

IU

F  
RD  
2239  
19990609E



**BANCO CENTRAL DE LA REPUBLICA DOMINICANA**



**EVOLUTION OF THE ECONOMY, MONETARY POLICY  
AND OUTLOOK FOR INVESTMENT  
IN THE DOMINICAN REPUBLIC**

ADDRESS OF GOVERNOR HECTOR VALDEZ ALBIZU  
OF THE CENTRAL BANK OF THE DOMINICAN REPUBLIC,  
AT THE ADAM SMITH SEMINAR



PARIS, JUNE 9-11, 1999

BANCO CENTRAL DE LA REPUBLICA DOMINICANA  
BIBLIOTECA

08-972

2009-09-12

Dom.



**Lic. Héctor Valdez Albizu**  
Governor  
Central Bank of the Dominican Republic

F  
RD  
2239  
1999060

# EVOLUTION OF THE ECONOMY, MONETARY POLICY AND OUTLOOK FOR INVESTMENT IN THE DOMINICAN REPUBLIC

## I. INTRODUCTION

I would like to express my sincere thanks for the kind invitation extended to me by the organizers of this Seminar, and for allowing me to share with you a synthesis of the economic evolution registered in the Dominican economy during the past years, the role of monetary policy, and the business perspectives offered to foreign investors by the country. I also bring you greetings from the Dominican people and its Government, in the person of our President, Dr. Leonel Fernandez.

The Dominican Republic occupies the eastern two-thirds of the Island of Hispaniola, the second largest in the Caribbean. The quality of its natural resources, the abundance of labor and its

proximity to the American market, mainly to such important destinations as Miami, only two hours away by plane, or New York, just over three hours away, give the country a strategic advantage for investments.

It is relevant to remember the historical fact that during the XV century the first contact of Spanish settlers with the civilization of the new world took place in what is now the Dominican Republic, and that the first colony, which would serve as a parting point for the Spanish conquests in the American continent was founded on this island.

The Dominican Republic has a population of just over 8 millions inhabitants and a territory of 48,670 Km<sup>2</sup>. Given its pleasant tropical climate, the consolidation of a democratic process, social peace and respect for its

---

citizens, and a largely young, hospitable and hard working population, the country has accomplished important transformations in its productive structure over the past two decades. As a result, for the past five years, its economy has been among those with the strongest growth in the world.

In the present decade, the Dominican economy has undergone a process of expansion and of macroeconomic stability, where sustained growth of the real GDP, an average inflation rate of only one digit, decrease in unemployment, relative exchange rate stability, and timely payment of external debt service with public guarantee has improved debt indicators, situation which has consolidated itself during the last four years.

### **Changes in the Productive Structure**

Until the beginning of the 80's the Dominican economy had depended on the export of commodity goods such as sugar, coffee, cacao and tobacco, and gold and ferronickel, to generate the necessary hard currency to finance the imports with which to complement internal demand for goods and services. This dependency on a few basic exports made the economy extremely vulnerable to cyclic changes of prices in international markets.

Halfway through the past decade, however, an important transformation started to take place in the country's productive structure. One of the most important characteristics of this process was the diversification of the country's exports. The development of the industrial free zones and tourist sector, as well as the considerable expansion of telecommunications, not only modified the country's exports, it became the propeller of a new economic growth in the Dominican Republic.

As a result, the Dominican Republic went from being an exporter of commodity goods to a country where exports of manufactured goods and services predominate, which is a characteristic of the industrialized nations that compete advantageously in international markets. As an example, the ratio of exported goods as a percentage of total exports of goods and services, decreased from 73% in 1980 to 33% in 1998. Besides, seven agricultural and mining exports items which two decades ago represented 90% of our income from exports, represent today less than 10 percent.

The effects of Hurricane Georges suffered by the country last September proved the strength of the country's productive system as a result of the economy's diversification. Despite the severe damage caused by the

---

storm, especially to the agricultural and livestock sectors, the national productive activity recovered its drive in a very short time and the year's economic performance concluded as one of the strongest in the recent past – an unthinkable feat for the productive structure of the country in the early 80s.

## II. THE ECONOMY'S RECENT EVOLUTION

### Gross Domestic Product

The economic transformation that took place in the 80s and the reforms adopted at the beginning of the 90s to consolidate political and social stability have, in a decisive manner, influenced the vigorous growth and relative price stability of the present decade. This expansion of productive activities has been financed by domestic savings, which in 1998 reached 24% of the current GDP, approximately 4 percentage points above the Latin-American average, according the Economic Commission for Latin America and the Caribbean (ECLAC).

These results have also been influenced by the fact that the country has not been directly affected by the international financial crisis, as short-term capital flows do not constitute an important source of financing for the country. On the contrary, the development of

the Dominican Republic external sector has depended mainly on direct foreign investment and on remittals of Dominicans living abroad, which traditionally have had an increasing trend.

**During the present decade, annual average economic growth reached a 5.7% rate, measured through the real GDP. Moreover, when projected growth for 1999 is included, we have that during the past four years the economy registered an average growth of 7.5%, one of the most vigorous in the world. During 1998, GDP increased by 7.3%, in real terms, the highest in all Latin America, despite damages caused by Hurricane Georges. The highest productive activity was registered in the telecommunications, hotel, bars and restaurants (tourist), electricity and water, construction and trade sectors.**

Economic growth in the Dominican Republic during this decade has translated in a substantial improvement of the main indicators of the population's wellbeing. During the last three years, per capita GDP grew at an average rate of 5.1%, in real terms, more than twice the rate of the population growth of 2.3%. The expansion of the per capita income, expressed in current dollars registered a similar performance, going from US\$813 in 1990 to US\$2,068 in 1998. Similarly, and according

to the Economic Commission for Latin America and the Caribbean (ECLAC), during the 1991-1996 period, within a total of 19 countries, private consumption per inhabitant in the Dominican Republic registered the second highest growth rate in the region.

It is expected that in 1999 economic growth will again exceed 7%. **In accordance, the International Monetary Fund (IMF) publication "World Economic Outlook", states that the Dominican economy could reach a growth rate of 7.3%, making it the highest in the world.** This growth would be reinforced by inflow of capitals from the privatization of important state-owned enterprises, such as the Dominican Electrical Corporation (CDE) and the international airports, as well as by the disbursements of new loans recently granted by the World Bank, and the Inter-American Development Bank. It must be pointed out that important foreign investment in tourism, telecommunications, trade and others will be taking place this year.

### **Unemployment**

In accordance with the outstanding expansion experienced by productive activities during the past years, the unemployment rate has decreased from 19.6% in 1991 to 14.3% in 1998. This past

year, 200,000 new jobs were created and this indicator is expected to drop to approximately 13%. An assessment made by consultants from the International Development Studies Institute of Harvard University, however, revealed that due to the methodology used, these unemployment rates have been overestimated and that the "open" unemployment rate, which is the indicator used by the International Labor Organization, would be between 6 and 7 percent.

### **Inflation**

Annual inflation rate levels as of 1991, measured through the variance of the consumer price index, has remained at a single-digit, except for 1994. During the 1991-1998 period an annual average inflation of 7.4% has been registered, while during this last year domestic prices grew by 7.8%, due mainly to the effects of Hurricane Georges. Before the storm, consumer price rates were projected to grow no higher than 5%. For the present year, it is estimated that inflation will not increase more than 5%.

### **Foreign Sector**

In so far as the new economic sectors succeeded in competing with external markets, the current operations deficit with the external sector, measured through the

---

balance of payments current account and expressed as a percentage of the GDP, decreased, going from -5.5% in 1993 to -1.1% in 1997. During 1998 this deficit deteriorated, reaching -2.4%, basically due to the numerous imports made to satisfy domestic demand for food, construction materials and others, as a consequence of the passing of Hurricane Georges. This deficit was totally financed by direct foreign investment, allowing the balance of payment to register surplus results at year-end.

It is important to point out that contrary to what happens in other developing nations, the current account deficit in the Dominican economy has been financed mostly by direct foreign investment. This has been a determinant factor for the country not having to depend on dangerous hot capitals.

Activities related to tourism, free zones and communications were reinforced by the approval of the new Foreign Investment Law of 1995, which completely liberalized restrictions on repatriation of profits and equaled investment opportunities for foreign and local investors. Thanks to this law the Dominican economy was able to capture larger capital flows than it had at the end of the 80s. The new legal framework reinforced investor's confidence, many of which are presently reinvesting a large share of their earnings. Direct foreign investment

reached US\$4,252.5 million, during the 1991-1998 period.

Central Bank net international reserves, which had deteriorated by mid-decade, have, in the past two years, experienced a process of sustained recuperation, despite the timely payment of the country's external commitments and negative net capital flows. This is a consequence of the foreign sector favorable performance.

### **Foreign Public Debt**

A prudent foreign public debt policy has been another characteristic of the Dominican economy during the present decade, following the successful renegotiations of the country's external debt, both bilateral, that is, with partner countries, and with the international commercial banks. This decreased public debt stock from US\$4,562.96 million in 1993 to US\$3,507.0 million in December 1998, a reduction of more than a billion dollars. It should be pointed out that over 80% of public foreign debt is either bilateral or multilateral. This debt is structured in the following manner: 18.8% is commercial, 48.7% bilateral, and 32.4% multilateral.

On account of the above, foreign public debt service indicators have shown a strong decrease. This may be observed in the Debt

Service/GDP ratio, which went from 5.6% in 1994 to 2.5% in 1998, while the Debt Service/Goods and Service Exports ratio decreased from 17.6% in 1994 to 8.2% in 1998. Another relevant indicator of the country's indebtedness is the fact that foreign public debt stock as of December 1998, as a percentage of GDP, is 22%.

### III. THE ROLE OF MONETARY POLICY IN MAINTAINING STABILITY

As well-known economists have pointed out, inflation is, and will always be, a monetary phenomenon. Therefore, in a general sense, the role of monetary policy in any given economy may be assessed by the monetary authorities' commitment to annual inflation goals. Making this statement our own, in the past years the actions performed by the Central Bank of the Dominican Republic have focused on preserving economic growth within an environment of domestic price and exchange rate stability, without allowing this to affect the competitiveness of the external sector, growth engine of the present decade.

During the present decade, the monetary policy of the Central Bank of the Dominican Republic has been permeated of pragmatism, that is, it has been flexible when the economy's basic equilibrium allows it, that is to say, when there is a favorable evolution

among the real sectors, both foreign and fiscal. On the other hand, it has demonstrated a firm will to guarantee price stability when lack of equilibrium in those same sectors has so determined.

The main challenges facing Dominican monetary authorities are: timely diagnose of the economy in order to detect when an overheating phase is approaching, that is, when domestic demand will generate inflationary pressures in the mid-term; permanent monitoring of money demand in order to give the economy adequate liquidity, and thus, favorably affect productive activity performance; maintenance of an exchange system with sufficient stability as not to hinder inflation rates, but with enough flexibility so as not to obstruct export sector growth.

In this sense, the country has an exchange system which could be cataloged as managed flotation, and which has satisfactorily achieved the above mentioned goals. Private market exchange operations represent 87% of the total, while the rest takes place in the official market and exclusively represents foreign public debt payments and the oil bill. The official exchange rate is determined by the weekly average of the market exchange rate.

In order to achieve the above mentioned objectives, frequently at odds with each

other, and to regulate monetary aggregates, the Central Bank of the Dominican Republic has used as policy instruments open market operations, legal reserves, credit limits to the public sector and timely intervention in the foreign exchange market in order to maintain the rate within an appropriate range.

As those present know, especially those acquainted with these issues, the degree of difficulty in monetary policy management in developing countries will depend, in good measure, on how prudent public expenditure policy is. If price stability is to be preserved, monetary policy will have to be used to counterbalance fiscal policy, adopting measures which bear on interest rates in order to adjust private aggregate expenditures, whenever public spending could affect the price level target established by monetary authorities.

It is appropriate to point out that in the past years coordination between fiscal and monetary policies has been strengthened. In 1996 and 1997 Central Government cash flow, measured as percentage of nominal GDP, experienced a deficit of only  $-0.4\%$  and  $-0.2\%$  of GDP, respectively. This is practically a balanced situation that reflects the prudent manner in which public finances have been managed during that time. In 1998 fiscal efforts were much more evident, resulting in a  $0.1\%$  of the GDP budget surplus.

During these years, the favorable performance of fiscal policy has been possible thanks to efforts made by the present administration in strengthening the efficiency of tax management through the simplification of tax collection and better supervision. In this regard, in the past two years a significant enhancement of the ability of public tax collection has signified a  $2\%$  GDP increase, that is in tax collection. This, despite the elimination of import tariffs on raw material and capital goods for agriculture and the textile industry, as well as the elimination of a commercial license which has represented a significant sacrifice in terms of fiscal income.

### **Dominican Financial System**

The combined efforts of Central Bank and Superintendence authorities have made possible that the regulation and supervision of the Dominican financial system, in which a universal banking structure predominates, are based on banking and prudential norms designed in accordance to Basle Committee standards. These standards suggest an asset classification by level of risk and the establishment of the corresponding provisions, as well as a series of warning indicators when liquidity or solvency problems arise.

As the most important sector indicators indicate, due to this effort a more solid,

stable and efficient financial system has emerged. Last year, equity strengthening (capital and reserves) increased by 33.9%, while the most recent asset assessment and qualification data, reflect a solvency index of 11.0%, higher than the 10% minimum requirement, and credit risk decreased from 5.4% in 1997 to 4.9% in 1998. Last year commercial bank average profitability was 34.2%.

Additionally, in face of the new millennium, the Central Bank, through a Monetary Board Resolution, has created an Interinstitutional Commission to coordinate the efforts confronting data systems in the year 2000. Similarly, it has prepared the report, "Guidelines for Confronting the Change of Millennium in the Financial System". As a result of this document, the country's commercial banks, to date, have totally adapted their computer systems to the solution of the Y2K problems.

#### IV. INVESTMENT OUTLOOK

As of 1995, the Dominican Republic has a new Foreign Investment Law, based on free trade and, as previously mentioned, this law permits the repatriation of all benefits generated by foreign capital enterprises. This law, also establishes equal treatment for local and foreign investors, who may invest in any area except those related to toxic and

radioactive waste disposal, or in those which adversely affect public health or the environment, or in the production of goods and equipment related to national defense and security.

Simultaneously to the approval of this Law, the present administration has deployed an aggressive foreign policy, personally directed by President Fernandez, and which has resulted in the signing of a free trade agreement with Central America and advanced negotiations with the Caribbean Community (CARICOM). Additionally, agreements for the protection of investments were signed with France, Chile, Ecuador and Taiwan. At the same time, missions led by the President of the Republic took steps to negotiate new investments which will finance modern infrastructure in the energy, urban, environmental and tourist sectors.

As a result of the above, during the last five years, by way of direct foreign investment, the country has received resources equivalent to 2.6% of the GDP. Tourism, industrial free zones and communications have been the sectors that have benefited the most. During that period, the number of hotel rooms built by foreign investors has reached record levels. This year there will be 43,299 available rooms. As of 1997, the number of new enterprises in the industrial free zones has again reached its past-decade

---

---

impulse, after feeling the negative effects of the Free Trade Treaty between United States, Mexico and Canada, which strengthened Mexico's position with respect to the rest of the Caribbean countries as receptor of free zone *maquilas*.

Still the most import aspect of foreign invest in Dominican Republic is taking place presently with the application of the General Reform of Public Enterprises Law, approved in 1997. This law permits foreign investments in areas other than the traditional ones, though equally important and beneficial.

The General Reform of Public Enterprises Law contemplates the privatization of the Dominican Electrical Company (CDE), the Dominican Corporation of State Enterprises (CORDE), which constitutes a holding of several industrial companies, state-owned hotels and the Sugar State Counsel (CEA). Similarly, the country's airports and harbors are being leased to private foreign enterprises.

The privatization scheme chosen is that of capitalization, whereby investors acquire 50% of an enterprise, and the Dominican Government is their partner. The new private firm would be responsible for the administration. This process would eliminate the fiscal burden which many of these enterprises represent for the

government, and at the same time state monopolies would be eliminated and competitiveness promoted. As an example, let me say that the privatization of the electrical company will generate resources in the amount of US\$643 million, which would be received by the country in a horizon of three years.

The leasing modality has been used for the privatization of the state-owned sugar entity. Sugar cane plantations and sugar mills have been leased for a period of 30 years, and future production diversification is contemplated. Presently, a prequalification process is taking place. It is expected that no later than next July, ten state-owned sugar mills will be leased, allowing these factories to recuperate their past efficiency, given the comparative advantages of the country in this sector.

Last April the administration of the country's international airports was granted to a holding company integrated by three international and one Dominican firms, who had won a public bid. The contract will have a 20-year duration and the winning companies have agreed to make investments in the amount of US\$203.0 million until the year 2015, in order to improve air traffic infrastructure, and for the continuous modernization of existing facilities, as well as to promote and develop tourism.

---

Regarding the state-owned enterprises which makeup the Dominican Corporation of State Enterprises (CORDE), the wheat processing firms were privatized at the end of last year, and presently, the domestic airline, a tobacco factory, a marble mine, a glass factory and a salt and gypsum mine, among others, are in a bidding process. Though this process is at different levels depending on the enterprise, it is expected that at the beginning of next year the privatization of these companies will be concluded. Similarly, the Reform Commission for Public Enterprises is preparing the necessary documentation for the privatization of state-owned hotels.

Another immediate possibility for foreign investment in the Dominican Republic is in tourism, in the "Playa Grande" project, on the northern coast of the island, property of the Central Bank. This project has an area of 3.5 million square meters and includes 1.5 kilometers of white sand beaches, among the most beautiful in the country as well as mountainous areas of dense vegetation. All this, together with the infrastructure developed by the Bank, such as a golf course by the sea, a residual water and solid waste treatment plant, internal roads and pathways, drainage systems and others, make it very attractive to investors. The sale price of this asset has been estimated at approximately US\$120 million, with a 10 year financing facility.

Presently, several bills are pending approval in Congress. These laws, which are expected to be approved at the beginning of next year, would promote competitiveness in the Dominican economy, in accordance to WTO guidelines. The development of private activities, through the transformation of its institutional structures is the objective of the efforts made by the authorities, so that our firms may compete on a productivity basis, not on the basis of cheap labor.

#### **V. MID- AND LONG-TERM ECONOMIC OUTLOOK**

In the beginning of the new millennium, the Dominican economy will find itself at one of its most advantageous stages, growing at an average rate of not less than 7% for the next two years, and with an average inflation rate of less than 5%. This data has been validated by the International Monetary Fund in its recent visit to the country to elaborate the report corresponding to the IV Article of the Articles of Agreement of said Institution. Therefore the Dominican Republic should remain during that period among the countries that share the highest economic performances in the world.

In accordance with this, a set of economic reforms which still await Congress approval, and on whose importance there

---

is ample political and social consensus, could empower the Dominican economy and guarantee that the actual average growth rate is maintained for at least five years.

We would like to conclude reminding you that the Dominican Republic is a safe destiny for investments, one that can be trusted. Participate with us and let us be partners in a climate of mutual benefit.

---