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Dominican Republic: Political and Economic Conditions and Relations with the United States

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Summary

President Leonel Fernández of the Dominican Liberation Party (PLD), who served as president previously (1996-2000), took office on August 16, 2004. Fernández is charged with helping the Dominican Republic recover from a deep economic crisis that occurred primarily as the result of three major banking failures and bailouts in 2003. Since then, the country has faced high inflation, double-digit unemployment, currency depreciation, and chronic power shortages. President Fernández used his electoral mandate to push the PRD-dominated Congress to pass tax increases as part of a fiscal reform package necessary to restart a suspended \$600 million IMF loan. The package has been controversial, however, as it contains a tax on high fructose corn syrup, a major U.S. product. If the tax is not repealed, it could jeopardize the Dominican Republic's inclusion in the U.S.-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA). For further information, see CRS Report RL32322, *Central America and the Dominican Republic in the Context of the Free Trade Agreement (DR-CAFTA)*, coordinated by Larry Storrs, or CRS Report RS21868, *U.S.-Dominican Republic Free-Trade Agreement*, by Lenore Sek. This report will be updated periodically.

Background

The Dominican Republic occupies the eastern two-thirds of the Caribbean island of Hispaniola, which it shares with Haiti. A population of about 8.8 million occupy a mostly mountainous area about the size of New Hampshire and Vermont combined. With a per capita income of \$2,230, it is considered a lower middle-income country. After fighting to achieve its independence from Spain in 1821 and then Haiti in 1844, the Dominican Republic embarked upon a bumpy road toward its current democratic form of government, characterized by long episodes of military dictatorship and frequent coups.

Political Situation

During the 1990s, the Dominican Republic underwent rapid economic growth and developed stronger democratic institutions. The “Pact for Democracy” in 1994 paved the way for free and fair elections by removing the aging Joaquin Balaguer from power in 1996 after a shortened two-year term and preventing consecutive presidential re-elections. Balaguer, a six-term president of the PRSC and acolyte of the deceased dictator, Rafael Trujillo, dominated Dominican politics for almost seven decades until his death in 2002. In 1996, Leonel Fernández of the PLD, a center-left party of middle class professionals, succeeded Balaguer and presided over a period of strong economic growth. After top PLD officials were charged with misusing public funds, Hipólito Mejía (2000-2004), an agrarian engineer of the populist Dominican Revolutionary Party (PRD), easily defeated the PLD candidate, Danilo Medina, by promising to promote rural development. Mejía lost popular support, however, by spending excessively and deciding to bail out all deposit holders after three massive bank failures in 2003 at a cost of between 15 and 20% of GDP.¹ Observers noted that Mejía focused more on his re-election bid, which required a Constitutional amendment reinstating presidential re-election, than on resolving the country’s deep economic crisis.²

2004 Presidential Elections. On May 16, 2004, Leonel Fernández won a convincing first-round victory with 57% of the popular vote compared to Mejía (PRD) receiving 34% and Eduardo Estrella of the Social Christian Reformist Party (PRSC) receiving 9%. Record numbers of Dominicans turned out to support Fernández, whom they associated with the country’s economic boom of the 1990s. President Fernández is seeking to use his strong electoral mandate to launch a period of austerity necessary to solve the country’s fiscal shortfall, rising Central Bank debt, and chronic power shortages.

Fiscal Reform and DR-CAFTA. In September 2004, the Dominican legislature, which is dominated by the PRD, passed the President’s fiscal package. The fiscal bill reportedly contained important provisions, including an increase in sales taxes and a 20% cut in public spending.³ Its passage opened the way for negotiations on the revision of the \$600 million stand-by agreement with the International Monetary Fund (IMF), which is likely to be signed by the end of 2004. The fiscal reform bill has become controversial, however, because it contains a 25% tax on high fructose corn syrup (HFCS), a major U.S. export, which is in conflict with the recently signed DR-CAFTA agreement.

Corruption. Former President Mejía was said to be linked to a number of corrupt activities for which observers believe he is unlikely to be held accountable. An official investigation recently found that Mejía was able to increase his personal wealth by \$800,000 during his four-year presidential term.⁴ Mejía, officials of all major political parties, and other individuals reportedly received money and gifts from Ramon Baez,

¹ Leo Goldstein, “Dominican Republic: A Look Ahead,” *Citigroup*, August 18, 2004.

² “Fernández Wins as Mejía Roundly Rejected,” *Latin American Regional Reports*, May 25, 2004.

³ “Poor Feel Pain of President’s Cure for Economic Ills,” *Financial Times*, October 20, 2004.

⁴ “Former Dominican Leader Defends His Own Wealth,” *Reuters*, October 22, 2004.

owner of the now defunct Banco Intercontinental (Baninter).⁵ The Mejía government later took control of Baninter's associated companies, including Listin Diario, the country's largest publishing company, and fired many editors and management officials, even if they were not party to the scandal. There are corruption cases pending against Mr. Baez and other prominent Dominican bankers associated with the scandals. President Fernández has promised to fight corruption; however, some analysts are questioning his commitment to that pledge after his recent decision to give four posts to officials from his previous administration who have been charged with misusing public funds.⁶

Human Rights. According to the State Department's Country Report on Human Rights Practices covering 2003, although the Dominican government has made some progress, it still has a poor human rights record. Official estimates of extrajudicial killings by Dominican police forces range from 150 to as high as 292. Human rights groups reported a decline in the use of torture against criminal suspects, although uniformed vigilantism persisted. In response to allegations of police misconduct, President Fernández recently forced 300 to 400 police agents into retirement.⁷ In addition to the use of corporal punishment, 14,500 prisoners are currently being held in overcrowded prisons designed to hold only 9,000 inmates. Finally, despite the enactment of an anti-trafficking in persons law in August 2003, the State Department has placed the Dominican Republic on a Tier 2 Watch List for failing to arrest and prosecute those accused of human trafficking.⁸

Status of Haitians and Dominican-Haitians. The Dominican government continues to receive international criticism for its treatment of an estimated one million Haitians and Dominican-Haitians living within its borders. Each year thousands of migrants, many without proper documentation, flock from Haiti, the poorest country in the hemisphere, to the Dominican Republic. The Dominican economy, especially the sugar and construction industries, has long profited from a constant influx of cheap Haitian labor. More than 90% of the country's seasonal sugar workers and two thirds of its coffee workers are Haitians or Dominicans of Haitian origin.⁹ In 2002, the Dominican Directorate of Migration forcibly deported more than 12,000 Haitians, including children born of Haitian parents in the Dominican Republic.¹⁰ According to most Dominican officials, including President Fernández, the recent crisis in Haiti, which resulted in the removal of President Jean-Bertrand Aristide in early 2004, has accelerated the level of

⁵ "Dominican Republic: Bank Bust," *Economist Intelligence Unit*, May 26, 2003.

⁶ "Dominican President Assigns Four Charged in Scandal to Top Posts," *Dow Jones International News*, August 20, 2004.

⁷ "Dominican Republic: Fernández Shocked by Surge in Violent Crime," *Latin American Regional Report*, October 19, 2004.

⁸ According to the Trafficking Victims Protection Reauthorization Act of 2003 (P.L. 108-193), countries that do not make adequate progress in combating human trafficking may be subject to sanctions.

⁹ Philip Martin, Elizabeth Midgley, and Michael S. Teitelbaum, "Migration and Development: Whither the Dominican Republic and Haiti?" *The International Migration Review*, New York: Summer 2002, Vol. 36, Iss. 2.

¹⁰ U.S. Department of State, *Country Reports on Human Rights Practices 2003: Dominican Republic*, February, 2004.

illegal migrants heading to the Dominican Republic and placed further strain on the struggling Dominican economy.¹¹

Economic Conditions

Fueled by rapid expansion in both the tourism and free-trade zone (FTZ) sectors, the Dominican economy grew rapidly throughout the 1990s at an annual rate of 6-8%. Despite the increased employment and earnings in those two sectors, mining and agriculture continued to be the country's highest export earners. Remittances from Dominicans living abroad contributed an additional \$1.5 billion per year to the country's stock of foreign exchange. Economic expansion was also facilitated by the passage of several market-friendly economic reforms in the late 1990s by then President Leonel Fernández. One critical reform was a 1997 law allowing the partial privatization of unprofitable state enterprises. Since that time, several state-owned entities have been privatized, including a flour mill, an airline, a hotel chain, sugar mills, and three state-owned regional electricity distribution companies. Some observers criticized Fernández's privatization of the electric sector, however, noting that it failed to remedy power shortages and financial difficulties.¹²

The success of both tourism and export-processing zones is extremely dependent upon the global economy. Although the Dominican tourism industry has begun to recover since late 2002, it suffered a significant decline in 2001-2002, as a result of the global recession, a weak euro, and the aftermath of the September 11, 2001 terrorist attacks. More significantly, the country's free trade zones have had to compete with cheaper goods coming from Central America and China. The trade deficit of the Dominican Republic with the Central American countries stood at \$85.6 million in 2003.

In 2002, the Dominican economy, despite strong performance in the mining and telecommunications sectors, entered a recession. The country's public finances were placed under strain after President Mejía elected to bail out the country's third largest bank in violation of the monetary code, Banco Intercontinental (Baninter), which collapsed in May 2003 after a record fraud. The Baninter scandal was a direct result of weak banking regulations that enabled bank executives to defraud depositors and the Dominican government of U.S. \$2.2 billion worth of account holdings — an amount equal to almost 67% of the Dominican Republic's annual budget. Ramon Baez, the former president of Baninter, paid out more than \$75 million worth of gifts and payments to government officials, including President Mejía and Leonel Fernández.¹³ The Mejía administration negotiated a \$600 million loan from the IMF in August 2003 to counter the effects of the Baninter bailout but only received \$120 million before failing to comply with conditions. A renegotiation in February 2004 allowed a disbursement of an additional \$62 million but the administration soon fell out of compliance with targets. In

¹¹ Alois Hug, "Somos el Patio Trasero de Estados Unidos, no Podemos Enfrentarnos," *El Pais*, July 19, 2004.

¹² Bacho Perez, "Widespread Blackouts Leave President Scrambling to Boost Power," *Agence France-Presse*, February 8, 2000.

¹³ Jose de Cordoba, "Caribbean Cloud," *Wall Street Journal*, June 30, 2003.

addition to the failure of Baninter, two other commercial banks were bailed out in late 2003, resulting in approximately \$700 million in losses to the Dominican Central Bank.

By the end of 2003, inflation reached 42%, unemployment stood at 16.5%, and the peso had lost more than half of its value. Since August 2004, the peso has regained some of its value, inflation has decelerated, and the economy has begun to grow. The fiscal bill should help cut the budget deficit, but measures of austerity that will be necessary to meet fiscal targets, which include the elimination of a subsidy on propane gas, may have deleterious consequences on the country's poor and middle classes. Moreover, electricity providers, saddled with dollar-denominated debts, are still struggling to provide service to a Dominican populace angry at expensive power bills and continued blackouts. Although the National Salary Council recently negotiated a 25% salary increase for private sector employees below a certain wage cap, this increase will not compensate for the purchasing power they have had in the past year due to 40% inflation. Public sector wage increases are unlikely to occur until after January 2005. Since January 2004, the U.S. Coast Guard has intercepted some 7,300 undocumented Dominican migrants en route to Puerto Rico, providing further evidence of the severity of the economic crisis.¹⁴

Relations with the United States

The Dominican Republic enjoys a strong relationship with the United States that is evidenced by extensive economic, political, and cultural ties between the two nations. The Dominican Republic is one of the most important countries in the Caribbean, because of its large size, diversified economy, and close proximity to the United States. Reforms of the Dominican justice system, as well as a number of market-friendly economic laws, were well received by the U.S. government. Despite these reforms, and the country's strong economic performance during the 1990s, the Baninter scandal and the ongoing economic crisis (that has led thousands of Dominicans to risk their lives in order to illegally migrate to Puerto Rico) have concerned investors and policy-makers in the United States. Although the Dominican Republic withdrew its contribution of 300 troops to the coalition in Iraq in May 2004, the Bush Administration has expressed appreciation to the Dominican government for its participation. The United States hopes to assist the Fernández Administration in restoring economic prosperity through free trade, building solid democratic institutions, fighting crime and corruption, and promoting regional stability. These cooperative efforts could be hampered, however, if the Dominican Republic's tax on the use of corn syrup causes it to be excluded from the DR-CAFTA agreement.

Foreign Aid. The United States is the largest bilateral donor to the Dominican Republic, followed by Japan, Venezuela, and Germany. For FY2004, the United States allocated an estimated \$31.8 million to the Dominican Republic, and the Administration has requested \$28.2 million in assistance for FY2005. These amounts include support for a variety of Development Assistance and Child Survival and Health Programs, a Peace Corps staff of some 185 volunteers, and a small military aid program. In response to a May 24, 2004, flood that left 414 dead and more than 1,600 families homeless in the

¹⁴ "Dominican Authorities Arrest Would-be Migrants but Some Escape during Shootout," *Associated Press*, October 20, 2004.

Dominican-Haitian border region of Jimani, USAID has donated a total of \$300,000 to various NGOs, such as World Vision and the Red Cross.

Counter-Narcotics Issues. In September 2004, President Bush designated the Dominican Republic as one of four major drug transit countries in the Caribbean, with 8% of all the cocaine entering the United States flowing through the Dominican Republic. To counteract those illicit activities, the Dominican government, acting with Haitian and U.S. officials, has stepped up drug-related seizures, arrests, and extraditions. The Dominican Republic is also on the State Department's list of major money-laundering countries. In 2002, the Dominican Republic enacted a tough anti-money-laundering law aimed at combating drug trafficking, corruption, and terrorism.

Trade. The United States is the Dominican Republic's main trading partner. The United States exported \$4.2 billion in goods to the Dominican Republic in 2003, with apparel and clothing (15%) and textiles (15%) the leading items. In the same year, the United States imported \$4.5 billion in goods, almost the same value as exports. Just over half (52%) of U.S. imports were apparel and clothing, and most of those imports (81%) entered under Caribbean Basin Initiative-related programs. The Dominican Republic has benefitted more from its involvement in CBI than any other Caribbean country. It was also one of the first countries in the region designated to participate in the expanded trade benefits of the Caribbean Basin Trade Partnership Act (CBTA) of 2000. It has a U.S. sugar quota of 180,000 tons, the largest of any of our trading partners. More than 254 U.S. companies operate in the Dominican Republic's 51 free trade zones (FTZs), which were the engine for the country's rapid growth throughout the 1990s. By signing DR-CAFTA, the Dominican Republic hopes to improve access for its exports to the U.S. market and to encourage new investment in its FTZs. It is also likely to increase trade with the Central American nations that are party to the agreement: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

Corn Syrup Tax and DR-CAFTA. In September 2004, the Dominican Congress passed a fiscal bill that included a 25% import tax on high fructose corn syrup (HCFS) used in the production of soft drinks. That portion of the law appears to be a protectionist measure that conflicts with the recently signed DR-CAFTA agreement. The U.S. Trade Representative and some Members of Congress have threatened to exclude the Dominican Republic from the FTA unless it repeals the HCFS tax. Other Members of Congress have criticized the Bush administration for its attempt to strong arm the Dominican Republic over the tax. Rather, they have suggested that the Administration should take its objections to the WTO as it did with a similar tax enacted by Mexico.¹⁵ President Fernández, who opposes the tax, has sent a bill to the Dominican Senate to repeal the portion of the law that levies the tax. However, at this time the PRD-dominated Congress seems unlikely to overturn the HCFS tax.

¹⁵ "USTR Reiterates Threat to Drop Dominican Republic from DR-CAFTA," *International Trade Reporter*, October 28, 2004.