number and quality of staff required and the compensation package that is appropriate to attract and retain the skills needed.

The new initiative to introduce budget reform as well as a standard integrated government financial information system (SIGFIS) is complementary to the public sector reform programme. They are designed to review government spending and assist in identifying and prioritising expenditure programmes and activities and to account for and analyse government expenditure on a real time basis. Altogether, the two programmes are intended to improve budget and financial management and to provide data analysis to facilitate policy review and reformulation. However, care should be taken to maintain flexibility in the budget reform programme so as to avoid the rigidity that surrounds the present system of expenditure allocation to traditional institutions rather than to dynamic programmes and activities.

The new system of programme and performance budgeting should also facilitate more accurate evaluation of government expenditure to obtain value for money and hold managers accountable for efficiency in public spending and procurement. At the same time it will facilitate analysis of the unit cost of service delivery which will help to price government services and determine more exactly user charges where services are provided on a cost recovery basis. Additionally, it will assist the formulation of policies towards commercialisation or divestment of government services.

With regard to the public sector investment programme, the absence of significant current account savings and the declining levels of grant funding call for careful programming of investment expenditure if the debt burden and debt servicing costs are to be kept within reasonable proportions. The need clearly exists for considerable improvements to economic and social infrastructure. Moreover, persistent storms and other natural disasters often require additional investment in existing assets to repair or to replace them. This, added to the high per capita cost of providing basic infrastructure and social and economic services, affects the viability of public sector investments and weakens the debt servicing capacity of the economy. Careful selection of investment projects and prudent financing will help to reduce this burden; but not completely eliminate the problem in the short term.

For all these reasons, the prospect of bringing the fiscal account in balance in the short term does not appear to be favourable. Considerable adjustments will have to be made to the fiscal system and strong measures will be required to rationalize and strengthen the administration to improve responses to changes to the economy and the external environment and to improve the savings level on a sustainable basis.

POLICY OBJECTIVES

In a similar vein to the discussion on the PSIP the policy objectives of the new administration have not been fully fleshed out. However, there are a few policies issues with which the new administration would need to confront.

(i) **Infrastructural weaknesses.** The poor airport facilities constitute a major constraint. The existing facilities are unable to accommodate a wide range of passenger aircraft currently used by airlines operating in the region. In addition, there is no night landing capability, cargo terminals are inadequate and the facility is located in a remote area of the country. The inadequacy of the road network is another constraint for which most of the solutions are extremely expensive given the terrain. Weak sea defences and the vulnerability of internal communications network to storm damage were recently highlighted by the passage of hurricane Lenny which left many areas of the country isolated.

(ii) **Institutional Weakness.** The country's institutional infrastructure for policy making and general economic management is a significant constraint on the development prospects. There are systemic weaknesses in the management of the PSIP, weak fiscal performance, rigidities in the labour market, weakness in the statistical services and the lack of a coherent policy framework.

SECTORAL STRATEGIES

The authorities in Dominica are focussing on four major areas for the development of the economy over the medium-term. These are Agriculture (both banana and non-banana), tourism, the services sector including offshore financial services and manufacturing. The specific strategies for these sectors will be discussed under the appropriate sub heading. However there are some cross cutting issues that affect all four sectors that can be discussed at this point. These are related to economic infrastructure, Social Infrastructure and the environment. These are potential constraints to the development of the productive sectors and would need to be addressed if the country is to take advantage of the opportunities afforded by trade liberalization.

THE SOCIAL SECTORS

The development of human resources has been identified as a critical prerequisite for the improvement of the competitiveness of the economies. In addition, it is also a social service to the society and one of the more effective avenues for the redistribution of wealth. The output of the education system - both in terms of quantity and quality - is inadequate to build sustainable competitiveness. Hence much effort and finance would need to be expended to upgrade the quality of the education system. The Government of Dominica spends 17.3%% of its recurrent budget on education but most of it is on personal emoluments and hence complaints about the inadequacy of supplies were cited in the 1998 MTESP. The nature of the terrain in the country restricts easy transportation and hence schools have to be built in several communities making it impossible to optimize the school districts. Additional resources would have to be found to provide equipment and supplies which are necessary for a modern education system. Similarly, the 1998 MTESP reported that there was considerable deficiency in the capital stock because of poor maintenance. It was estimated that at least 50% of the schools were in need of repair or renovation. The state of the education system can be summed up in the World Bank appraisal for the Basic Education Reform Project, which suggested that the overall management of the education system was extremely weak. Planning, policy formulation and school supervision are hampered by an inadequacy of human and material resources.

The weaknesses in the public finances suggest that the government would need to use the resources in the sector more efficiently and mobilize external resources to finance the additional requirements of the sector. The OECS Basic Education Reform project seeks to address the issue of efficiency by reducing the student teacher ratio at both the primary and secondary level and via improved management of the sector. A major objective of the project is to provide universal access to secondary education by 2003.

The provision of adequate level of primary health care at a reasonable cost is one of the major challenges of the authorities. It would require significant enhancement of the healthcare delivery system. This would involve improvement in both the management of the system and the physical infrastructure. At present expenditure on health accounts for 14.2% of the recurrent budget and is the second largest component. The weakness in government finances and the need to generate savings to improve social and economic infrastructure had prompted the former administration to begin looking at cost recovery mechanisms and greater private sector participation in the provision of health services. The current administration would also need to address these issues.

In spite of improvements in water and sewage that took place during the 1980s and 1990s deficiencies in the system still persists. Improved water and sewage management is critical to the sustainability of the rapidly developing tourism sector. The improvement of the service is rendered more costly by the difficulty of the terrain and the successive reparations that are required after the passage of tropical storms and hurricanes.

THE ENVIRONMENT

The country of Dominica is blessed with a variety of flora and fauna, large sections of which remain relatively unspoilt. Thus, Dominica has always been aware of its potential as an eco-tourism destination but also aware of the fragility of its ecosystem. This is particularly so, since the budding tourism sector is heavily dependent on the preservation of the environment, but at the same time, can wreak untold damage to the environment. During the last decade the authorities have expended much effort to develop the country as a premiere eco-tourism destination with some success. The country has won awards as diving destination one of the top 10 most exotic destinations. In contrast to the most of the other OECS countries whale watching has been promoted as a tourist attraction. To maintain this exotic allure greater attention has to be paid to environmental issues including protection of the fragile ecosystem, bio-diversity, environmental impact assessment and general environmental issues. It is possible to turn the emphasis on environmental issues into profitable opportunities for the citizens of the country.

There are several initiatives at varying stages of implementation to address these critical environmental issues. A Watershed Management project is being implemented with the objectives of rehabilitating the hydraulic systems of the country and the development of a watershed management plans to enhance sustainable watershed development and to strengthen Governments' capacity in environmental management and flood preparedness. The implementation of the World Bank Solid Waste project and the environmental levy for its finance is another initiative to protect the natural environment. Comprehensive plan for coastal zone management has also been developed in conjunction with the OECS Natural Resource Management Unit. In particular millions of dollars have been spent on sea defenses to ward off excessive erosion. The introduction of measures aimed at protecting forestry resources are other positive steps being taken by the authorities to try to preserve the environment. In addition, user fees and incentive mechanisms for agriculture, tourism and industrial uses of forest resources to reflect environmental costs would promote sustainable practices and discourage the unsustainable ones.

A quote from Eleanor Jones (2000) aptly sums up the situation in Dominica,

> *"As natural hazards seem to be increasing in frequency so too have we, through our investment decisions personally, sectorally and nationally, increased our vulnerability and risk. I believe the evidence is glaring that we ought to begin to take seriously the need for systemic change in our development planning process and our approach to livelihoods. We are challenged by vulnerabilities, but there are proven approaches to reducing the ecological and natural hazard vulnerabilities to which we are prone. We need to develop a systematic and phased approach to applying the approaches, recognising that there is no blueprint for every government, enterprise or stakeholder group.*
>
> *We have not mentioned stakeholder consultation, but that is an essential ingredient of the sustainable development approach. Citizens in every sector must be appropriately engaged in consultative dialogue which will in turn facilitate design of the most appropriate and acceptable strategy for any aspect of development".*

The pristine environment in Dominica provides significant opportunities to develop ecologically friendly activities. The seas and mountains are natural attractions for eco-tourism development. The purity of the air and the climate create natural environs for recuperative vacations and for telecommuting workers from the developed countries. The practice of ecologically friendly agriculture can bring great rewards in an international market place where organically grown foods command a premium. But this advantage can be easily lost if attention is not paid to the carrying capacity of the island. Environmental risk assessment would have to become an indispensable tool in the planning process. The use of environmental impact assessments would have to be made mandatory rather than desirable as is now the case in Dominica.

As Jones (ibid.) notes, reducing loss and social dislocation from natural and technological hazards is central to Caribbean development as the need for repeated reconstruction in the aftermath of natural disasters diverts limited resources from other development priorities.

Natural hazards are always going to be with the Caribbean but the effect of these disasters are often exacerbated by the vulnerability arising from settlement and by human activity and negligence. Storm water drains which are not cleaned and rivers which are choked with sediment will hinder storm runoff and hurricanes, storm surge, sea level rise and floods will damage poorly sited and designed buildings and infrastructure.

AGRICULTURE SECTOR

Contribution and Performance

Historically, agriculture has been the cornerstone of the Dominican economy, based on an export sector dominated by banana production, and a more diversified, albeit, loosely organised domestic food production sector. Banana became the dominant export crop at the turn of the eighteenth century, replacing sugar, limes and vanilla, in that order. Crop production has been the major agricultural activity, and given the extensive cultivation of bananas, coconuts and citrus, crop production accounts for over 80% of gross agricultural production. In 1995, the volume of available land suitable for crop production was estimated at 58,000 acres, representing 29.7% of the total land area. Of this total, 61.7% was cultivated, dominated by permanent cultivation (82%). The area under temporary crop was estimated to have declined by 64% between the two census periods, 1961 and 1995. In contrast, there was a marked increase in permanent crop cultivation, of almost 31% over the same period. This was partially attributed to expansion in banana cultivation, as well as the expansion of non-traditional crops, specifically avocado, mango and other fruit tree crops as part of the agricultural diversification programme.

Dominica is well endowed with forest resources, estimated at 14,400 acres, which provide a relatively small, albeit valuable contribution to gross agricultural production and linkages to the small furniture manufacture industries. Due to land constraints, both in terms of availability and terrain, livestock production has traditionally been centered on the rearing of small ruminants, sheep, goats as well as pig farming. With a few exceptions, such as a very small number of poultry and dairy cattle operations, these activities have traditionally been undertaken on a non-commercial, back-yard scale. The acceleration of agricultural diversification, which also placed emphasis on expanding activity and output in the livestock sub-sector, resulted in a general improvement in livestock operations in the 1990s.

Similar emphasis on modernising the fisheries sector and increasing its contribution to the agricultural gross domestic product (GDP) also focused on the upgrading of fish-landing site island-wide. As a result, fishing experienced significant growth in gross output in 1993-1994, of 11%, compared to less than 1% growth in 1990-1992 (Table 1). In fact, fisheries was the only sector reporting high average growth between 1990-1994, with relatively low growth in livestock and forestry, and negative average growth in crop production. In fact, crop production displayed a highly variable rate of growth and decline between 1995-1998.

Agriculture, which accounted for 25% of GDP in 1990, declined to 18% in 1998. This percentage share was the highest among the OECS countries, which is reflective of both the relative significance and limited diversification in the Dominican economy The decline in percentage share in the 1990s was reflective of low and negative growth in the agricultural sector, which averaged –1.34% per annum between 1997 and 1998. Except for 1996, real growth in the agriculture sector was less than the growth rate of the overall economy over the last four years, which contributed to the decline in the percentage share of agriculture in GDP. The negative growth recorded in 1995 was due largely to the adverse effects of two hurricanes and two tropical storms that year, which devastated the banana industry. These natural disasters have been a major factor contributing to the annual instability in the performance of the agricultural sector.

Table 1: Dominica: Share and Growth Indicators, Agriculture Sector

Real Prices (1990)	1990-94 Avg	1995	1996	1997	1998	1999
Agriculture share in GDP %	23.67	20.27	20.75	20.04	19.14	**na.**
Agriculture GDP growth %	**-0.51**	**-8.13**	**5.47**	**-1.49**	**-1.19**	
- Crops	-1.40	-10.47	6.51	-2.72	-1.91	
- Livestock	2.02	2.06	1.30	1.57	1.54	
- Forestry	3.29	1.90	1.55	1.53	0.90	
- Fishing	6.18	1.50	1.89	5.69	1.63	
Real GDP Growth	**2.22**	**1.60**	**3.08**	**1.98**	**3.45**	

Source: CSO

Both the declining trends in percentage share and growth in agriculture throughout the 1990s resulted largely from the difficulties experienced in the banana industry and slow pace of non-traditional agricultural production. Declines in banana production and exports were a feature of the banana industry in the 1990s. Over a seven year period, banana exports declined by 53%, from 58,024 tonnes in 1992 to 27,264 tonnes in 1999. Banana exports peaked at 71,474 tonnes in 1988, and the highest export volumes achieved since then has been 58,024 tonnes in 1992 (Table 2). This steady and severe decline has been attributed to the combined effect of adverse market conditions, declining farmer confidence and disruptions associated with natural disasters. The industry has also been affected by the depreciation in the real exchange rate of the Pound Sterling, price variances, and increased production and shipping costs, and the cost price squeeze due to rising input and falling commodity prices. The pervasive changing trends in consumer requirements have also increased production costs and increased the level of non-acceptance of fruit on the basis of low and unacceptable quality. Other domestic constraints include the inadequacy of the internal transportation network and low and declining factor productivity (including labour).

Table 2: Banana Industry, Selected Performance Indicators

	1994	1995	1996	1997	1998	1999
Production (tonnes)	43,047	33,865	40,920	34,911	28,641	27,775
DBMC Exports (tonnes)	42,872	32,667	39,545	34,902	28,135	27,264
DBMC Exports (EC$/Mn)	42.87	44.80	45.50	42.20	37.06	38.90
Quality ratings (%)	80.96	75.80	80.00	83.00	90.00	90.59
GMP (£/tonne)	618	551	545	513	520	526
Exchange rate(EC$/£)	4.11	4.27	4.14	4.39	4.46	4.33
No. of Active farmers	4,840	4,366	3,844	3,676	2,993	2,534
Per cent certified	na	na	65	181	1.034	1,400
Acreage under cultivation			9,000	7,800	7,000	6,593

Source: DBMC Annual Reports

Quite apart from the external factors affecting the banana industry, industry officials identify the labour problem as a serious constraint to industry recovery and competitiveness of exports. In an attempt to address the problem of inadequate labour supply, an initiative to import labour from Haiti was embarked upon. This initiative, which was financed for a farmer with a loan of EC$76,000 from the corporation, was short-lived. Of the 40 persons expected, only 27 arrived and 10 were classified as unsuitable. Shortage of labour and low productivity continue to plague the industry and required serious attention to productivity improvements are to be achieved. All of these factors combined have led to farmer withdrawal from the industry, with the active population declining from 4,366 in 1995, to 2,993 in 1998, and 2,534 in 1999. Between 1996 and 1999, it is estimated that 1,700 growers left the industry and that the acreage under cultivation declined by 25%. Certified farmers now account for approximately 55% of the currently active population, an increase of 20% from 1998.

Agricultural diversification programmes have been implemented since the early 1980s. Much of the focus was on expanding production and export of non-traditional fruit, including avocado and mango. Through the International Fund for Agricultural Development of the Caribbean Development Bank (CDB), Dominica has been provided with assistance to expand opportunities in non-banana crops, livestock, fishing and other micro-enterprises. During 1996, the sector benefited from a farm productivity programme financed by Stabilisation of Exports Programme (STABEX) resources, designed to increase production, productivity and quality control in non-banana production. Due to continued efforts by the Dominica Export Import Agency (DEXIA) to increase the volume and value of non-banana crops, specifically dasheen, pumpkin, ginger, hot pepper and grapefruit, there has been a noticeable increase in acreage under cultivation of non-traditional crops, but the level of production and exports remains far below that of bananas (Table 3).

Table 3:Production of Major Agricultural crops:1990-1999

Tonnes	1994	1995	1996	1997
Bananas	53,188	39,144	49,487	43,806
Coconuts	15,300	15,453	10,800	13,408
Dasheens	11,878	11,858	11,862	11,281
Grapefruit	12,252	10,682	11,641	11,012
Limes	1,058	1,102	1,353	1,143
Oranges	3,335	3,367	3,514	3,871
Plantains	7,886	7,899	8,212	8,637
Tannias	4,379	4,408	3,636	3,500
Yams	6,659	7,066	7,672	7,648

Source: CSO, MoA

The Hucksters Association was also instrumental in the promotion of non-banana agricultural exports. Mainly in response to the efforts of DEXIA and the continuing growth of huckster operations, the non-banana sub-sector recorded an estimated 100% increase in the value of exports over the 1996 – 1999 period. In terms of volume, the top ten non-traditional export crops in 1997 were plantain (2005 tonnes), grapefruit (784 tons), orange (637 tons), coconut (630 tons), avocado (320 tonnes), yam (266 tons), tannia (209 tons) and hot pepper (145 tons) (Table 4). In 1998 DEXIA was successful in promoting dasheen exports in North American markets. DEXIA reports indicate that 1999 dasheen exports amounted to 240.8tonnes, worth an estimated $0.5 million. In 1999, expanded demand for hot peppers as a primary product for pepper sauce resulted in increased production. To meet and sustain the increased demand for hot peppers, efforts were concentrated on the bulk buying of seeds and seedling multiplication for distribution to farmers.

Continued growth in non-traditional and food crops in 1999 resulted in a 2% increase in output that year. This positively impacted exports, which was estimated to increase by 25% in 1998. Data indicate that the share of non-banana in total agricultural exports increased from 28.1% in 1996 to 43.5% in 1998. With the exception of 1994, non-banana crop exports registered fairly stable growth over the period (Table 5). The continuation of efforts at non-traditional crop production remains critical both in terms of agricultural and economic diversification.

Table 4: Principal Agricultural Exports

Value EC$000	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Bananas	56,684	45,476	49,130	46,331	40,510	39,930
Coconut	420	219	1,140	1,277	946	37
Dasheen	1,067	1,457	1,564	1,728	2,190	2,285
Grapefruit	942	951	1,075	794	1,195	1,340
Lime	236	329	562	324	341	297
Orange	473	656	1,060	1,689	1,586	1,141
Plantain	3,022	2,825	4,153	5,111	5,736	5,176
Tannia	783	945	1,130	1,040	881	852
Yam	799	1,089	1,716	1,433	1,792	1,188

Source: CSO Annual Trade Reports

Table 5: Non-banana Agricultural Exports- Performance Indicators

	1993	1994	1995	1996	1997	1998
Total Agricultural exports (EC$m)	83.19	67.08	57.68	63.27	65.34	66.52
Non-banana exports (EC$m)	20.45	7.20	12.88	17.77	23.14	28.93
Agricultural Export, % of Total Domestic Exports	64.7	53.9	49.10	46.8	47.1	41.8
Non-banana exports, Per Cent of Total Agricultural exports	24.6	10.7	22.30	28.1	35.4	43.5

Source: Ministry of Finance

Policies and Prospects

The agricultural sector continues to be critical to economic development in Dominica through its contribution to real growth, export earnings and both direct and indirect employment generation, particularly in rural areas. In this regard, the sector features prominently in Governments development policy regarding both sectoral and economic diversification. At the end of 1999, the banana industry appeared to have been on a path of recovery, although uncertainty persists regarding the direction and impact of emerging international trade relations between the US and EU, and the acceleration of trade liberalisation under the auspices of the World Trade Organisation (WTO).

The Banana Industry

The Dominica Banana Marketing Corporation (DBMC) has outlined the following strategy for the continued development of the banana industry in Dominica:

- improving productivity/quality increasingly;
- restricting the focus on new production areas;
- working towards privatisation through consensus building approach and education whilst moving the DBMC towards cost efficiency standards applicable to corporate business; and
- engaging in diversification of the banana product.

A major initiative of the Banana Recovery Plan targets the provision of financial and technical assistance to certified producers or those deemed to have potential to achieve a yield of at least 12.5 tonnes per acre in the long run. The production recovery programme is being financed by a mix of loan and grant funds from the European Union, Geest and the Governments of the banana producing islands and the industry. The Banana Industry Trust for Dominica, which was formally launched in November, 1999 has now finalised the administrative actions necessary for the operation and administration of the Trust Fund. The objectives of the Trust are to *inter alia*:

- Encourage, assist and support the development of sound farm practice in the production of bananas and to restore and maintain confidence in the banana industry including the development and provision of services to the industry;

- Deliver technical assistance, information and training in the latest innovations organization and management systems;

- Consider request for funding support through a specific agricultural service organization

- Disseminate information about its work; and

- Promote and encourage greater participation by the private sector, farming communities and the banking sector.

All service providers, including DBMC, the District Branches and Producing Divisions, Input Suppliers and other private sector service providers are qualified to access funds in support of enhancing banana production and the banana industry in general. It is anticipated that as a result of this programme, the following will be achievable within the immediate-to-medium term:

- establishment of 800 acres of irrigated and well drained banana fields;

- construction of two inland and distribution centers to improve efficiency of receiving and transporting bananas and other commodities, input and distribution;

- construction of twenty cable ways, ten culvert crossings and 40,000 ft of concrete wheel tracks to improve access to farms; and

- enhanced environmental management of banana farms.

Non-Traditional Production

Under the 1995 Stabex, an estimated $4.4 million was allocated to agricultural diversification programmes. In 1999 the fund disbursed an estimated $0.8 million to five financial intermediaries including the NDFD and Credit Unions for on-lending to farmers for investment purposes at concessionary rates of interest. Of this amount, an estimated $0.6 million is earmarked for livestock development, the cultivation of root crops, fruits and vegetables. The remaining $0.2 million is earmarked for on-lending to the fishing and agro processing sectors.

MANUFACTURING SECTOR

Contribution and Performance

Although industry has traditionally been a relatively small segment in Dominica, it has expanded somewhat since the late 1970s, growing at a rate of 10% per annum between 1978-1983. Such growth focussed on two areas: processing of natural resources and agricultural products, and enclave-type light assembly manufacturing industry. From the mid-1980s, efforts to expand light-manufacturing promoted the availability of low-cost labour in an attempt to attract labour-intensive industry. Between 1978-1981, employment in the manufacturing industry accounted for 7% of the total labour force, compared to an estimated 25% share for agriculture.

The manufacturing sector in Dominica can be broadly divided into two broad sub-sectors, the traditional import substitution and agro-processing. They vary in their potential to be internationally competitive and contribution to real output of the local economy.

The agro-processing sector has strong linkages with the agricultural sector and has the potential to be competitive in selected niche markets. The agro-processing sector is characterized by home based family production and small processing employing 5 to 20 employees. The technology is characterized by varying degrees of sophistication; but in general there is little modernization of equipment and facilities. The local raw material content ranges from 80% to 100%. Surplus agricultural output is the main component of local raw material.

The import substitution manufacturing sector consists of paint and varnishes, cardboard cartons and solar water heaters. It is characterized by a high import content in the production processes. Not only are capital goods imported; but in some cases up to 100% of raw materials are imported from extra-regional sources. Production is geared mainly to the local and regional markets and very little is exported extra-regionally. World Bank (1990A) asserts that the sector is highly uncompetitive internationally and can only survive with excessively high amounts of effective protection. Moreover, they argue that this is compounded by industrial incentives which have a high anti-export bias. The granting of blanket duty-free import inputs, untied to export performance only encourages inefficient production for the local market.

Most of the plants are built for the minimum efficiency scale of production and still operate with excess capacity as high as 60 to 70%. Regional trade and payments problems have pushed capacity utilization to even much lower levels. The production of soaps and dental cream is a major exception to these strictures. This sub-sector of manufacturing is quite competitive and seems to be able to hold its own in a liberalized environment. The plant was recently bought by international interests which have subsequently closed plants elsewhere and concentrated production in the Dominica facility.

Efforts to expand labour-intensive industry contributed to an increase in the contribution of manufacturing to real GDP growth, from 6.8% in 1978-1980 to an average of 8% between 1986-1989. In spite of the relatively low share in GDP, the value-added from manufactured exports comprised a relatively significant share of exports, averaging 40% between 1984-1985, declining to 25% between 1986-1988, recovering somewhat to 35% in 1988-1989. This share was dominated by exports of toilet and laundry soap, produced by the single major manufacturing concern, the Dominica Coconut Products (DCP). Other traditional agro-based industries include tobacco processing for the manufacture of cigarettes, and furniture manufacturing. Growth of enclave-type light manufacturing industry proceeded very slowly from the early 1980s. While coconut-oil based by products experienced steady growth between 1984-1989, other manufactured exports, which included galvanised sheets, declined between 1985-1988.

During the late-1980s-early 1990s, other firms included a garment and glove producer, established under U.S. 806/807 regulations, and a cardboard box manufacturer, established under Puerto Rican 936 provision. A bottling factory began operations and exports of mineral water in late 1983. This water-based industry, however was deemed to be of limited potential with regard to the creation of additional employment opportunities or value-added in the economy. In 1991, a cosmetics factory came on stream and other new manufacturing enterprises included computer-related firms and a plastic factory. One garment factory closed operations due to unfavourable labour relations. In the early 1990s, Dominica was relatively more successful in establishing firms geared towards the domestic market, largely small businesses, promoted by the National Development Foundations. Though small, these businesses have tended to expand more rapidly and made an important contribution to employment.

Because of the difficulties experienced in expanding industrial activity, the manufacturing sector in Dominica was still considered to be in an embryonic state in the 1990s, and activities remained heavily concentrated around agro-industrial activity, led by the traditional oils and fats industry. Only one company, Colgate Palmolive (previously DCP) continued to dominate the sector. Other industrial concerns include cigarette and beverage manufacturing plants, water bottling operations, fruit and vegetable processing industries, such as the manufacturers of Bello products, and “Blows Industries” processors of herbal tees. Though important in this thrust for economic diversification and employment creation, these industries are relatively small contributors to the sector’s total manufactured output and exports.

Manufacturing experienced relatively high growth between 1991-1992, averaging 5.8% per annum. The scaling down of several non-agro-industrial based industries resulted in a slowdown in the sector, and eventual negative growth of –9.6% in 1994, which is responsible for the negligible average growth rate of 0.89% between 1990-94 (Table 6). In fact, manufacturing recorded the largest decline in the economy during 1994, largely influenced by a drop in the production of banana boxes which accounted for 25% of cardbox production. Other major manufactured products, including toiletries and cigarettes, posted small, but steady growth. Since then, growth in manufacturing GDP has been sluggish, and led by the performance in the oils and fats industry. Soap manufacturing received a boost with the signing by the DCP of a supply contract with two major cruise lines in the late-1994-1995 period. The acquisition of DCP by Colgate-Palmolive Co. (US) in 1995, also ensured facilitated expansion and the continued viability of the fats and oils based manufacturing in Dominica.

Table 6: Dominica Share and Growth Indicators, Manufacturing

	1990-94 Avg	**1995**	**1996**	**1997**	**1998**	**1999^{P}**
Manufacturing share in GDP Per cent	7.27	6.77	6.96	7.00	8.19	7.22
Manufacturing GDP growth Per Cent	**0.89**	**2.28**	**6.01**	**2.51**	**21.14**	
Real GDP Growth	**2.22**	**1.60**	**3.08**	**1.98**	**3.45**	

Growth of 2.2% in 1995 following the –9.6% decline in 1994 was led by continued strong growth in Colgate Palmolive Co. which contributed nearly 35% to total exports in 1995. Also contributing to the turnaround in the sector in 1995, was the opening of a new German-operated brewery and spring water bottling operation, Dominica Brewery and Beverages Ltd. and the reopening of the banana box manufacturing plant under new ownership in late 1995. Other manufactured products, including household cleansers and disinfectants, candles, plastic sheets and bags, pepper sauce, pasta, paints, tobacco, bay oil, rubber foot wear, aggregate and solar water heaters contributed to a total of 13% of domestic exports. Continued strong growth in these industries in 1996, as well as an expansion in the range of brewery products, to include production of beer, guinness and malt, also boosted growth and led to a 2.2% increase in the sectors share of GDP, contributing also to the 3.1% growth in the overall economy that year. The slowdown in sectoral growth in 1997 was attributed to loss of market share of soap and detergent in the CARICOM market. The commencement of toothpaste production in late 1997, which accounted for roughly two-thirds of the Colgate-Palmolive Co., 1998 production and export volume, was a major factor contributing to the significant growth in the manufacturing sector in 1998. In that year, the sector was pivotal to the 3.5% real growth recorded in the economy. Other activities in the manufacturing sector during the year included the expansion of one solar water company, the establishment of a shoe manufacturing operation and the commencement of construction work on a bio-mass plant in the north of the island.

Growth trend in manufacturing continued into the first quarter of 1999. However, mechanical problems and staggered supplies of primary products resulted in declines in soap production, by 19.7% and declines in exports by 9.6%, registering sales of $65.1 million in December 1999. Production of dental cream registered growth of 3.4% amounting to 1,691 tonnes. Preliminary indicators also pointed to declines in other areas of the manufacturing sector in 1999. Output of the Dominica Brewery declined marginally by 1.2% on account of a significant loss in production in the last quarter. Contraction was also experienced in the packaging industry in response to the reduction in soap, banana and beverage production.

In 1992, the World Bank noted that manufacturing in Dominica was plagued by a number of constraints, including skilled and unskilled labour problems. Transportation difficulties have contributed to the segmentation of the labour market making it difficult to recruit unskilled workers throughout the island at wage rates which would allow for competitive production. Moreover, there was a tendency for skilled labour to migrate to other islands in the region where tourism activity has contributed to wage levels higher than those existing in Dominica. While these constraints have been minimised, somewhat, they remain relevant today, particularly with regards to potential expansion of labour-intensive industries.

Constraints to the Development of Manufacturing

The manufacturing sector in Dominica operates under several constraints. These include:

Finance. Although large firms have access to foreign finance or can attract local financing quite easily, indigenous firms face great difficulties in accessing finance. The commercial banks have a penchant for short term less risky lending and hence lend more for mercantile activities, rather than for manufacturing and agriculture. The percentage of loans to the personal and distributive sectors account for more than 60% of loans outstanding while the manufacturing sector receives less than 10%. Moreover indigenous firms do not have the requisite expertise in the conceptualisation of projects and presenting them to commercial banks as projects for financing. Neither do the commercial banks have the expertise to assist in this type of activity.

In addition, the high cost of finance in the face of high price elasticities of consumer demand, regional trade and payments problems, excess production capacity, primitive technology, deficient technical skills, unreliable transport and quality of raw materials all constrain the development of the sector.

Technology and technical skills are two other sources of concern. The rapid pace of technological development worldwide hastens the obsolescence of capital and erodes the competitiveness of less technologically dynamic countries. The high cost of upgrading capital and the inadequacy of technical capability to speed up the transfer and diffusion of technology retards the export competitiveness of the firms. Hence their inability to penetrate extra-regional markets and even its ability to hold on to domestic markets. The paucity of technical training results in wastage of raw materials, inadequate maintenance leading to loss of production during down times, and the need for foreign technical assistance to diagnose and solve some very simple problems.

High labour costs. Dominica is by no means a low wage area. The boom in banana prices during the 1980s pushed up the cost of agricultural labour and had a demonstration effect on the other sectors. Thus the type of manufacturing sector which emerges in the post liberalisation period must take this as a given. Moreover higher remuneration in the emerging tourism sector has tended attract workers away from manufacturing. In 1992, the World Bank noted that manufacturing in Dominica was plagued by a number of constraints, including skilled and unskilled labour problems. Transportation difficulties have contributed to the segmentation of the labour market making it difficult to recruit unskilled workers throughout the island at wage rates which would allow for competitive production. Moreover, there was a tendency for skilled labour to migrate to other islands in the region where tourism activity has contributed to wage levels higher than those existing in Dominica. While these constraints have been minimised, somewhat, they remain relevant today, particularly with regards to potential expansion of labour-intensive industries.

Inadequate transportation links. The paucity and reliability of transportation links is another constraining factor. Sea transport is not only scarce but sometimes unreliable. In addition, the cost of sea transport is not significantly lower than air transport which is usually more reliable. However, due to insufficient air access into Dominica, the country has not attracted quite as many firms in the enclave sector. Even the countries with superior air access suffer from a shortage of dedicated air cargo space.

The size of firms and local market. As mentioned earlier, most of the manufacturing firms in the country employ less than 20 employees. This limits the ability of the firms to reap economies of scale and spread overheads. Moreover the majority of indigenous firms are contented to produce for protected local markets which are extremely small. The markets are protected by the CARICOM CET and in some cases by Article 56 of the CARICOM treaty[1].

The regulatory framework for businesses. The regulatory and legal framework in which business operate may have impeded the development of the manufacturing sector. The process by which projects are approved is too long and circuitous. In addition, there is the perception that the process favours foreign investment over local investment. Nuisance regulations and onerous legal requirements impede the flexibility of the firms.

The Protective Regime. The protection accorded by the CET along with an incentive regime which treats production for the local market and production for export in the same way create an anti-export bias. There is no incentive to produce for the more competitive, more risky export market, while production for the protected local market is quite profitable. The reduction in the CET would tend to redress this bias to some extent but specific incentives have to be put in place to encourage production for export. However the regime of quantitative restrictions is being phased out via a process of tariffication which would initially increase the import duty. The incentives regime reflects the earlier inward looking policy of industrialization and need to be given a thorough overhaul to reflect an external orientation.

Fiscal charges. The size of the country and the inadequacy of transportation links already impose severe disadvantages on the countries in terms of their ability to compete internationally. Thus it is essential that no inordinate charges are imposed to prevent the firms from sourcing their inputs at international prices. Additionally high port charges impose further restrictions on the ability of the firms to compete internationally. The consumption tax on inputs which is not rebated on export goods creates a disadvantage for Dominican firms vis-à-vis their CARICOM counterparts whose exports are zero-rated under the VAT.

Non-tariff barriers in export markets. The existence of non-tariff barriers in the export markets especially the USA has tended to impede the growth of manufacturing exports. Dominican exports face a myriad of regulations which only experience in the markets can help to get around. Many firms are seeking ISO and other international certification to facilitate entry into international markets. Although the greater transparency under the new WTO rules may have reduced the uncertainty of entry, many indigenous firms may be unable to finance the cost of the barrage of legal challenges that they may face in these markets.

Knowledge of export markets. The paucity of knowledge about export markets is another significant obstacle to export development. Basic information regarding the structure of markets, changes in taste, import regulations in the foreign country, appropriate technology, new processes, new products and potential competitors has to be assembled. Market intelligence is a costly undertaking for the individual producer and there are also externalities associated with this activity. This suggest the need for co-ordinated action at the OECS level. The activities of Export Development and Agricultural Diversification Unit (EDADU) are aimed at reducing some of these difficulties, but the organisation remains largely under-funded and suffers from a

[1] Article 56 allows the less developed CARICOM countries to impose quantitative restrictions and suspend origin treatment for goods of the more developed countries in an effort to develop the manufacturing sector in the less developed countries.

lack of clear commitment and strategic focus. In addition tapping into international producer and market information networks would reduce significantly the cost of gathering market intelligence.

Inadequate Infrastructure. The inadequacy of economic and social infrastructure of the country is a significant constraint on the development not only of manufacturing but all of the productive sectors. The inadequacy of infrastructure is usually reflected in higher cost of basic utilities that are critical inputs into the production process.

Policies and Prospects

Government policy already makes provision for numerous exemptions and incentives to the manufacturing sector. Among the elements of the investment incentive package offered, is the provision of pre-fabricated factory shells, estimated at over 100,000 square feet of factory facilities, with additional 80,000 square feet in the planning stage. Export processing zones are being planned near the country's two airports.

The current tax incentives system does not differ much from the mid-1980s, and in addition to the provision of factory building and industrial estates, offers the following benefits:

- Tax holidays;
- Import duty exemptions (plant, machinery, equipment, building materials, raw materials, packaging materials, others as appropriate);
- Repatriation of profits (usually to the extent of the percentage of foreign participation in the company);
- Withholding tax exemptions;
- Alien's land holding license fee exemption. The Alien's Landholding Act has been revised to allow a non-national to purchase up to 3 acres of land for business purposes and one acre for residential use without obtaining an Alien Landholding License or paying the 10% related fee; and
- Residence work permits and economic citizenship.

TOURISM

Tourism and tourism related services have played relatively small role in the economy of the Commonwealth of Dominica in the 1980s and early 1990's. The economy has been dominated by the agriculture sector in general with the banana sub-sector being the major earner of foreign exchange (see Agriculture section). During the period 1986-89 stay-over visitors grew on average by 12.1% to 29,650. This growth was sustained at an average rate of 12.0 over the period 1990-94 with the level of stay-over visitors 49,363. However by 1995-98 growth in stay-over visitor arrivals slowed to an average 3.8% (63,669).

Cruise ship passengers in contrast recorded single digit growth of 8.7% to 9,968 during 1986-89. However with the construction of berthing facilities during the period 1990-94 and increased promotion of eco-tourism attribute, cruise ship passengers grew considerably (186%) to 74,992. This growth however stabilised at 19.0% with average arrivals reaching 200,897 over the period 1995-98.

Total visitor expenditure grew by 15.6% on average to $33.5m over the period 1986-89. This growth rate was sustained at 15.9% during 1990-94 while gross expenditures averaged $70.4m. In reflecting a slower growth in stay-over visitors, visitor expenditures grew on average by 4.3% to $100.2m.

As the tourism industry gained prominence over time the service penetration index increased gradually over the sub-periods from an average 0.41 during 1986-89 to 1.24 during 1995-98. The sectors relative contribution to GDP also rose from an average of 1.5% during 1986-89 to 2.7% during 1995-98. The Caribbean market has consistently been the major source of stay-over visitors to the destination across all sub-periods of analysis. Average market share stood at 42.8%, 46.1% and 44.9% respectively. Within the Caribbean market visitors from the French overseas departments of Guadeloupe and Martinique accounted for the majority of stay-overs from the Caribbean market. The USA was the second most important market at 17.2% during 1986-89, 15.3% during 1990-94 and 20.8% during 1995-98. The UK market ranked third but demonstrated a decline in market share over time from 11.9% during 1986-89 to 8.1% during 1995-98.

Constraints to Tourism

Limited air access continues to constrain the expansion in room capacity in the territory. The numbers of rooms in 1986 stood at 400 and by 1998 were estimated at 623. The absence of a major international airport is a major disincentive to FDI equity inflows for hotel construction. Current attempts by the Government of Dominica to raise capital for an international airport have met with some success. However the costs of such a venture will considerably increase the country's indebtedness.

CONSTRUCTION

Recent Economic Developments

The contribution of the construction sector to economy has increased from 5.6% of real GDP during 1986-94, to 7.6% during 1990-94 to 8.3% during 1995-98. The corresponding real growth rates associated with these sub-periods were 18.2%, 7.1% and 8.9% respectively. The construction business cycle mirrors agricultural export sector performance. In the 1980's when the terms of trade for banana exports were favourable, high real growth rates were recorded. As the sector faced increased competition, and consequently lower foreign exchange the construction activity tended to be procyclical and highly variable. Most construction activity is concentrated public sector investment and in residential and commercial construction. The savings investment profile of Dominica also illustrates the variability in both public and private sector savings and consequently the levels of investment. Investment decisions by both sectors are closely linked to the variability in the terms of trade shocks whether favourable or unfavourable and the degree of uncertainty surrounding the performance of exports.

TRANSPORTATION

The transportation sector's contribution to real GDP has gradually increased from 9.0% in 1986-89 to 10.0% during 1995-98. In contrast, real growth in the sector has declined from 6.7% during 1986-89 to 2.8% over the period 1995-98. Road transport accounts for the majority of value added in the sector followed by sea transport. Developments in road transport reflect the level of trucking activity in the banana industry, which has undergone a fair degree of adjustment over the review period. Drought, storms and the degree of price uncertainty in the banana industry in the 1990's would have impacted adversely on value added in the sector. There is also an indirect effect of adverse terms of trade on income for the purchase and use of minibuses within the territory. The impact of the contraction in banana production on the transportation sector would have been mitigated to some extent by increased demand for tour operators associated with cruise ship activity.

Opportunities and Constraints

Activity in the sector is constrained by the general mountainous terrain that limits the extent of the road network. Moreover, a lower volume of banana exports in recent times arising from both weather conditions and unfavourable developments in the international community have adversely affected the sector. Revitalisation of the banana industry with a view to increasing output will have a favourable impact on the sector. The need for increased trucking services to support the construction of the international airport will also have positive short-term impacts on developments in the sector.

COMMUNICATIONS

The communications sector in the absence of a vibrant tourism sector is by far the most important source of FDI inflows into the territory. This sector's relative contribution to real GDP has increased from 5.6% in 1986-89 to 9.7% during 1995-98. Real GDP growth was highest during the 1986-89 period with substantial investment in telecommunications infrastructure. Given, the increasing role of reinvested earnings over time real GDP growth was sustained in the 1990's averaging 7.1% and 8.9% over 1990-94 and 1995-98 respectively.

The liberalisation of basic telecommunications under the General Agreement on Trade in Services (GATS) signed in 1997 has unleashed a wave of competitive pressures which has resulted in a spate or international mergers, as formerly protected national telecommunications companies scramble to position themselves to be players in the global market. No doubt this development has forced the monopoly provider of telecommunications services in the Organisation of Eastern Caribbean States (OECS) countries to soften its stance and agree to renegotiate its contract with five of the independent OECS countries[2]. Many of these contracts date well into the new millennium.

At the same time, technological advances in the telecommunications industry is threatening to create a glut of bandwidth internationally that would force the price of telecommunications services to near zero levels. These advances are taking place at all three critical points in telecommunications networks, i.e., international/long distance carrying capacity, switching gear and the local loop. Cost reduction in the local loop is critical for 75.0 to 80.0% of the cost of a call consists of the cost of the link in the last couple of miles. About two thirds of the assets of telephone companies is invested in this segment hence making them a candidate for natural monopolies.

The reform of the telecommunications sector in Dominica began in 198 with the privatisation of the telecom services. The telecommunications reform occasioned by the re-negotiation of the licenses and continued advances in technology will usher in major changes in the industry for which the country needs to be prepared.

Recent Performance

Telecommunications is already the fastest growing area in Dominica and its increased contribution to GDP has largely offset the decline in the contribution of agriculture in recent years. For the OECS as a whole, over the period 1977 to 1998, the contribution of agriculture to GDP declined from 19.8% to 8.5% while the contribution of communications have grown from 2.1% to 9.7%. Hence any prices stimulus that increases demand and hence the equilibrium quantity of telecom services would be adding to an already dynamic leading sector. In examining the effect which the reform process would have on the GDP for the OECS, it is important to recognise the role which telecommunications play in economic development. In doing so, it is imperative that one examines the sector's contribution to GDP over a given period of time.

Over the period 1977 to 1998, the percentage contribution of the communications sector in the OECS (of which telecommunications is the largest sub-sector) ranged from 2.8% at the beginning of the period to 9.6% at the end of the period. Over the years, the sector's contribution to GDP has been growing at a steady rate, largely reflecting the impact of an improved telecommunications sector. The liberalisation of the sector is expected to lead to a reduction in the cost of telecommunications services, thereby fostering an improvement in the linkages between other vital sectors in the economy

Dominica like the other OECS countries which have a comparative advantage in the provision of services. The information infrastructure is the pillar on which many of these services are delivered. Therefore, the fall in the cost of international and regional communications which liberalisation of the telecommunications sector is expected to achieve, will in fact increase the potential for trade in services and consequently improve the regions value of services produced. As was mentioned

[2] Five of the independent OECS countries are involved in a World Bank financed project to reform the telecommunications industry. The five countries are Dominica, Grenada, St Kitts-Nevis, St Lucia and St Vincent and the Grenadines.

earlier, expansion in areas such as the informatics industry would have a positive impact on the regions Gross Domestic Product.

The major issues facing the communications sector are regional in scope and are addressed in the OECS Overview.

FINANCIAL SERVICES

Domestic Financial Services

The banking sector's contribution to real GDP has increased from 10.3% during 1986-89 to 12.3% during 1995-98. Real growth in the sector mirrored the business cycle linked to the variability in export performance. Real growth in banking sector activity declined to 5.3% during 1990-94 and then slowed to 2.0% during 1995-98. During the latter period storm activity and drought affected the volume of agricultural exports which faced a continuous deterioration in the terms of trade. Loans accounted for the majority of the banking sector assets over the review period increasing from 51.0% during 1986-89 to 71.1% during 1990-94 and finally to 71.7%.

Domestic credit grew on average by 14.0% to $103.2m reflecting robust real GDP growth and favourable performance of primary exports during 1986-89. The terms of trade for merchandise exports were at their highest during this period. While net credit to Central Government, credit to the private sector increased on average by 19.0%, the non bank financial sector and the other public sector were net creditors to the banking system during this review period. Total monetary liabilities (M2) grew on average by 16.3% to $150.5m. Within M2 the narrow definition of money M1 and quasi money grew by 15.4% and 17.4% respectively. As a result of the faster growth in M2 relative to domestic credit, liquidity conditions increased to 62.1% based on the loans to deposit ratio. Consequently, net foreign assets of the banking system increased substantially to an average $68.5m.

During 1990-94, domestic credit continued to grow on average by 18.4% to $283.0m. The private sector and the Central Government increased their demand for credit while the non-bank financial institutions and the other public sector were net depositors to the banking system. Total monetary liabilities grew at a slower pace 10.1% reflecting M1 growth of 7.3% and growth in quasi money of 11.1%. Savings deposits accounted for the largest share of quasi money during both sub periods. There was a decline in the accumulation of net foreign assets by 23.3% to $40.2m due mainly to commercial banks drawing down on external assets and borrowing from the rest of the banking system.

The average growth in domestic credit of 5.0% was slower than in the two periods although liquidity conditions tightened on average to 76.1% during 1995-98. The growth in credit to the private sector also slowed to 7.1%. This period also reflected deterioration in the terms of trade for primary exports on which the country is very dependent. The non-bank financial institutions and the other public sector were net depositors within the banking system. Total monetary liabilities (M2), experienced their lowest average growth (10.0%). The slower growth in M2 was attributed to quasi-money as the average growth in M1 was higher than in the previous period.

Structure And Financial Data
of the Dominica Banking System - 1999

Financial Institutions	Number	Total Assets	Loans	Deposits	Loans/ Assets	Deposits/ Liabilities
		$M	$M	$M	%	%
Commercial Banks	5	754.8	525.2	631.8	69.6	83.7
Non-Bank Financial Institutions						
Development Banks*	1	-	-	-	-	-
Credit Unions*	19	-	-	-	-	-
Insurance Companies/Agencies	18	-	-	-	-	-
National Development Foundations	1	-	-	-	-	-
Finance Companies	1	-	-	-	-	-
Building & Loan Associations	1	-	-	-	-	-

OFFSHORE FINANCIAL SERVICES

The term Offshore Financial Services refers to a variety of activities which take place between corporations registered in a country with residents in the rest of the world and with little interaction with domestic residents. It is rather limiting for offshore financial services does not accurately describe the range of activities undertaken in these centres and may also limit the scope of opportunities considered when one is trying to visualize the future development of the industry. A more accurate descriptor would be International Business Facilitation Centres. Not only does this nomenclature cover the wide range of services provided by the offshore sector, it also makes for a much neater classification of the activities and would ultimately assists in resolving some of the ticklish regulatory issues, since different types of activities do not necessarily need the same level of regulation.

The offshore sector was developed to provide services which are normally provided in the domestic economy at lower cost or under a less demanding regulatory environment. Thus, all of the activities which take place in the offshore sector have counterparts in the domestic economy and it is quite natural that any such classification would be equally applicable to the offshore sector. The International Monetary Fund along with the other international institutions has recently revised its classification of financial institutions and this framework can be useful in the development a taxonomy of International Business Facilitation Services (IBFS).

The IMF Classification divides corporations/enterprises into five mutually exclusive sectors, Households, General Government, Financial Corporations, Non-financial Corporations and Non-profit Institutions. IBFS are concerned with Financial Corporations and Non-financial Corporations and the bulk of the activity is concerned with the former.

The offshore Services Sector in the OECS territories is currently at varying stages of development ranging from Antigua and Barbuda which is the most established, dating back to

1982 and St. Lucia where the legislation was passed in 1999 (see appendix I). The oldest offshore centre is St. Vincent and the Grenadines which had offshore banking and ship registry legislation enacted in 1976. However the activities, promoted by the St. Vincent Trust Authority Limited based in Liechtenstein have not really taken off. The legislation was modernized in 1996 to give the sector a new lease on life. The most dynamic centres are Nevis and Anguilla which have recently passed modern legislation creating fiscal consumer products which are on the leading edge of the industry.

The legislation of most of the OECS countries is patterned on that of the British Virgin Islands which is reputed to be one of the most successful emerging offshore financial services centres. The sector is usually exempt from all forms of corporation taxes in the jurisdiction of incorporation. These include income taxes, corporate taxes, capital gains taxes, inheritance taxes, withholding tax, other indirect taxes levied on international business activity. Offshore activities are also exempt from indirect taxes such as stamp duties and customs duties. Government revenue from these activities is generated by modest licence fees. A variety of products are offered but countries seem to be operating in specific niches as shown in Appendix I.

Several opportunities exist for the countries in the ECCB jurisdiction to develop offshore financial centres. The opportunities can be discussed under seven broad categories:

Tax Advantages - Individuals of high net worth and multinational corporations are attracted to offshore jurisdictions because of the many tax advantages they offer. These jurisdictions offer legitimate deferment, reduction or avoidance of taxes on certain profits earned abroad. Most of the OECS countries have chosen to be no tax jurisdictions. This factor makes them attractive to external investors as possible tax havens. However, this non-tax situation may make these offshore jurisdictions reluctant to enter into bilateral double taxation agreements with other nations because the initial benefits are not always apparent. These bilateral agreements do however have certain distinct advantages for the developing financial services provider jurisdictions. Some of the benefits may be that the home country provides the developing host offshore jurisdiction with avenues for resolving disputes, procedures for exchanging information regarding drug abuse and other illegal activities, favourable tax treatments for residents or companies organised under signatory laws.

Product Development - Offshore financial product and laws can be viewed as fiscal consumer goods. The range of legal products offered can be as broad as the jurisdiction so desires and spans the fields of banking, brokerage and other "traditional" financial services, immigration and nationality, manufacturing and general law services. Emerging jurisdictions are advised that the more readable, and understandable the laws, the more saleable is the jurisdiction. Putting the appropriate legislation in place is a therefore a necessary, albeit not sufficient, condition for the development of the offshore sector. Jurisdictions have to be vigilant to ensure that their legal products always remain on the leading edge of the industry.

Niche Positioning - Since it may not be possible or advisable for an emerging centre to simultaneously develop the full range of financial services to the same degree, countries should seek to develop niches and therefore position themselves and gain an international advantage. In the development of a niche profile countries should seek to render quick, efficient and professional service, and be innovative in meeting the needs of a niche clientele in a changing and dynamic environment. It is advisable for emerging centres to develop niches and to seek to gain an international advantage in a particular segment of the market. This strategy may, however, prove difficult to pursue given that other more established and resourceful jurisdictions are competing to diversify into new and different products.

Marketing and Promotion - A continuous marketing and public relations programme is necessary to support the legislation in place.

Private-public Sector Co-operation - Other successful Caribbean jurisdictions have identified the need to have co-operation between the private sector professionals and government officials.

Communications Technology - Private banking and other financial services increasing utilise high technology communications systems and electronic payments systems, which offer opportunities for emerging centres to compete globally. Moreover an offshore jurisdiction cannot compete effectively if it does not offer twenty-four hour online searches and registration.

Supervisory and Regulatory System - Those jurisdictions with effective systems for supervision are increasingly the choice of reputable institutions and individuals. The threats of money laundering and other illegal activities require that countries put in place a competent and efficient regulatory system.

Among the major challenges facing the offshore industry in the OECS are the following:

Limited Professional Expertise - To attract desirable investors OECS countries must have in place an infrastructure accompanied by highly trained professional accountants, bankers, taxation specialists and legal experts.

Telecommunications and Air Transportation - The cost of telecommunication service in the region is generally regarded as high and in some cases prohibitive. The irregularity or unavailability of international flights also inhibits efficient travel services.

Regulation and Supervision - Unregulated or inadequately regulated financial services centres pose a threat to global financial stability. Hence the need for new regulatory standards for their operation. The new regulatory standards will constrain growth of new centres due to increased financial and human resources requirements. At the same time the need for a good reputation should ensure that laxity in regulation frameworks is not encouraged.

Financial Liberalisation in Developed Markets - In the 1980's many of the regulations which encouraged institutions to move offshore were dismantled as developed countries have liberalised and deregulated their economies. New threats are always emerging from the anti-tax haven posture of the U.S Government and new laws are being continuously passed which serve to restrict the development of offshore centres. The recent threat by the OECD countries on harmful tax competition follows in this same vein. Such challenges are likely to increase in the future. It is therefore incumbent on newly- emerging offshore centre like the OECS countries to maintain the highest standard of regulation and propriety

In spite of these constraints the offshore sector provides significant opportunities for economic diversification. The global offshore sector is growing at a rapid pace propelled by the growth in the world economic wealth. Countries embarking on this path however need to remain cognizant of the many responsibilities they face to uphold the integrity of the financial system.

OFFSHORE FINANCIAL SERVICES IN DOMINICA

The offshore financial services sector in the Dominica started in the early 1990s in an effort to diversify the economy consequent on the imminent decline of the banana industry. The sector initially focussed on the Economic Citizen Programme and International Business Corporations (IBCs). Today there is a wider variety of offshore entities as the country has moved into Trusts, Offshore Insurance companies and Internet Gaming. The economic citizen programme went through a number of changes to enhance its contribution to the economy and to curtail abuse of the programme by persons looking for a stepping-stone into the USA and Canada. The programme was finally discontinued in 2000. Internet gaming has expanded rapidly in recent years and is now the largest part of the offshore financial services sector.

The offshore sector contributes to the economy in a variety of ways. The most direct contribution is to government revenue in the form of fees, licenses and taxes. Table? Gives government revenue from the various elements of the offshore financial services sector. It shows that revenue peaked in 1999 at about EC$ 9.7m but declined in 2000 due to the cessation of the economic citizenship programme and the slower registration in new offshore entities due to the bad publicity created by the blacklisting of the country. Revenue from Internet Gaming increased from just under half a million in 1997 to more than EC$4.5m in 2000.

Most of the financial services are intermediated through Registered Agents (usually a local law firm), which provides a second source of revenue and foreign exchange earning to the country. Some employment is created but this is minimal. Some institutions are required to maintain a physical presence in the country and the rents and expenditure by the expatriate workers are additional sources of foreign receipts. The economic citizenship programme was designed to foster investment by foreigners in Dominica and there have been some increase in investment via this avenue. There have been investments in light manufacturing and the tourism sector however it has not been as successful as expected.

Apart from the cessation of the Economic Citizenship programme the Authorities in Dominica have made several steps to reform the operations of the offshore sector to accord with international best practice. The legislation has been amended to strengthen the anti-money laundering provisions and to make the Eastern Caribbean Central Bank the regulator for offshore banking and trusts. The sector has some potential to contribute to the diversification of the economy if the threats discussed earlier can be addressed.

Offshore Companies
1999

Types Of Institutions	Number
Banks	7
Insurance	2
Trusts	1
IBC's	6,532
Exempt Companies	-
Internet Gaming	35
Economic Citizens	135
Registered Agents	30
Limited Liability Companies	-

Dominica
Government Revenue From Offshore Financial Services
EC$ '000

	1996	1997	1998	1999	2000
Economic Citizenship	4,577	8,738	7,845	7,787	3,478
Offshore Banking	43	140	115	133	174
IBCs	-	750	722	331	30
Internet Gaming	-	442	1,243	1,436	4,577
Exempt Trust	-	-	17	21	29
Exempt Insurance	-	-	6	22	13
Management Companies	-	-	6	11	-
Other Services	-	-	14	41	-
Total	4,620	10,871	9,555	9,748	5,225

Source: Ministry of Finance

ROLE OF FOREIGN DIRECT INVESTMENT

Given a savings-investment gap, long term capital flows in the form of FDI has played a significant role in fostering economic development. These flows averaged approximately 8.8% of GDP during 1986-89 and 1990-94. By 1995-98 FDI inflows averaged 12.0% of GDP with the investment of Colgate Palmolive in Dominica Coconut Products limited. Dominica's share of FDI inflows into the currency union declined over time given constraints in hotel capacity due to limited air access. Land sales accounted for the largest share of FDI flows during 1986-89 (45.4%) and 1990-94 (34.2%) but declined in relative contribution by 1995-98 (36.9%). Equity inflows which ranked second, increased in importance from 28.7% during 1986-89 to 41.3% by 1995-98. These inflows were primarily concerned with communications sector. Re-invested earnings associated with equity inflows into the communications sector grew in relative importance to account for the majority of FDI inflows (45.8%) by 1995-98.

TRADE LIBERALISATION

Dominica is simultaneously taking part in a number processes of trade liberalization. The first results from the deepening of the CARICOM Integration movement, which has resulted in a phased reduction of the CET. At the same time the country is participating in a number of international negotiations which would lead to freer trade. These include the FTAA, the post Lomé IV, the millennium round of the WTO and a number of CARICOM sponsored trade liberalization negotiations.

STATUS OF THE CET

As part of the regional integration movement and towards the structural adjustment of the economies of the CARICOM countries, a common external tariff was adopted for implementation in 1991. The tariff was later reviewed in the light of developments in the international economic environment with greater emphasis on trade liberalization and competitiveness as well as the formulation and expansion of regional economic groupings. A number of factors were taken into account in formulating policies for the new tariff structures:

- differences in the levels of development of member states;
- differences in their industrial structures;
- their respective exchange rate regimes; the nature of their fiscal regimes; their respective administrative capabilities.

These factors determined the principles guiding the design of the new tariffs:

1. international competitiveness;
2. efficient production for the regional market;
3. the preservation of government revenues;
4. controlling inflation so as not to increase the price of basic foods and social services;
5. duty exemptions regime should be reduced/removed so as to foster uniform treatment of production inputs across the common market;

6. there should be uniform rates for the same items notwithstanding their economic use;
7. the special needs of the LDCs should be taken into account;
8. the tariff structure should be simplified with fewer rate bands with less room for discriminatory application.

The phasing of implementation of the new common external tariff for the OECS was as follows:

January – June, 1993	0 – 5% to 30/35%
January – June, 1995	0 – 5% to 25/30%
January – June, 1997	0 – 5% to 20/25%
January – June, 1998	0 – 5% to 20%

Dominica is now at Phase III of the CET implementation programme. The new CET was implemented in 1993 with a revenue loss of $3.6 million which was more than compensated for by a 5.0% increase in consumption tax. The second phase was implemented in 1995 with a marginal loss of import duties and without compensatory measures. There was, however, an overall gain in taxes on international trade and transactions as the value of non-CARICOM imports grew at a faster rate (21.9%) than CARICOM imports, including petroleum imports, (11.8%) between 1994 and 1995. No significant loss of revenue was experienced in 1998 when the third phase was implemented. Dominica has requested assistance to undertake a study to assess the trade and revenue implication of implementing Phase IV of the programme.

Meanwhile Dominica has taken steps to eliminate trade licenses by introducing a process of tariffication of Article 56 items at rates ranging from 150% to 200%. It has been reported that revenue from these items has fallen substantially. The trade and revenue implications of this measure are still being examined.

TRADE AND REVENUE EFFECTS OF CET

The Common External Tariff (CET) represents an attempt by CARICOM countries to promote industrialization in the region and to harmonize their trade policies as a first step in meeting the challenges of global competition and trade liberalization. The CET proposes that all CARICOM members should apply common tariffs on imports from non-CARICOM countries. Starting in 1993, the CET was to be implemented in four phases.

By the end of the last phase, which was adopted for implementation by 1998, all CARICOM countries should have the following CET rates (on non-CARICOM imports) in place: (1) a 0-5% import tariff on non-competing, primary, intermediate, and capital inputs; (2) a 10% tariff on competing primary inputs and capital goods; (3) a 15% tariff on competing intermediate inputs; (4) a 20% tariff on non-competing final goods; and (5) a 20% tariff on garments, general manufactures and agro-industry commodities. For most CARICOM countries to meet the requirements of the CET, they would need to decrease import tariffs on some items and increase it on others. Declines in imports arising from tariff rate increases may suggest the extent to which CARICOM production is being substituted for non-CARICOM imports. On the other hand, tariff rate decreases imply loss of tariff revenues that member countries may need to make up for by increasing non-CET import taxes.

This study analyses the effect of changes in CET rates on OECS tariff revenues, and non-CARICOM agricultural imports. OECS imports were grouped in accordance with seven CET rate brackets: 0%, 0-5%, 5-10%, 10-20%, 20-30%, 30-45%, and >45%. The Analysis will help OECS policy planners to anticipate, in the presence of CET rate changes, the extent to which CARICOM production would substitute for non-CARICOM imports, and the amount by which non-CET import taxes would have to rise to keep net import tax revenues unchanged. To conduct the analysis, the study employed a simulation exercise in which the CET rate on non-CARICOM agricultural imports was increased by 5, 10 and 15%. Next, CET rates were adjusted to ensure that commodities in each rate group faced a CET rate of 100%.

For the purposes of this exercise, the CET rate increases and adjustments were applied only to commodities that fell within the CET rate brackets of >20% (20-30%, 30-45%, > 45%). The study assumes that non-CARICOM imports entering the OECS face symmetric unitary import demand elasticities. The elasticities are symmetric in that a given percentage increase or decrease in CET rates (or in import prices) would produce the same magnitude of change.

In 1997, OECS (excluding Antigua) imports of agricultural commodities from non-CARICOM countries amounted to $232.62 million. About 54% of these imports faced no import tariffs, 21.4% faced import tariffs of 5% or less, 4.9% faced rates ranging between 5 and 10%, 4.2% faced rates between 10 and 20%, and another 15% faced tariff rates in excess of 20%. Over $15 million in CET revenues were collected, representing 41% of all import taxes. Commodities falling in the >20% rate groups accounted for a disproportionate 80% of the CET revenues**.**

The simulation results suggest that the CET rate increases on commodities in the >20% rate groups would cause imports to fall, CET tariff revenues to rise, and the resulting decline in imports would cause non-CET import tax revenues to decline. However, increases in CET revenues would more than offset non-CET revenue losses. For example, a 10% increase in the CET rate would cause OECS imports to fall by 1.2%, CET revenues to rise by 15.3%, or $2.40 million, and net import tax revenues to rise by 6%, or $2.25 million**.**

Dominica's 1997 import of non-CARICOM agricultural commodities totaled $38.4 million, a rise of 9.2% from the previous year. Most of these imports (87.5%) were subjected to CET rates of under 5%, implying that a large share of the goods was of CARICOM origin or were accorded special treatment. Despite the increases in imports, tariff revenues declined by 37%, from $1.72 million to $1.08 million. The share of imports falling in the >20% tariff brackets decreased from 11.9% in 1996 to 7.5% in 1997. This shift in imports was largely responsible for the observed decline in tariff revenues. CET revenues accounted for 29.6% of all import tax revenues. However, declining CET revenues along with declines in custom service tax revenues caused total import tax revenues to decrease by 39% to $3.6 million.

A 5 to 15% increase in CET rates among the >20% CET rate groups would cause imports to decrease by less than 1.5% in both 1996 and 1997. However, because of the shift of imports away from the >20% rate groups, the decline in imports in 1997 was less pronounced than in 1996. For instance, while in 1996 imports declined by 1.4% as a result of the 15% rate increase, imports in 1997 declined by only 0.89%.

The effect on imports of imposing CET rates of 100% was much more pronounced than in the other three simulated rate changes. Imports fell by 6.8% in 1996 and 4.4% in 1997. As to be expected, the simulated rate increases caused average tariff rates to rise. Considering the 20-30% rate group, a 5% rate increase would cause the average tax rate to rise from 23.6% to 27.5%, while a 10 and 15% rate increase would cause average rates to increase to 31 and 34%, respectively.

Although the rate increases would cause non-CET import tax revenues to fall, the resultant increases in CET revenues would be such that there would be a net increase in import tax collections. The 1997 simulation results suggest that import tax revenue increases would range from 2.95% or $107 thousand in the case of the 5% rate increase to 7.8% or $282 thousand when the 15% rate increase was imposed. These revenue increases for 1997 were more pronounced than those for 1996. Among the simulated rate increases, the 100% tariff imposition produced the greatest effect (an increase of 40%) on CET revenues. For all simulations, the 20-30% rate group, followed by the 30-45 had the leading share of tariff revenues. Figures 1.a and 1.b confirm that the 20-30% rate group had the largest share of imports and tariff revenues, while the 100% tax imposition produced the greatest effect on these variables.

TRADE LIBERALIZATION NEGOTIATIONS (FTAA & WTO)

Dominica is to conduct negotiations on trade liberalization through the Regional Negotiating Machinery established by CARICOM to represent the interests of the region at the WTO and the FTAA. Experience with adjustments towards the CET has shown that there has not been any significant impact on the revenue up to Phase III of the implementation schedule. Minor adjustment to the consumption tax has more than compensated for any direct revenue loss involved. Moreover, reductions in the tariffs have served to shift imports towards third country goods thus realizing higher revenue yields where demand elasticity has resulted in increased volumes of imports. Given the weak fiscal situation that presently obtains, the government has taken a more cautious approach to implementing the final stage and has requested assistance to assess the macroeconomic impact of the change.

Trade liberalization on a global scale takes on even greater significance as far as Dominica's fiscal situation is concerned. There are a number of factors which must be taken into account:

- the importance of import duties to Dominica's revenue (10.6% of total recurrent revenue in 1998);
- the deficiencies in the current fiscal regime that slows down responses to economic changes both internal and external;
- the market structure of the import trade and the virtual absence of effective price competition;
- possible contraction in the economy arising from negative sector response to external competition which would have an impact on revenue generating capacity.

The major reforms indicated above would serve to strengthen the fiscal regime to better withstand the shock of trade liberalisation; but these reforms must be supported by adequate technical assistance and programme support. In any event such reforms take time given the inherent weakness in the administration to reform itself and the present low absorptive capacity for both technical and financial assistance. Accelerating delivery of programme support is unlikely to hasten the process and would be counterproductive. A well-designed programme with realistic phasing would be more successful.

Any programme of reform must follow two distinct phases:

(i) A comprehensive reform of the present fiscal regime including tax and budget reform to strengthen the fiscal structure in particular tax efficiency and expenditure control.

(ii) A phased approach towards the elimination of tariffs so as to minimize disruptions to revenue flow.

In order to address the latter simulations of the effect of the reduction in tariffs were conducted using the World Bank 123 model.

SIMULATIONS OF A REDUCTION IN TRADE TAXES

This section proposes to analyse the impact on the fiscal accounts, the sequential reduction in tariff rates based on trade liberalisation. The basis of the exercise is premised on a given set savings investment balance of the economies in question. By how much would indirect taxes have to increase in order to maintain this balance. The adjustment is therefore entirely fiscal and consistent with the economic foundations of the Eastern Caribbean Central Bank Currency Union. Given the limits placed on the degree of Central Government borrowing from the monetary authorities, there is a binding constraint on governments' ability to monetise their deficits. This adjustment is further reinforced by the choice of nominal anchor whereby the exchange rate is pegged at a fixed rate to the United States dollar. Given our degree of openness the economies of the Currency Union have been heavily dependent on taxes on international trade and transactions as a major source of revenue. This degree of dependence increases the vulnerability of the economies to shocks arising from increased trade liberalisation. The likely establishment of Regional Economic Partnership Arrangements (REPAs) under the new Lomé 5 protocol and accession to the Free Trade Area of the Americas (FTAA) will alter tariff rates among the membership in these regional trading blocks.

Member countries of the Currency Union therefore must take a proactive and anticipatory stance in mitigating the costs of adjustment arising during the transitional period.

<u>The One Country, Two Sector, Three Good (123) Model</u>

This model refers to one country with two producing sectors and three goods. The sectors are the traded and non-traded goods sectors while the goods produced are the export good, a domestic good and an import good. The three agents involved in the model are a producer, a household and the rest of the world. There are a total of twenty equations and two accounting identities. Five equations describe the underlying relationships that generate real flows. Six explain price relationships. Four describe nominal flows while the remainder describe equilibrium or market clearing conditions. These market-clearing conditions state that supply must equal demand and that the balance of trade constraint must be satisfied. The model does not assume that all tradables are perfect substitutes with domestic goods. The model is static and does not yield a dynamic solution but a one period result based on the type of shock that is selected.

TRANSMISSION MECHANISM OF A REDUCTION IN TARIFFS

One of the key assumptions underlying the model is imperfect substitution between tradables and non-tradables. This assumption enables deviations from the law of one price which is standard in classical trade theory. By relaxing the assumption of perfect substitution between traded and non-traded goods the model reflects the body of empirical evidence that indicates that changes in the price of imports and exports are only partially transmitted to the prices of domestic goods. Product differentiation of both imports and exports given the level of aggregation permits an extension of the Salter Swan model and gives rise to normally shaped offer curves. All domestic goods that are not exported are effectively treated as non-tradables (semi-tradables). Another key assumption in the model is the small country assumption whereby the country is a price taker in both import and export markets.

In this model, consumers consume a composite good (Q) that is comprised of imports (M) and domestic good (D). Relatedly all income is spent on the composite good to satisfy the equilibrium condition that the value of goods demanded must equal aggregate expenditure. The desired ratio of imports to the domestic goods is a function of relative prices for a given degree of substitution. This allows for the relative demand functions to be linearly homogeneous of degree zero thus mitigating issues of “money illusion”.

When the import tariff rate is cut this changes the relative price of imports to the domestic good. Imports become cheaper and there is a real appreciation of the exchange rate. There are two effects that arise: the income effect and the substitution effect as imports become relatively more attractive. For a given propensity to import consumers maximize utility by consuming more of the import good as real income is now higher. For most developing countries such as those of the currency union the income effect is likely to dominate given low elasticities of substitution. Both exports and the domestic good will be more expensive relative to imports.

In the simulation, the constraint that the overall savings investment balance should remain the same is imposed. The simulation basically asks the question how much would sales tax/value added tax or excise tax revenues have to be raised in order to ensure revenue neutrality. The current revenue has three components related to (a) tradable sector; (b) non-tradable sector and (c) overall income. Revenue is therefore a function of the product of the import tariff rate times the real exchange rate times the value of imports plus the product of the sales/excise/value added tax rate times value of demand for the composite good plus the product of the direct tax rate times total income. Hence when the import tariff rate is cut it, the income effect results in more imports hence the quantity effect dominates the price effect for a given propensity to import in the revenue function. The second effect is traced through the sales/excise or value added tax rate as it is applied to demand for the composite good which is comprised of both imports and domestic goods. The sales or excise tax provides a compensatory mechanism that ensures that the savings investment balance is maintained for a given cut in the import tariff rate. Walras' Law ensures that the sum of the price-weighted excess demands summed over all markets must be zero.

SIMULATIONS

The simulations were based on a 25.0%, 50.0% and 100.0% reduction of import tariff rates in the face of increasing trade liberalisation. The method of adjustment assumed was internal based on a change in the tax regime. It was assumed that given the reliance on trade taxes for most revenue that indirect tax rates would have to change in order to maintain the existing savings investment balance. The indirect taxes could take the form of a sales tax or some other form of indirect tax on consumption. The baseline year chosen was 1998.

During the 1980's Dominica derived 53.1% of its current revenue from trade taxes. By the 1990's this proportion declined to an average of 49.5% each year. The degree of tax buoyancy in this economy is highly correlated with the performance of the export sector for primary commodities. During the 1980's the revenue and trade tax elasticities were generally inelastic at 0.8 and 0.9 respectively. There was an improvement in the revenue elasticity to 1.04 during the 1990's while the trade tax elasticity remained inelastic at 0.79.

Dominica Revenue and Trade Tax Elasticities

	1980-98	1980's	1990's
Revenue	0.86	0.80	1.04
Trade Tax	0.80	0.89	0.79

The question that arises is by how much will domestic indirect taxes need to be raised in order to keep the current account from deteriorating while keeping the same level of productive investment in the economy. The average tariff rate for Dominica in the baseline year was 30%. In order for the current account to stay the same and not deteriorate, the indirect tax rate would have to increase to 2.8% of GDP with a 25.0% reduction in import tariffs. At a 50.0% reduction the indirect tax rate would have to increase to 5.7% of GDP. At full liberalisation the adjustment would be considerable at 13.6% given the high degree of export concentration on a narrow rage of exports.

Dominica Simulations

Tariff Rate	**Indirect Tax Rate Per Cent GDP**
25% reduction in Import Tariff	2.8
50% reduction in Import Tariff	5.7
100% reduction in Import Tariff	13.6

Dominica Baseline Indicators

	EC$M	**1998 Baseline Per cent of GDP**
GDP Market Prices	693.6	
Consumption	548.7	79.1
Private	365.7	52.7
Public	182.9	26.4
Domestic Saving	144.9	20.9
Investment	204.0	29.4
Imports of Goods	327.6	47.2
Exports of Goods	168.4	24.3
Foreign Saving	49.3	7.1
Av. Tariff Rate /1	0.3	-
Current Revenue	209.8	30.3
Trade Taxes	94.2	13.6
Current Expenditure	222.9	32.1
Current Account Balance /2	10.5	1.5
Overall Balance	-68.9	-9.9

1/Defined as the ratio of Trade Taxes to Imports of Goods
2/ Denotes Current Account After Grants

Fig. 1.a: Dominica, Simulation Results on Imports, 1997

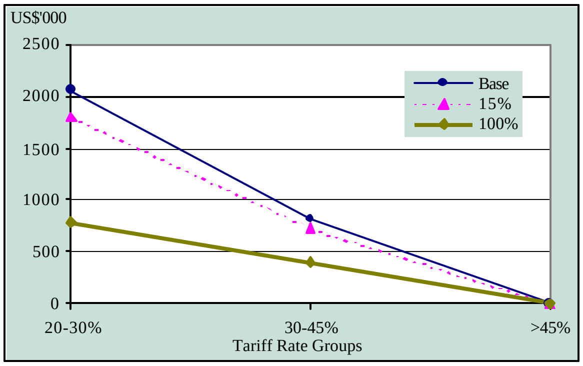
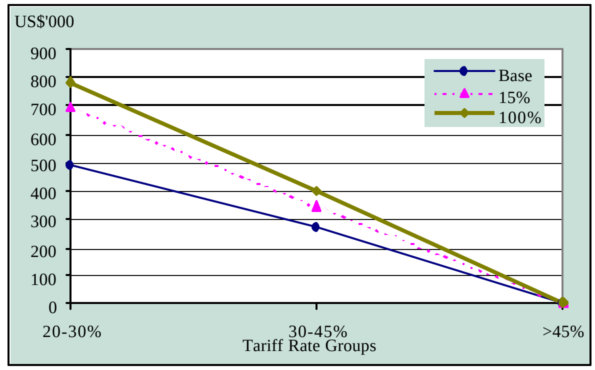


Fig. 1.b: Dominica, Simulation Results-Tariff Revenue, 1997



LIBERALIZATION OF TRADE IN SERVICES

Dominica's international obligations for the liberalisation of trade in services are related to its commitments under the GATS and Protocol II amending the CARICOM treaty. The commitments under Protocol II represent advancement on the GATS hence this section begins with a discussion of the GATS

COMMITMENTS UNDER GATS AND TRADING ARRANGEMENTS

The general objective of the GATS is to develop as set of rules that would foster increased transparency, consistency, certainty and non-discriminatory norms and regulations in the governance of trade in services. The services not covered by the agreement pertain to transportation and airline services. With regards to modes of supply four specific mechanisms apply as follows:

(1) cross border supply;
(2) consumption abroad;
(3) commercial presence; and
(4) presence of natural persons.

The Most Favoured Nation (MFN) principle under the GATS dictates that trading partners whether with the Free Trade Area of the Americas (FTAA) or the Regional Economic Partnership Agreements (REPA) of the EU, albeit temporary exemptions may be allowed for transitional purposes. The principle of National Treatment dictates that once a foreign entity supplies a service to WTO member country then there should be no discrimination between this entity and a local one.

The Commonwealth of Dominica has made commitments under GATS for the following services:

(1) Communication services;
(2) Financial services, specifically reinsurance services;
(3) Tourism and tourism related services; and
(4) Recreational, cultural and sporting services; and

.

In the above five areas limitations to market access pertain to horizontal commitments are specific to commercial presence and presence of natural persons. In the above mentioned services commercial presence requires that foreign entities incorporate or establish companies locally in accordance with the laws of Dominica. Some of the stipulations under the law include withholding tax provisions under the Income Tax Act and aliens landholding. Dominica also reserves a number of small business service opportunities for nationals. Specifically, foreign entities wishing to invest in hotel development are limited to the development of hotels in excess of fifty rooms. With regards the presence of natural persons, immigration laws and work permit regulations apply. Some professionals may also be required to register with the relevant professional or government body.

COMMUNICATION SERVICES

The only commitment made under communication services pertains to courier services of which there are no limitations to market access with respect to cross border supply and consumption abroad. However, with respect to commercial presence and the presence of natural persons market access is subject to alien landholding and immigration regulations respectively. With regards to national treatment there is only limitation specific to commercial presence which is subject to withholding tax.

FINANCIAL SERVICES

As in the case of communication services there are no limitations to market access and national treatment pertaining to cross-border supply and consumption abroad. Provisions under the Insurance Act and withholding tax under the Incomes Tax Act apply to commercial presence. The presence of natural persons is also subject to work permits and immigration regulations.

TOURISM AND TRAVEL RELATED SERVICES

Unlike Antigua and Barbuda hotel development in Dominica is unbound with regards cross border supply. While consumption abroad is not subject to any limitation on market access, FDI investments in hotel plant must be in excess of fifty rooms. This sector is also subject to withholding tax with regards national treatment. Work permit and other immigration regulations apply to managerial and specialist positions.

CONCLUSION

The economic performance of Dominica was characterised by high growth rates during the 1980s but these fell precipitously during the 1990s as the effects of liberalisation of the international markets for bananas - Dominica's main export - resulted in a decline in the production of that commodity. The fall in growth rates affected the level of employment and the fiscal performance of the country.

The adjustment to a more liberalised international economic environment poses several challenges for Dominica. One of the major challenges for the Dominican economy is to diversify from its traditional reliance on primary agricultural exports. While diversification around bananas is a priority ways have to be found to expand the role of tourism. Air access to the destination remains a limiting constraint. Recent efforts to develop and construct an international airport while laudable have serious debt service implications given the narrow export base and the degree of vulnerability. The mountainous topology of the territory will increase the costs of airport development given the limited availability of suitable areas. Reliance on cruise ship based tourism must be place in the context of desirable thresholds in the number of visitors. As the penetration ratio and density of cruise ship passengers increase this will eventually conflict with the marketing and promotion of the destination primarily eco-tourism product.

The competitiveness studies for agriculture suggest that Dominica was export competitive in a large range of fruits and vegetables including tannia, yams, plantains, taro, bananas, citrus fruits, coconut, avocados, cinnamon, mangoes, ginger, pumpkins, and cocoa beans. Tannia was the most competitive. Yams followed by plantains, taro and bananas were next in line.

Dominica has a thriving manufacturing sector that has developed with the aid of high levels of protection. The agro-processing sector has strong linkages with the agricultural sector and has the potential to be competitive in selected niche markets but the survival of some firms in the sector may be doubtful without the protective arrangements. In this regard the authorities may need to allow the least efficient firms to exit the sector in an orderly manner while providing support to those firms that have the potential to be export competitive. A package of assistance would need to be provided to these firms and may include, finance and technical assistance in product development, factory layout, marketing etc. Given the tight budgetary constraints facing the country and the expected loss of revenue from trade liberalization it may be necessary to access the required resources from external sources.

There are no major areas of inconsistency with WTO standards in Dominica's tax structure. One exception could be an alien's land license fee required for non-nationals involved in land transactions. There is some concern about the social effects of deregulation in this area, especially given the critical need for basic shelter among lower income groups, the scarcity of residential land and the price/demand spiral that could result from immediate liberalization. A phased approach to deregulation over a reasonable transition period is indicated.

Dependence on international trade taxes is high. Given the inherent inefficiencies in the tax system, the low buoyancy ratio of tax revenues and weaknesses in tax administration, major reforms will be required before further liberalization takes place, not only to recoup potential revenue losses; but also to improve the responsiveness of the economy to changes in the external environment and to improve the incentive framework for investment.

There is urgent need to improve the efficiency of resource allocation towards spending both in the recurrent and capital budgets so as to reduce budget deficits and borrowing requirements. Considerable adjustments will have to be made to the fiscal system; and strong measures will be needed to rationalize and strengthen administration to improve responses to changes to the domestic economy and the external environment and to improve the savings level on a sustainable basis.

The major reforms indicated should strengthen the fiscal regime to respond positively to further steps towards trade liberalization. Such reforms will require considerable international support and should be effectively done over a period of transition given the inherent weaknesses in the administration. Accelerating the delivery of programme support would be counter-productive in a situation of low absorptive capacity.

The study suggests that the market for services in Dominica is already characterized by significant liberalization further liberalization would benefit the country more than it would lose. Thus a negotiating strategy would move to further liberalize the services sector in exchange for concessions in agriculture. The study could not identify a case for the Dominica as part of the OECS grouping to pursue a negotiating strategy that was different from the rest of CARICOM except in so far as the sequencing of adjustment measures and the transition period for liberalization are concerned. Action to be taken and the transition period required are indicated in the Section on the Way Forward in the Overview.

Table 7: Dominica Tourism Statistics

	Mean 1986-90	**Mean 1990-94**	**Mean 1995-98**
Stopovers	29,650	49,363	63,669
Cruise ship Passengers	9,968	74,992	200,897
Stay-over growth (%)	12.05	11.95	3.78
Cruise ship Passenger growth	8.72	186.02	19.03
Total Visitor Growth	10.26	39.64	14.69
Visitor Expenditure $EC m	33.53	70.40	100.23
Visitor Expenditure Growth	15.78	15.92	4.28
Service Penetration Index /1	0.41	0.59	1.24
USA Market Share	17.18	15.30	20.78
UK Market Share	11.85	9.44	8.05
Caribbean Market Share	42.76	46.12	44.86
Canadian Market Share	6.79	3.68	2.91

1/ Defined as the ratio of service exports to merchandise exports

Table 8: Dominica Terms of Trade Indices

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Exports Unit Value	97.3	97.4	105.7	100	108.9	111.9	112.5	103.6	115	116.2	112.4	111.7
Imports Unit Value	75.6	88.6	98.1	100	98.4	101.1	106.1	103.9	109.3	117.8	118.8	117.8
Merchandise Terms of Trade	1.29	1.10	1.08	1.00	1.11	1.11	1.06	1.00	1.05	0.99	0.95	0.95
						(Annual Percentage Change)						
Exports Unit Value	12.8	0.1	8.5	-5.4	8.9	2.8	0.5	-7.9	11.0	1.0	-3.3	-0.6
Imports Unit Value	2.1	17.2	10.7	1.9	-1.6	2.7	4.9	-2.1	5.2	7.8	0.8	-0.8
Merchandise Terms of Trade	10.5	-14.6	-2.0	-7.2	10.7	0.0	-4.2	-6.0	5.5	-6.2	-4.1	0.2

Table 9: Contribution of Major Economic Sectors

	Mean 1986-89	Mean 1990-94	Mean 1995-98
Tourism			
Contribution	1.47	2.45	2.66
Growth	10.60	16.20	0.41
Construction			
Contribution	6.01	7.63	8.31
Growth	8.30	6.32	1.52
Communications			
Contribution	5.64	7.61	9.74
Growth	18.24	7.14	8.86
Transportation			
Contribution	8.99	9.61	10.01
Growth	6.72	4.63	2.81
Banks			
Contribution	10.57	12.15	12.32
Growth	5.78	5.26	1.98

Table 10: Dominica Foreign Direct Investment Profile

	Mean 1986-89	Mean 1990-94	Mean 1995-98
FDI as % of GDP	8.89	8.8	11.4
FDI as % of ECCB Inflows	31.35	18.92	11.98
Equity Share of FDI	28.67	32.35	41.32
Land Sales Share of FDI	45.41	34.22	36.85
Reinvested Earnings Share of FDI	10.55	20.04	45.79
Other Investment Share of FDI	15.57	13.39	8.72

Table 11: Dominica Savings Investment Profile

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Source of Funds	67.6	79.3	120.6	170.7	183.2	148.6	150.4	155.6	156.8	195.8	189.3	207.4	174.6
Gross National Savings	50.1	63.0	79.3	50.7	69.0	61.3	84.4	83.1	53.2	72.6	81.5	116.8	125.3
Gross Domestic Savings	49.7	51.7	65.7	41.2	66.5	62.2	84.0	77.5	63.5	87.4	104.8	133.7	144.9
Public Sector	19.2	27.4	31.4	28.5	17.9	14.5	17.2	7.1	8.6	17.8	18.3	15.4	19.6
Private Sector	30.5	24.3	34.3	12.7	48.6	47.7	66.8	70.4	54.9	69.6	86.5	118.3	125.3
Foreign Savings	17.5	16.3	41.3	120.0	114.2	87.3	66.0	72.5	103.6	123.1	107.8	90.6	49.3
Use of Funds													
Domestic Investment	67.6	79.3	120.6	170.7	183.2	148.6	150.4	155.6	156.8	195.8	189.3	207.4	174.6
Public Sector	40.7	38.5	48.6	68.3	82.7	66.1	37.8	31.5	51.2	72.0	71.7	60.2	60.2
Private Sector	26.9	40.8	72.0	102.4	100.5	82.5	112.6	124.1	105.6	123.8	117.6	147.2	114.4
(In% GDP Market Prices)													
Source of Funds	22.3	23.2	31.1	41.2	40.8	30.5	29.0	28.8	27.0	32.6	29.7	31.4	25.2
Gross National Savings	16.5	18.5	20.4	12.2	15.4	12.6	16.3	15.4	9.1	12.1	12.8	17.7	18.1
Gross Domestic Savings	16.4	15.1	16.9	10.0	14.8	12.8	16.2	14.3	10.9	14.5	16.4	20.3	20.9
Public Sector	6.3	8.0	8.1	6.9	4.0	3.0	3.3	1.3	1.5	3.0	2.9	2.3	2.8
Private Sector	10.1	7.1	8.8	3.1	10.8	9.8	12.9	13.0	9.4	11.6	13.6	17.9	18.1
Foreign Savings	5.8	4.8	10.6	29.0	25.4	17.9	12.7	13.4	17.8	20.5	16.9	13.7	7.1
Use of Funds													
Domestic Investment	22.3	23.2	31.1	41.2	40.8	30.5	29.0	28.8	27.0	32.6	29.7	31.4	25.2
Public Sector	13.5	11.3	12.5	16.5	18.4	13.6	7.3	5.8	8.8	12.0	11.2	9.1	8.7
Private Sector	8.9	12.0	18.5	24.7	22.4	16.9	21.7	22.9	18.2	20.6	18.4	22.3	16.5

Table 12: Dominica Monetary Survey

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Net Foreign Assets	25.71	81.13	99.17	67.92	45.64	47.12	65.47	35.75	6.94	43.47	71.93	64.68	91.14
Central Bank (net)	23.20	45.05	35.93	30.37	38.20	47.91	63.23	53.67	41.67	60.50	62.60	64.47	74.66
Commercial Banks (net)	2.51	36.08	63.24	37.55	7.44	(0.79)	2.24	(17.92)	(34.73)	(17.04)	9.33	0.21	16.48
External (net)	(3.88)	24.71	40.13	33.31	3.30	(3.32)	(0.93)	(9.27)	(16.37)	(13.59)	8.85	9.86	30.79
Other ECCB Territories (net)	6.39	11.38	23.11	4.24	4.14	2.53	3.17	(8.65)	(18.36)	(3.44)	0.48	(9.66)	(14.31)
Net Domestic Assets	87.81	60.50	62.79	116.82	176.21	216.41	231.79	246.19	286.36	317.54	296.17	316.27	333.19
Domestic Credit	100.80	74.63	88.23	149.28	221.60	268.74	287.00	304.97	332.49	360.99	345.71	370.56	401.94
Cent. Govt. (net)	43.09	23.89	(1.73)	6.13	36.41	49.58	48.43	49.46	58.60	65.36	70.89	74.50	51.55
Other Public Sector (net)	(22.12)	(32.87)	(26.06)	(14.79)	(1.02)	4.50	(5.34)	(3.02)	(8.20)	(17.34)	(29.69)	(26.99)	(14.26)
Non-Bank (net)	(6.32)	(9.99)	(12.70)	(13.55)	(24.93)	(19.77)	(20.08)	(31.04)	(31.33)	(31.70)	(48.07)	(60.27)	(43.45)
Subsidiaries (net)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.93	0.03	(5.90)	(3.02)	(1.88)
Private Sector	86.16	93.59	128.73	171.49	211.13	234.43	263.99	289.57	312.48	344.63	358.48	386.35	409.97
Other Items (net)	(12.99)	(14.13)	(25.44)	(32.46)	(45.39)	(52.33)	(55.21)	(58.78)	(46.14)	(43.45)	(49.54)	(54.30)	(68.75)
Money Supply (M2)	113.52	141.63	161.96	184.73	221.85	263.53	297.26	281.94	293.30	361.01	368.10	380.95	424.32
Currency	6.64	20.77	22.83	20.69	24.96	30.76	31.13	27.86	24.49	29.16	28.53	28.21	29.13
Demand Deposits	22.87	24.93	27.65	25.06	33.23	28.94	40.56	36.71	37.80	43.71	42.90	46.49	56.32
Savings Deposits	46.97	61.64	77.63	92.92	107.29	122.98	136.74	140.96	153.99	177.92	193.86	202.48	208.57
Time Deposits	33.41	32.19	33.32	45.70	55.98	73.78	78.47	67.42	70.19	105.36	99.05	96.49	120.21
Foreign Currency Deposits	3.64	2.10	0.54	0.37	0.38	7.07	10.36	8.98	6.83	4.85	3.76	7.28	10.10