



EVOLUTION OF THE STABILIZATION PROCESS
AND THE EXTERNAL DEBT

By

HUGO GUILIANI CURY

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It is a tradition in our country, strengthened by the years, that the Governor of the Central Bank of the Dominican Republic present during the month of March, at the American Chamber of Commerce, a report of the evolution of the economy during the recently past year, as well as its perspectives for the immediate future. This year, it was not possible. The difficulties encountered by a Governor at present, are numerous and various. That circumstance and the fact that insofar as my administration goes, I have had to be an itinerant Governor, have prevented my appearance before this Chamber during the month of March and, subsequently, forced me to postpone it once again. I beg the Directors and friends of this Chamber to forgive me for it.

Having to come to this important forum obliges me to sit down and write a speech, and that is convenient because it allows me to share with you and the Dominican people, certain thoughts on what is happening in our country. It also gives me the opportunity to deal with a crucial subject for the country's immediate future, such as the external debt.

For the sake of keeping with the mentioned tradition that the Governor of the Central Bank presents a summary of the results of the past year's economy, I will immediately proceed to enumerate briefly the most significant figures of the economic course of events of the year 1984.

1. RECENT EVOLUTION OF THE DOMINICAN ECONOMY

The behaviour of the Dominican economy in 1984 was a reflection of the serious situation being experienced by the developing countries since 1980, particularly, those in Latin America. Nevertheless, the economic activity, ^{as} measured ~~against~~ ^{by} the real Gross National Product registered a growth of 0.6%, which was lower than in 1983.

An analysis of the sectorial component reveals that mainly responsible for this behaviour were the Mining sector which grew 8.4%; the Government 3.3%; Electricity 12.5%; and Construction 2.8%. On the hand, Industry decreased by 3.9%, and Agriculture by 0.2%, the latter influenced by the dramatic 20% fall of sugar cane. Excluding this product, the agricultural and livestock sector revealed a growth of more than 3.0%.

The level of annual inflation, measured by the consumer prices index, was 24.0%, raking highest the increase on the price of petroleum derived products, the application of the transfer on industrialized goods tax (ITBI) and the ad-valorem tax.

The average money supply increased by almost 30% and currency in circulation by 13.4%. the attraction of funds by financial entities showed the following increase: commercial banks, 12.9%; development banks, 37.6%; mortgage banks, 28.3%; savings and loan associations, 15.1%; and private developement banks, 18.0%. Regarding the loan portfolio of these firms, the commercial banks increased it ^{by} 9.1%; mortgage banks, 21.2%; savings and loan associations,

10.7%; development banks, 16.3%; and private development banks, 15.1%.

With reference to the external sector, the deficit of the commercial balance ^{was} reduced by 23.0% responding to an increase in exports, particularly non-traditional ones- as well as to a decrease in imports, with the exception of petroleum. As a consequence, the exchange balance of the Central Bank had a \$74 million surplus, which resulted in an improvement of our gross reserves.

2. THE ORIGIN OF OUR PRESENT PROBLEMS

I don't think it is necessary to explain on this occasion, the origin of our present problems, nor to refer to the stabilization program with the IMF for 1985, because my intervention last week at the Association of Commercial Banks fully covered those subjects. It would be proper to recall and briefly repeat that the negative effects of an external nature which our economy received during the decade of the '70s, among them the deterioration of ^{terms of} ~~exchange~~ ^{trade,} trade terms, the rise on petroleum prices, rise of inflation, establishment of sugar quotas, fall of the price of sugar and the rise of interest rates prevailing in the international market, should have conducted us during that decade to the adoption of internal adjustment measures to protect us from those external adverse effects. But, that did not happen. We defended, to an irrational point, the fiction that a peso was worth a dollar in order to continue importing, giving a dollar for a peso. We thereby ^{stimulated} ~~incentivated~~ imports, capital flight, and penalized export activities upon paying them with a peso that was not worth a

dollar. We went on creating enormous deficits in our balance of payments and continued depleting our monetary reserves, which through the years we converted from positive into negative. In order to maintain that monetary fiction, we happily indebted ourselves abroad and used those dollars as support of the balance of payments; we monetized the pesos generated by the dollars and used them in expenses and non-priority projects. But, still, not satisfied with those actions, we went on printing large quantities of "inorgánicos" or pesos without backing, so as to maintain the growth of the economy through public expenditure. The unsustainability of this policy became evident when the international financial community pointed out that from 1982 on, it was not willing to keep on financing nor giving ~~trade~~ commercial credit to an economy whose balance of payments position was unsustainable. when no one no longer granted us credit abroad, we began to realize that we had big problems.

This was the sad panorama inherited by the present Administration: and economy which needed to undergo great economic readjustments and a totally new orientation. Sometimes people complain about the measures that needed to be taken as if they did not want to understand that it was impossible to postpone it any further and that there was no other alternative. Any other arrangement, without the collaboration of the international financial community, would have been more severe. This country still has enormous possibilities if we can admit the present need of austerity, hand work, and confidence in the country in which we were born. I shall adapt to the Dominican case, a joke that originally referred to Mexico,

which tell of a Dominican dog that met a Cuban dog, a Russian dog, and an American dog. The Dominican dog complained that he had to bark a lot before the maid of the house brought him his meat. "What is meat?" asked the Cuban dog. "What does barking mean?", asked the Russian dog. "What is a maid"?, asked the American dog. This joke, more than a profound and complicated analysis, will probably explain best the situation of our country with regards to others.

Being, as we are, a developing country, we cannot simply pretend to have the best of two worlds, that is, enjoy a good democracy with ample political liberty and, at the same time, enjoy the facilities and advantages offered by fully developed countries, without making a sacrifice which, sometimes, can be painful.

We must understand that the measures taken are necessary and realistic, that an adjustment process was needed to correct the external and internal imbalance and create the basis for the way to development objectives. We acknowledge the cost implied in the adjustment, but this process is in itself a transition from an unsustainable balance of payments to a feasible and affordable situation and that is a requirement of economic growth. In that order, one of the crucial mechanisms for reducing the constraint imposed upon us by the balance of payments is to negotiate our foreign debt with international banks and the bilateral debt with the Paris Club. However, before being able to renegotiate those debts, an agreement with the IMF was necessary for which the adoption of certain adjustment measures was indispensable.

3. EXTERNAL DEBT

3.1 Organizational Aspects

One of the problems that I found upon arriving last April at the ministry of Finance and, subsequently, at the Central Bank, was related to the existing organization and management of the Dominican external debt. The gathering, processing and presentation of the debt data was slow and deficient.

Debt computation was still done manually, thereby hindering policy makers from having adequate and reliable information on time. To correct this, I requested and obtained technical assistance from the World Bank, who responded immediately to my requirements by sending a technical mission.

We also proceeded to coordinate the work on foreign public debt being carried out by the Ministry of Finance, the Central Bank and the Technical Secretariat of the Presidency. Subsequently, and already in the Central Bank, we went on to create the External Debt Department which would consolidate all scattered efforts in the public sector and train a number of persons who, in the future, would be able to fully serve the country in such a delicate and important area.

Today, I feel a legitimate satisfaction when I say that we have been able to improve the preparation and basis of data by having part of our operations computerized. Moreover, policymakers today can dispose of exact and up-dated figures on the debt and its service. Also, the debt projections are made, taking into

consideration the disbursement program of the contracted but pending debt.

The above, together with the balance of payments projections that have been made, permits us to take a closer and more accurate look at the balance of payments situation for the next five years. At this time, and for purposes of the external debt negotiations in process, the most advanced techniques have been used, among them, computerizing the debt service, using systems such as "carving out" and "picking up" techniques, with scenarios under different pluriannual restructuration premises, such as interest rates, grace periods and total maturity. This has made vital information available to us in order to be efficient at the negotiating table with the international bankers.

3.2 AMOUNT AND STRUCTURE OF THE EXTERNAL DEBT

Our external debt to December 31, 1984, was approximately US\$3.4 billion and its composition can be easily appreciated in the following figures:

<u>TYPE OF LENDER</u>	<u>AMOUNT OWED IN MILLIONS OF US\$</u>	<u>% OF TOTAL</u>
Multilateral	722.0	20.9
Bilateral	1,216.9	35.3
Commercial Banks	852.1	24.7
Suppliers	105.8	3.1
Central Bank Short Term Liabilities	265.4	7.7
Prepayments on Exports	57.5	1.7
Other Obligations (Letter of Credit and Arrears)	227.2	6.6
TOTAL	<u>3,446.9</u> =====	<u>100.0%</u> =====

The main categories of creditors that make up this voluminous figure are bilateral institutions, that is, the official entities of other countries with 35% of the total, private international banks with approximately 25%, multilateral institutions with 21%, and the Central Bank's liabilities and other obligations with 14% of the total debt.

The structure of the debt, according to the terms of contract, shows that 43% of it has been contracted at eight years term and 39% at terms between one and eight years. This means the pressure of the external sector at present comes not only from the amount of the debt in relation to our exports and the level of our dependency on imported petroleum products, but also from the actual structure of the external debt, that is, the payment profile.

In order to prove this affirmation, it is merely necessary to point out that if in 1985, ~~it~~ payment would have been made on the debt service on the 3.4 billion owed without restructuring the debt, the country should have spent 1.5 billion dollars during the present year in payment of ~~capital~~ ^{principal} and interest, including arrears.

This means that payment of the debt service alone would require an amount bigger than that produced by all exports ^{of goods} and services of the country projected for the current year.

Ladies and gentlemen, from the above said, one can conclude that,

under these conditions, it is impossible to fulfill satisfactorily the country's obligations with the rest of the world.

This administration has firm intention of solving this critical problem. To that end, it has undertaken the renegotiation of the external debt in an effort to achieve a profile in its service which will bear relation with our future payment capacity but which, in addition, would permit us to comply with the growth and economic and social development objectives towards which our people justly aspire.

3.3 NEGOTIATION STRATEGY

The Dominican Republic has demanded of its creditors a treatment at least as favorable as that of any nation which has achieved the best conditions in the restructuration of its debt. This is so even though we recognize that our country cannot have the same importance to the creditors as other countries such as Mexico, Brazil, Argentina and Venezuela, because of the size of their debts and the implications brought forth to the Banks and the entire international community with the possibility of their financial collapse.

In spite of this, the international banking community has acknowledged that it is necessary for the countries that have undertaken a serious financial stabilization of their economies to have a relief in the burden of their external debt during a reasonable period of time in order to return to their "credit-worthy" condition. This was evident at the last quarter of the previous year when several of

the major countries of Latin America were able to negotiate their external debt at better conditions. Nevertheless, it is important to point out that the fact of having first Mexico and Venezuela renegotiate their debts, took some of the pressure off the international financing community at solving the external indebtedness crisis.

In the Dominican case, the service of the external debt, including for the coming years the ~~debt disbursement~~ ^{service of debt} program already contracted and not ~~year~~ ^{yet} disbursed or restructured, shall amount to almost 4 billion dollars during the 1985-1990 period, of which, 78% represents amortization and 22% interest payments. In any case, the debt service will be so high during the 1985-1990 period, that it will use 75.0% of the total of exports.

On the other hand, the balance of payments projected for the 1985-1990 period presents a gap amounting to 714.0 million dollars. Based on these records, we have formulated over 30 different scenarios that reveal the debt service and the balance of payments deficit, assuming different terms, grace periods, margins on LIBOR, and consolidation periods which, under different calculation techniques, using the lifting or picking up system, show different results in reference to the structure which the debt service would have during the above mentioned period.

The country has set forth the renegotiation process with the commercial banks on the basis of restructuring the payments of ~~capital~~ ^{Principal} in arrears, from December 31, 1984, as well as those that will

mature during the 1985-1989 period.

The first position of the Dominican negotiating team is that our renegotiation program should be structured under the system known as "pluriannual", Mexico was the first country to use it and obtained a 3 year period of consolidation. We are trying to consolidate five years.

It would be of great advantage to the use of ^apluriannual concept instead of the previous annual system under which the 1983 renegotiation was carried through, since it only involved the matured capital and the one to mature in one year's term. That is also true because, upon consolidating the maturities of ^{principal} capital for five years (1985-1989), a restructuring of 821.0 million will be carried out with the commercial banks, which represents 96.3% of the existing debt with these institutions. This will permit us to place those future maturities under new conditions regarding total terms, interest rates and grace periods. In our case, if we obtain a long period of consolidation, that is 1985-1989, we would be not only structurally modifying the debt, but also avoiding the uncertainty which is generated when restructuring has to be accomplished every year.

Equally important is the position of obtaining an amortization period of over ten years, an adequate grace period, lower interest rates and eliminating the option that the banks presently have of calculating the interest rate on the basis of the prime rate.

It is significant to point out that we are endeavouring to delete the payment of commissions that encumbered the previous restructuration whereby we would save a considerable amount of foreign exchange for the country. We have also requested an amount of new resources which will permit us to reduce the balance of payments gap to manageable levels.

In relation to our bilateral debt which is to be renegotiated at the Paris Club and which has been primarily contracted with the governments of the United States and Spain, we are glad to announce that it shall be done on May 20th. the sum of the debt which we will renegotiate at the Paris Club amounts to a little less than 300.00 million dollars. The restructuration of the debt at the Paris Club is done in a different way than with commercial banks. At the Paris Club, it is customary to negotiate ~~capital~~ ^{principal} and overdue interest together with maturities which shall occur during the period during which the agreement with the IMF is in effect. It should be pointed out that, recently, there was a variation to that practice with one Latin-American country.

Please understand that, due to negotiation strategies, it is not yet possible for me to reveal certain data and positions because, if I do so, it could weaken the Dominican bargaining position in both negotiations. But, I can anticipate that the effect of these two renegotiations on the payment profile of the debt shall be a net substantial reduction on future expenses in foreign currency for ~~capital~~ ^{principal} amortization and interest payments. Its impact is estimated in a reduction of a little more than 500 million dollars

in payments of the debt service during the 1985-1990 period.

We have experienced a difficult process of negotiation with the banks but it has always been surrounded by an atmosphere of confidence and cooperation. My impression is that, at present, we are close to reaching an agreement with the international banks and that, in terms relative to other Latin-American countries, to the size of our economy and amount of debt, and the results presented by our balance of payments for the coming six years, we shall have a very successful renegotiation. The same should occur at the Paris Club, wherein we shall negotiate our bilateral debt on May 20th.

4. EXCHANGE MEASURES

One of the fundamental objectives intended by the authorities with the measures that are being implemented since January 23rd, is to stabilize the exchange rate in the free foreign exchange market for the purpose of placing it at a level compatible with the reality of our economy.

In this order, it is necessary for the business leadership of our country to be clearly conscious of the need of collaborating with the economic authorities of the nation in the achievement of its goals. Until we succeed in joining efforts of the private enterprise sector and the public sector in this important task, we shall be threshing a tortuous road.

It is within this frame of mind that we should analyse the policies

that the monetary authorities have been adopting. In effect, the solution recently offered by the Monetary Board to the problem of letters of credit not honored by the Central Bank as of May 10, 1984 constitutes, besides being a just solution for the affected firms, a mechanism which has acted in two favorable ways in the free foreign exchange market. On one hand, it has permitted the Central Bank to withdraw from circulation more than RD\$60.0 million which were exerting pressure on the free foreign exchange market and, on the other hand, with the acknowledgement of the letters of credit that are being honored with the Bank's foreign exchange, it has decreased the demand on the free market. Moreover, a substantial economy was achieved on the country's scarce foreign exchange since this meant a net saving of US\$20.7 million for the Central Bank.

In this same context, one can place the disposition of the Monetary Board of January 23rd., which establishes a marginal reserve equivalent to 50% of the additional net deposits taken by the commercial banks. This reserve is intended to reduce the pressures that those resources could endeavor on the rate of exchange and the level of imports. On this account, it has been possible to withdraw RD\$16.2 million from circulation.

Within this stream of ideas, it is proper to highlight the decision of the monetary authorities for the Central Bank to issue Stabilization Bonds at an amount equivalent to 5% of the money supply. These securities which yield up to 16%, constitute essential instrument for the Bank to counteract the monetary expansion

generated by the unified rate of exchange.

I take advantage of this opportunity to exhort the banking system and the insurance companies to destine part of their reserves to the acquisition of these securities because, if the desired results are not obtained through moral persuasion as we have done up to now, the monetary authorities will have to resort to measures of a compulsive nature in order to achieve this ~~objective~~^{objective} within the program. Up to date, RD\$15.0 million in securities have been placed in the market, the goal being to reduce money supply during the present year by RD\$100.0 million through this mechanism.

A similar purpose to the one I have just mentioned is that which with the statement of the Monetary Board, seeks to reduce by 10% and 5%, respectively, the amount of the lines of discount granted by the Central Bank to commercial and development banks. Up to now, through this measure we have reduce the means of payment by RD\$15.0 million. Furthermore, this disposition intends to re-establish the primary function of discount, which is a credit mechanism of last resort only designed to cover extraordinary needs of liquidity for the institutions that make up the financial sector.

I do not wish to conclude this brief synthesis of each of the demonetization controls we have designed, without pointing out that the need of strengthening the demonetization process was one of the main considerations weighted by the monetary authorities to authorize a plan which permitted exporters, who in the past had not complied with their obligations, to exchange the currency generated by their sales. Under this program, such exporter can resort to a payment

plan in pesos equivalent to the value of the surplus they obtained by not delivering the foreign exchange on the actual date of their exportations. In this perspective, I would like to exhort those managers who find themselves in this situation, to go to the Foreign Exchange Department of the Central Bank to put themselves up to date in the compliance of their obligations since they are not doing so within a reasonable period of time, will force us to apply more severe and less pleasing mechanisms.

As we have been able to appreciate, this group of policy devices affect the currency excess that, for many years, has been existing in our economy and which, in fact, has made us live precisely beyond our means. Hence, the need of being able to assimilate them as they are: a fundamental part of the adjustment process which we must necessarily impose on ourselves in order to create internal and external stability conditions.

Nevertheless, not all of the policy controls that we have been using throughout the current year have aimed at the restriction of the means of payment. As you all know, the Central Bank has placed at the disposal of the import sector the US\$50.0 million that the country received as a donation from the United States Government at the end of last year to cover the purchase made by them in the North-American market. To this, we can add the US\$45.0 million which entered the Central Bank last Tuesday, April 29, under the same concept. We appreciate this timely and substantial help which in moments like this is offered by the United States.

The Central Bank has also extended credit facilities to the import sector through Reciprocal Credit Agreements with the Central Banks of Argentina, Chile, Brazil, Colombia, Venezuela, Peru, Costa Rica, El Salvador, Mexico and Haiti. Using this mechanism whose total amount reaches 117.0 million dollars, importers may receive financing up to 120 days, which is equivalent to 50% of the value of the purchases made in those countries.

We have also established a line of credit for US\$50.0 million under the Industrial Reactivation Plan, managed by FIDE, in order that industrialists may import their inputs, using this line of credit in a revolving manner. These mechanisms are meant not only to influence the rate of exchange, but also to relieve the credit and liquidity situation of our importers and industrialists.

In an adjustment process of this nature, we must understand that we do not accomplish anything by only designing measures if, at the microeconomic level, these might later be rejected and incorrectly applied.

It is for this reason that I once again appeal to your understanding and cooperation with this task of reducing unnecessary pressures exerted on the free foreign exchange market.

I appeal to importers and industrialists ^{in order} that, instead of purchasing directly in the free foreign exchange market, they ~~would~~ analyze their needs and under a good budget program and through their respective banks, they ~~would~~ make an effort to pay for their imports

under the various procedures I have previously mentioned whose available funds, as a whole, amount to US\$235 million. I am sure that an adequate combination of these mechanisms would also help these sectors to solve part of their actual liquidity problem.

5. CONCLUSIONS

Monetary and credit instruments are merely a component of the entire economic policy of the country. In order for the stabilization program to be effective and to fulfill its objectives, it is necessary that the remaining policies, that is, fiscal, price and development policies, also comply with the objectives and goals which were drawn and strengthen and complement each other. The private sector should also adjust, innovate and respond with its dynamism to the new situation. Indispensable and I would add absolutely necessary, is the fact that the public sector and its principal autonomous entities, specifically the most significant ones, that is, CDE, CEA, INESPRES and CORDE understand that they have to adjust to the new policies should be more efficient and austere with the available resources, and also, should rationalize their investments in accordance with the limited resources, acknowledging that a country can only invest what its resources permit.

I assumed the position of Governor of the Central Bank fully aware of the fact that I was undertaking a serious ~~responsibility~~ ^{responsibility}. I was facing the most difficult external imbalance of our times. At the time, I was important to be conscious of this responsibility because, in addition to capacity and astuteness, firmness of character and a profound conviction were needed to resist all the pressures generated in a society such as ours, under a situation of this nature. During

During my administration, I have had full support from the President of the Republic, Dr. Salvador Jorge Blanco, as I have fully assumed the governorship's responsibilities in this difficult transition.

Likewise, I have acted within the reality of the present context of the Dominican society and economy as well as of its international relations, in order to carry out the adjustment and stabilization measures which have been necessary. I recognize that in a process such as this, certain strategies and policies will frequently need to be changed. However, I would like to advise that, in the future, the stabilization process and efforts which have been undertaken, must continue. If human conditions fail, if the economic policy falls in immature and unexperienced hands, if we don't rid ourselves from all types of prejudices, interests and influences, we shall lose all hopes of ever having a sound economy with possibilities of growth.

To conclude, I believe this time suitable to reiterate an exhortation which I formulated during my recent appearance at the Association of Commercial Banks of the Dominican Republic regarding the fact that today's difficult circumstances demand cooperation, effort, support and even sacrifices from all of us. All of you present here, members of the American Chamber of Commerce, should also render your contribution in the assurance that, with united efforts, we can and shall overcome the problems of the present.

Santo Domingo, D. N.
May 3, 1985

Mr. President of the Dominican Republic, Dr. Salvador Jorge Blanco,
First Lady, Asela Mera de Jorge,
Mr. President and Members of the Board of Directors of the Association
of Commercial Banks of the Dominican Republic
High Officials of the Nation,
Ladies and Gentlemen:

I am extremely pleased with the opportunity the present speech before this Association gives me to hold a frank and open dialogue with its distinguished audience, representative of the Dominican financial sector. I firmly believe that the exchange of impressions is the only possible way to transmit ideas and reasonings in support of great national decisions. And, today, more than ever, engaged in an adjustment process as we are, I deem as necessary to share with you our views on what this adjustment really means.

INTRODUCTION

The Dominican economy has had to undertake a strict stabilization program, which is being implemented by the Gobierno de Concentración Nacional for the purpose of eliminating the internal and external imbalances that have characterized our economy during the last decades. Allow me to make a fast retrospective overview on how the economy was managed during those years.

HISTORY

In 1968 the Dominican Republic opted for an industrialization strategy through ~~substituting imports for the domestic market. This strategy,~~
of increasing domestic production to substitute for imports.

However, this strategy, contrarily, led to an expansion
~~whose objective was to replace imports, resulted in an increase~~
of imports. Various factors explain this development.

In the first place, the industrialization through import substitution took place in final consumption goods. The overvaluation of the peso, the availability of credit and the tariff exemptions were factors that altogether, stimulated the use of imported raw materials in detriment of those of local origin. In addition, the overvalued peso exchange rate, upon subsidizing the import of intermediate imported goods, constituted a stimulus for their usage.

In the external sector, the prices of our exports of traditional goods were subject to drastic fluctuations in the international markets. Investment in activities aimed at the export of goods lagged, due to the incentives granted to other areas, that in fact constituted a tax to the export sector, thereby causing stagnation of the exportable production.

For a country that depends considerably on taxes to foreign trade, the growing participation of tax exemptions to different sectors of the economy and the existence of an inflexible tax structure, logically reduced the tax pressure. A paradox which I would like to point out is that Rosario Dominicana contributes with an amount equivalent to one half of the total income tax proceeding from private companies operating in this country.

The growth strategy adopted in 1968 was also based on the nominal wage freeze of the public and private sector. This implies that the

purchasing power of wage earners would deteriorate with inflation. In order to avoid that this deterioration of real salary would be reflected in political instability, the price of the principal foodstuffs was frozen. Gradually, agricultural activities became no longer profitable, their production declined and the difference between production and domestic consumption was covered with imported goods. Imports of some of these products were carried out by INESPRES with external financing. Upon using a fictitious exchange rate of one peso for one dollar, low prices could be maintained for these products. Implicitly, the consumer was being subsidized through the exchange rate, but, at the same time, the country was recurring to external indebtedness. The salary and agricultural staples price freeze, the lack of reforms in the agricultural sector in technical and financial aspects, and the concentration of investment in Santo Domingo as well as its urban attractiveness, caused deterioration in the agricultural sector as well as migration from the country to the city. In addition, the price of certain public service utilities was kept fixed, -particularly energy- and, to produce that energy, oil was imported at an exchange rate with an over-valued peso. This not only produced a growing value and volume of oil imports, but also lessened the financial capacity of the CDE. Operational deficits increased as cost increased at a faster pace than income. It was impossible to carry out the necessary capital investment in equipment and the maintenance of distribution networks. All this resulted in CDE having to be subsidized by the State.

This background leads us to a conceptual framework of present economic policy.

CONCEPTUAL FRAMEWORK OF THE PRESENT ECONOMIC POLICY

The Dominican economy, whose high rates of growth during the 1968-73 period converted the country into one of the most dynamic economies in Latin America, began to show signs of fatigue. During the 1974-75 period, the rate of growth slowed down in spite of the high prices of our basic export items prevailing for that period. As of 1976, an increasing imbalance began to be reflected both externally and internally. It is during that year that the economy suffers a deterioration in its trade terms of 34.2%. This would have been an ideal time for the Dominican economy to begin to make the necessary adjustments. That year, the IMF report on the country stated the following: "It is our understanding that any program to strengthen the balance of payments situation of the Dominican Republic on a long term basis requires fundamental changes in its exchange system, establishing a unified rate of exchange which shall be viable without having to resort to exchange restrictions."

However, the country did not adopt adjustment measures and preferred to continue living beyond its means. An expansionary monetary policy was maintained, public expenditure increased, previously positive net international reserves turned negative, the external indebtedness process accelerated, fiscal pressure diminished, imports increased, and the terms of trade worsened.

Expansionary policies enabled the country to maintain a positive rate of growth in real terms of the gross domestic product during the 1977-78 period, but the time came when there were no longer resources to continue partying with someone else's resources. The accumulation of imbalances throughout all those years culminated in 1982 with a depletion of the flow of external resources, thereby ~~compelling~~ ^{compelling} the nation to adjust its level of economic activity to its purchasing capacity in international markets.

What happened? It happened that, at the end of 1981, the international banking community informed the economic authorities that, starting in 1982, it would not make new loans to the country.

The real gross product per capita closed in 1982 with a 1.3% drop in relation to 1981. The Central Government revenues decreased to 757.0 million pesos, while expenses were 988.8 million, meaning a global deficit of 231.8 million. the current account of the balance of payments closed with a negative balance of 442.0 million dollars and the net international reserves of the Central Bank showed a negative balance of 615.0 million dollars, while the total external indebtedness closed at approximately 3.1 billion dollars.

This is the state in which the President, Dr. Salvador Jorge Blanco, found the country when he took office. It is evident that although the crisis manifested itself in an open manner during the present administration, it had been taking shape for many years. Possibly

had there been a different situation at a world level with higher prices for our main export products, and if the flow of external resources had continued, the Dominican crisis could have been delayed beyond 1986, or it could have been manifested in a different manner but, sooner or latter, in one way or another, our country was bound to impose adjustments to correct the serious imbalances that affected our economy.

It is the Gobierno de Concentración Nacional that has been faced with the difficult and ungrateful task of correcting the many imbalances of structural nature, as well as those imbalances that have their origin in economic policies applied in the past. The present administration has been the one that has taken in its hands the historic responsibility of applying the necessary measures to assure steady growth of income and employment, conscious all along of the need to diminish the impact of adjustment on the lower-income groups.

If we accept the premise that, within a short period of time, the country has to adjust the level of economic activity to its external payment capacity, it is evident that the application of these economic measures will imply economic benefits for some and losses for others. Everyone agrees that public investment should increase, but no group is willing to pay its share to the Public Treasury. Everybody suggests direct taxes, but any initiative in this sense suffers immediately from premature death, without presenting alternative taxation proposals. Others suggest a reduction in current expenditure but, when the question is asked as to the

social programs they are willing to cut, or how many public employees they are willing to dismiss, a deathly silence falls over all sectors of public opinion.

A similar case is noted with respect to the need for promoting exports or reducing the deficit of CDE and INESPRES, problems all closely related. The promotion of exports requires an exchange rate unification so that exporters will receive the true value of their earnings, but the exchange rate unification also implies that the imports of CDE and INESPRES must experience an increase in their cost and, consequently, if they do not effect price increases, they will have larger deficits.

CDE's deficit, on a short term basis, can only be partially financed in the following manners: Increasing the rates, reducing the payroll, through the taxation system or through the export surcharge. The increase of rates is unpopular because it reduces real income and increases production costs to the productive sectors. If we refer to the current expenditure of the CDE and if we assume, as does the World Bank, that the excess of personnel costs this entity RD\$11.0 million per year, the dismissal of employees would still leave a deficit of approximately RD\$300.0 million. In addition, no one answers the question of who created those supernumerary payrolls and what alternative jobs are to be provided to those Dominicans that have a family to support. If we turn to taxes, everyone wants them to be charged to someone else and those whose contribution to the government is derisory, argue that the tax burden is

excessive. But, excessive for whom? With respect to the exchange surcharge, it is argued that it is excessive but, there is no recognition of the fact that the present administration increased the rate of exchange to exporters to RD\$1.48 per dollar and, later on, unified it, whereby traditional exports presently receive a net RD\$2.10 and non-traditional, RD\$3.10 per dollar. In addition, the same phenomenon is noticed with respect to INESPRES. The price control policies applied in the past practically devastated the local agricultural production, having to import increasing amounts of foods. Today, the situation demands an ^{adjustment} ~~adjustment~~ in the price structure so as to stimulate local production. The cost structure of INESPRES, as a result of the exchange unification, has been radically altered. Now, if we do not wish to increase consumer prices, who is willing then to pay the taxes? and, if we are not willing to subsidize the final consumer through heavier taxes, how can we assure remunerative prices to our domestic producers?

This entire analysis brings into evidence a common element: Each group wants the Government to use its power to protect them and to oblige others to carry out what is of collective interest. In the past, problems were solved through external indebtedness and issuance of money without backing. In those cases wherein decisions were inevitable, political and economic powers were distributed in such a manner that the price of decisions was not uniformly charged to the entire population. For better or for worse, the Gobierno de Concentración Nacional considers that the external indebtedness and the allocation of the costs of adjustment should not only fall on the lower-income groups but, rather, that the burden should be equitably distributed among all sectors.

An example of this is the fact that when the IMF pointed out the need of increasing electricity tariffs as an indispensable requirement of the program, we had to work out an interesting computerized job wherein 20 different scenarios were presented so as not to affect residential consumers whose consumption was of 0-300 KWH a month who constitute 87% of the CDE consumers- in order to meet the President's request that this increase should not affect the lower income sectors. Little has been said about the fact that based on this initiative of the President, the increases of electricity tariffs did not affect 87% of the consumers.

I have no doubt that to have had an economy able to function for many years on fictitious foundations, creating around itself a complex system of ambiguities, has made the adaptation of aspirations to real possibilities more difficult. Our aspirations are not to be chimeras, which are unattainable because they go against the laws of nature nor utopias which are dreams difficult to materialize even though they are attainable. Rather, our actions are framed within the external and domestic realities of our country.

The year 1985 is crucial in the adjustment process of the external sector of the Dominican economy.

During the first months of the year, a difficult liquidity crunch was foreseen in the external sector. Over 400 million dollars had to be paid in December 1984 and during the first three months of 1985. We were able to ease that external sector crunch through a fast combination of negotiations and internal measures. What we

did was to ration the use of dollars and to restructure maturities of debt which the country had incurred under different agreements with Venezuela, Mexico, and Central Banks of the regions and Spain, thereby allowing us to comply with our obligations.

Having overcome that serious liquidity crunch, we faced the problem created on May 10, 1984, regarding letters of credit. It was necessary to look for a solution which was fair for the private sector but, at the same time, for the country, in this case represented by the Central Bank.

I can announce today that the decision taken in this respect on January 23rd of the current year has had the following results:

Letters of Credit paid - RD\$1.00 per US\$1.00	=	RD\$11.9 million
Letters of Credit paid - RD\$1.62 per US\$1.00	=	RD\$19.2 million
Letters of Credit paid at the unified rate of the Free Foreign Exchange Market	=	<u>RD\$29.4 million</u>
TOTAL		RD\$60.5 million

This has meant to the Central Bank net savings of foreign exchange of US\$20.7 million.

At the same time that we effected these **tasks**, negotiations were initiated to restructure the external debt with international banks and, at a bilateral level, with the Paris Club. This is a key

aspect in the reorganization of the Dominican economy. It is so for one simple reason. It is precisely in 1985, when all the errors committed in this economy during two decades were accumulated and felt. At the close of 1984, the total external debt reached US\$3.5 billion and the bulk of the maturities of that enormous debt which had accumulated for two decades would begin to mature in 1985. Our economy can not endure going through the 1985-1990 period with the debt service profile of the next six years and its amount in relation to our export of goods. During that period, the country has to pay almost US\$4 billion in external debt service and the ratio of debt service to export of goods is 131%.

It is for that reason that we have given so much importance to external debt restructuring. The Dominican negotiating team has drawn up a clever strategy in the formulation of its position and has also made use of refined methods for the presentation of data on debt and projections of its service under different scenarios and restructuring techniques.

This has allowed us to be effective and advance rapidly in the negotiations, hoping to conclude both of them by the month of May. We can already announce that we are certain it will be possible to restructure the debt under very favorable conditions for the country, at the commercial bank level as well as the bilateral debt. We will thus achieve a debt service which is more in accordance with the country's payment capacity, reducing the balance of payment gap to manageable levels for the next five

years. This also indicates that we are not working only to solve the country's immediate difficulties, but the great and future problems of the Nation as well.

FINANCIAL PROGRAMMING

The Dominican Republic requires a coherent strategy as regards as fiscal, monetary, credit, foreign exchange and development policies, in order to face today's difficult economic problems.

The financial program being carried out consist of a series of economic policy measures for specific areas which are prone to reach determined objectives if one acts upon them in a coordinated fashion.

We had to take action over the bank credit growth rate. The excess in money supply was being reflected in an increase in the demand for goods and services, as well as for external assets, which in turn increased the nominal value of the gross national product and weakened the balance of payments.

For this reason we have to maintain a maximum ceiling for this variable of 1902 million for June 1985 and reduce it to 1802 million by the end of the year. Of equal importance is the ceiling on net external assets, which should reach US\$300.0 million by June. We also want to reduce the fiscal deficit from 6.4% of the gross national product in 1984 to 4.9% in 1985. The reason for this is

that fiscal policy is a basic instrument to restrict consumption and aggregate demand as well as to reduce the State's need to turn to the banking system for financing, thus preventing loans to the private sector from being crowded out given the absence of compensatory flows from outside the country.

Of equal importance is the modification of the public sector pricing policy so as to reduce price distortions and eliminate subsidies. For this reason we had to increase the price of fuel, energy and some basic foodstuffs.

We considered and carried out a small readjustment in interest rates so as to reinforce other economic policy instruments and increase savings at the expense of consumption and speculative foreign exchange holdings.

In our case, the exchange rate policy is an important element in the adjustment process. It is necessary to change the incorrect direction that for decades has taken the Dominican economy and to reorient production towards goods that can be traded internationally, paying both our imports and exports at their real value.

In addition, the exchange unification positively affects the service account of the balance of payments, increasing revenues from tourism and private transfers. With the exchange unification, the unbearable process where the Central Bank was granting a dollar for a peso for several imports without being able to do so came to an end. In order to maintain that policy it was necessary to run

down the country's monetary reserves and get into foreign debt only to keep a fictitious equilibrium in the balance of payments, while accumulating arrears in external payments.

We also had to act upon the external debt. New public sector indebtedness will not be allowed for loans of less than a year and a ceiling was established for net disbursements of external loans with maturity between 1 and 12 years.

SIGNIFICANCE OF THE JANUARY 23, 1985 MEASURES

I would like to refer specifically now to the significance of the measures adopted last January 23 so as to give this distinguished audience a better idea of the reach, philosophy and objectives behind them.

One of the main problems of the Dominican foreign exchange system has been the existence and maintenance of a parity that did not correspond with the country's economic reality. It was an artificial parity in which the national currency was kept overvalued with subsequent deterioration of the monetary reserves and accumulation of high levels of commercial arrears. This situation was gradually maiming our credit capacity in the international markets. Later we ended with a variety of exchange rates that promoted the proliferation of subsidies to other sectors, making it difficult to apply a healthy foreign exchange policy due to the complexity of the system, while contributing, at the same time, to aggravate the problems.

It is precisely within this reality that the monetary authorities decided to unify the exchange rate for all foreign exchange transactions carried out by the Central Bank. The aim is to recover the proper duties of the Central Bank which were being lost for reasons not worth mentioning since they are part of history now. In this respect, the situation of the foreign exchange market demanded quick and energetic action, since no responsible government or monetary authority would accept to remain idle and let such a powerful policy instrument as the exchange rate be subject to the fancies of accidental forces.

Similarly, several exchange measures were implemented in order to have a certain degree of information which will allow for the future efficient administration of the international reserves of all the economy, among them:

- Measures to unify the systems and procedures for the exchange of currency from exports and services.
- Measures to unify the exchange rate for all foreign exchange payments and transactions carried out by the Central Bank.
- A requirement establishing that the Central Bank gives previous approval to all payments for imports of goods and services carried out without special dollar accounts.
- A resolution establishing that commercial banks must present to

the Central Bank all documents regarding payments charged to the special dollar accounts.

- The modification of the conditions established in the controversial Resolution of May 10, 1984, affecting letters of credit opened by commercial banks.

- The presidential order whereby the Central Government and the autonomous public sector institutions must prepare and annual program of foreign currency requirements which must be sent to the Central Bank to coordinate and authorize their purchase.

The purpose of these measures was to have a trustworthy and updated statistical system which would allow for the application of a sound foreign exchange policy, thus providing the monetary authorities with the opportunity to make an adequate programming of the flow of foreign currency and to prevent the future repetition of the problems we are intent in solving today. Please allow me to clarify something that has created quite a number of favorable as well as negative comments. I am referring to the so-called export surcharge of 36% for traditional exports and 5% for non-traditional ones. This surcharge has several objectives, one of them being to prevent the expansive effect created by the exchange unification. The other is to close deficit gaps in several sectors of the economy which would otherwise have caused greater increases in electricity charges and the prices of other basic products. The pesos from this surcharge only have a monetary accounting effect in the Central Bank records and serve to compensate for an exchange

differential to C.D.E. (Dominican Electricity Corporation) and the government in the payment of oil imports and debt service. As an example, when the C.D.E. needs to buy oil and the exchange rate is RD\$3.25 per dollar, that Corporation brings RD\$2.08 to the Central Bank and the RD\$1.17 difference is debited to the account the C.D.E. has in the Central Bank which is nurtured by the resources from the surcharge. I hope this explanation will clarify, in a definite way, that the resources from the exchange surcharge will not be monetized and therefore will not have an expansive effect.

Evidently, this type of measures are always unpleasant, whether it be for those who have to pay, for obvious reasons, or for those who must apply them. Nevertheless, we must not forget that our economy is immersed in an adjustment process that, although painful, is virtually unavoidable. As part of this process, a series of measures have been implemented in the foreign exchange, monetary as well as credit fields with the purpose of achieving an economic recovery in the shortest possible time and at the least cost.

It is useful to point out that as far back as 1934, the Bishop of Gloucester, England, said these words which reflect, with surprising accuracy, the Dominican situation at present:

"There are two roads for a nation to take: the first is popular, attractive, sentimental and in the end harmful for those it seeks to please; the other requires seriousness, courage, but finally will bring happy times to the people of that country".

For this reason I must remind you that the Resolution establishing this export surcharge is in force for only one year and you can be sure that, as far as circumstances permit, and according to an evaluation which will be periodically carried out on the economy and its development, the Monetary Board will make the application of this measure more flexible.

It is also worth mentioning that this exchange surcharge aims to prevent that the monetization generated by the unification cause expansive and unsettling effects on domestic prices. At the same time, the surcharge allowed to cushion the increase in electricity charges so that they had less effect on the lower income sectors.

Aware that the correction of the country's economic difficulties requires the adoption of measures that modify the distortions in the productive process, the monetary authorities established the norms that shall govern the financing granted by the Central Bank for the purchase of State Securities. They also froze the renewal of credit facilities through the advances and discount mechanism.

All this is part of the new definition of the Central Bank's internal financing policy so that it respond to the philosophy which originated it, turning this financing into an instrument of last resort when faced with the liquidity problems of the banking sector. The aim is also to make the cost of such financing respond to the money market price and that the users of this money make the most efficient use of these resources. Something similar occurs with the change in interest rates for the FIDE

which have been affected by the increase in interest charged by international sources of funds.

On the other hand, as a way to further encourage savings, and being aware of the present value of money in the market, the interest rate paid by financial institutions was raised through the Financial Certificates of Deposit. The amounts and terms for which these certificates can be issued were also modified to make them more accessible to a greater number of users. The types of activities which can be carried out by mortgage banks, development banks and savings and loans associations were also increased so these institutions can assign up to 20% of their total portfolio to ventures related to their main activity, allowing them to widen and diversify their operations in the market and, what is more important, to compete under better conditions with the informal institutions.

As to the unregulated financial market, the Monetary Board has decided to outline the norms by which these enterprises can operate so as to ensure the existence of a sound financial system and the effectiveness of adopted economic measures.

As you have probably noticed, the Monetary Board Resolutions have been motivated by the desire to achieve an adequate balance in the country's economic performance and, in some cases, are framed within the Stand-by Agreement recently signed with the I.M.F. The effects and significance of all measures have been carefully weighted in order to make the adjustment required by our economy -an adjustment

which could not be postponed- as least painful as possible.

We must be careful in wanting to place all the weight of a stabilization program on only one instrument, that is, the monetary and exchange policy. You cannot reach different, and many times contradictory, objectives with only one instrument. It is even worse when the policies at the macroeconomic level are not well understood or are badly executed at a microeconomic level. A policy might be well designed but its instrumentation might be bad. there is also the resistance of the status quo. For this reason we must try to improve the quality of the public and private administration. We must have open minds and understand the problems we face. This effort in which we are all involved requires close cooperation and sacrifice, not only from the public authorities but also from the private sector which is our development motor.

Finally, to conclude this point, let us remember the wise words of Sir Arthur Lewis, Nobel Prize in Economics in 1979, when he said: "In the proper management of the economy it is of vital importance to have a series of mutually congruent exchange rates, interest rates, international reserve proportions as well as prices and salaries."

THE SITUATION OF OTHER LATIN AMERICAN ECONOMIES

It is not my wish to take advantage of the patience of this distinguished audience, but I would like to read to you some abstracts from the reports presented at the Annual Meeting of

Governors of Central Banks of Latin America and Spain -held in Mexico this month-, on the state of their respective economies:

- "The Costa Rican economy experienced serious economic and social imbalances during the beginning of the decade caused, to some extent, by internal factors but also as a result of the circumstances that have been affecting the world economy."
- "The Honduran economy has been affected since 1980 by a strong economic and financial depression."
- Venezuela has experienced a reduction in its real economic activity from the beginning of the 80's and its product fell markedly in 1983."
- "The weak economic performance of the 70's, especially the accute worsening of inflation and inflationary attitudes at a world level, leave a sequel of greater imbalances in the world economy."
- "During the 1980-84 period, of all the Latin American and Caribbean countries, 14 had very significant devaluations and 8 turned to multiple exchange rates."
- "In summary, we must recognize the great difficulties that the financial and stabilization policies will face in the medium-term and graduate them adequately through time. But, nevertheless, from the European experience, I believe that the persistence of

these policies is a necessary condition for our economies to overcome their problems and get into a new stage of sustained growth and employment generation."

- "During the last four years, the Latin American and Caribbean economies have been under the most profound and prolonged recession since the 30's. These figures indicate the serious financial problem the region faces, when it starts to emerge from the worst economic crisis of the last 50 years."

The above quotes belong, in order of appearance, to the reports of the Central Bank Governors of Costa Rica, Honduras, Venezuela, Canada, Trinidad-Tobago, Spain and the report from the Centro Monetario de América Latina.

I strongly believe that the Latin American and Caribbean countries will be able to overcome their present problems if they continue making the necessary adjustments in their economies. To achieve this, however, it is necessary that the surrounding conditions improve at a world level to simplify the solution of the problems we are enduring today, especially as far as the external debt service is concerned. There are risks and hopes but, nevertheless, I must point out that those years of the 60's and part of the 70's are a thing of the past and will never come back. Our countries must learn from this experience. In the good years when we should have made adjustments, we spent our reserves and happily monetized our external debt, printed money without backing and continued a feast that had to come to an end. Today we are paying for what

we so irresponsibly consumed. It is time to work and be austere as an only and real solution to the problem.

I believe I have provided you today with an idea of the economic moment we are living in, its origin, its implications and the heroic measures we are adopting to face our present and future problems. But even though the local authorities are working hard to overcome the present times, little can be achieved without the cooperation, effort and even the sacrifice of all. I would like my last words to be a strong exhortation to you all, especially the dynamic representatives from the financial sector, the majority present here, to contribute, with a spirit of understanding and tolerance, with the effort and sacrifice which is indispensable under these difficult circumstances.

Thank you very much!