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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. President Fernández has entered the second half of his four-year term in a relatively strong position. He has presided over a period of rapid economic growth (an estimated 10% in 2006), enjoys continued popular support, and now has a majority in both legislative chambers. Fernández has restored investor confidence in the Dominican economy and enacted some fiscal reforms recommended by the International Monetary Fund but struggled to resolve the country's ongoing problems with corruption and electricity shortages. President Fernández seeks to maintain close ties with the United States and to improve relations with neighboring Haiti. His government has been criticized, however, for its mistreatment of undocumented Haitian migrants and for failing to comply with a 2005 ruling against it by the Inter-American Court of Human Rights, which mandated the provision of identity documents to Dominicans of Haitian descent. The Dominican Republic is expected to implement the U.S.-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) by mid-January 2007. This report will be updated.

Background

The Dominican Republic occupies the eastern two-thirds of the Caribbean island of Hispaniola, which it shares with Haiti. A population of about 9.2 million occupy an area about the size of New Hampshire and Vermont combined. With a per capita income of $3,074, it is considered by the World Bank to be 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 posted 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, a six-term president and acolyte of the deceased dictator, Rafael Trujillo, from power in 1996. Leonel Fernández of the center-left PLD succeeded Balaguer and presided over a period of strong economic growth. In 2000, after top PLD officials were charged with misusing public funds, Hipólito Mejía (2000-2004), an agrarian engineer of the populist Dominican Revolutionary Party (PRD), defeated the PLD candidate. He lost support, however, by spending excessively and deciding to bail out all deposit holders after three massive bank failures in 2003. 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.

Fernández Government. President Fernández of the PLD took office on August 16, 2004, after being elected in the first-round with 57% of the vote in May 2004. Fernández has restored investor confidence in the Dominican economy and enacted some fiscal reforms recommended by the International Monetary Fund since signing a $665 million standby agreement with the Fund in February 2005. In addition to pursuing economic and political reform, President Fernández launched an anti-crime initiative in 2005 that has been relatively successful. The program set high performance standards for police officers working in several of the country's most violent neighborhoods who were then given higher wages. It has since expanded into other areas of the country.[1]

During the first two years of his term, President Fernández faced stiff resistance to many of his legislative initiatives, particularly proposed tax increases, from the PRD, which dominated both chambers of the Dominican Congress. His position has recently improved, however, as a result of the PLD's strong performance in the May 2006 legislative elections. The PLD captured 22 of 32 seats in the Senate and 96 of 178 seats in the Chamber of Deputies in elections that were deemed to be free and fair. Analysts predict that Fernández has a good chance of being re-elected in May 2008 if he is able to address the country's ongoing problems with corruption and electricity shortages.

Corruption. The Dominican Republic ranks among the countries in which corruption is perceived to be "rampant" according to Transparency International's 2006 Corruption Perception index.[2] Although the Fernández government has charged some former government and business officials with corruption, trials have been subject to frequent delays and resulted in few successful prosecutions. For example, although Luis Alvarez Renta, a dual American citizen implicated in the 2003 Banco Intercontinental scandal, was ordered to pay $173 million by a U.S. federal court in November 2005, trials against Ramon Baez, Alvarez Renta and other top suspects in the scandal did not get underway in the Dominican Republic until October 2006. Fernández has been criticized for failing to improve the prosecution rate for those accused of corruption, to ensure that

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[1] "Miami Firm Helps Cut Crime," *Knight Ridder Tribune News*, March 19, 2006.

[2] Transparency International, *Corruption Perceptions Index 2006*, November 6, 2006, Available at [http://www.transparency.org/news_room/in_focus/cpi_2006].

there is open bidding for public infrastructure projects, or to crackdown on delinquent electricity customers, many of which are large corporations.[3]

Human Rights. According to the State Department's Country Report on Human Rights Practices covering 2005, although the Dominican government has made some progress, it still has a poor human rights record. Security forces killed between 400 and 440 individuals in 2005. In addition to the continued use of torture and physical abuse by police, prison conditions ranged from "poor to harsh" as some 13,00 prisoners are currently being held in overcrowded prisons designed to hold only 9,000 inmates. On March 7, 2005, rival gangs set a fire in one Dominican prison that resulted in 133 deaths and 26 injuries. Finally, despite the enactment of an anti-trafficking in persons law in August 2003, the State Department placed the Dominican Republic on a Tier 2 Watch List in 2005 for failing to arrest and prosecute those accused of human trafficking. In 2006, the Dominican Republic moved up to Tier 2 as it has made "significant efforts" to improve its response to the problem of human trafficking.[4]

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.[5] Each year thousands of migrants, many without proper documentation, flock from Haiti, the poorest country in the hemisphere, to the Dominican Republic to work in the sugar, construction, and tourism industries. Haitians and their Dominican-born children are regularly denied identity documents necessary to prove their citizenship and job status and to permit their children to attend school, a practice that was condemned by an October 2005 Inter-American Court of Human Rights ruling against the Dominican government. Human rights organizations have also criticized the ongoing forced repatriations of undocumented Haitian migrants.[6] There is also an ongoing concern about the illegal trafficking of Haitian children into the Dominican Republic to work as domestic servants. In early January 2006, 25 Haitian immigrants died of asphyxiation while being transported by human smugglers from Haiti to the Dominican Republic.

Many observers predict that relations between Haiti and the Dominican Republic will improve now that President Préval, with whom Fernández had a positive working relationship when both men governed in the late 1990s, has taken office. A bilateral commission to work on border security, trade, environmental protection, and other issues has been re-started. The status of Haitians and Dominican-Haitians living in the Dominican Republic may be one of the most difficult bilateral issues to resolve.

Economic Conditions

During the 1990s, fueled by rapid expansion in both the tourism and free-trade zone (FTZ) sectors, the Dominican economy grew at an annual rate of 6-8%. Remittances from

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[3] Ken Stier, "Tropical Paradox: the Dominican Republic's Economic Plan is at Odds With Its Politics," *Time*, April 24, 2006.

[4] U.S. Department of State, *Trafficking in Persons Report, 2006,* June 5, 2006.

[5] "Dominican Republic Rejects Criticism of Migrant Treatment," *Reuters*, December 10, 2006.

[6] "Jesuits Urge Stop to Deporting Haitians from Dominican Republic," *EFE,* July 7, 2006.

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. Some observers criticized Fernández's privatization of the electric sector, saying that it failed to remedy power shortages and financial difficulties.[7]

The success of both tourism and export-processing zones is extremely dependent upon the global economy. Although the Dominican tourism industry has recovered 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 (FTZs) have had trouble competing with cheaper goods coming from Central America and China. The Dominican Republic's share of the U.S. garment market fell from 3.3% in 2002 to 2.4% in 2005. Since the expiration of global textile quotas on December 31, 2004, employment in the Dominican garment sector has fallen from 190,000 to 147,000 as companies have shifted production to countries with lower wages. A recent report asserts that working conditions in the FTZs have deteriorated significantly during that same period.[8]

President Fernández inherited an economy that had been wracked by banking scandals and economic mismanagement during the preceding PRD administration of Hipólito Mejía. The country's public finances were placed under enormous strain after Mejía bailed out the country's third largest bank, Banco Intercontinental (Baninter), which collapsed in May 2003 after massive incidents of 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.[9] In addition to Baninter, two other commercial banks were bailed out in late 2003, resulting in approximately $700 million in losses to the Dominican Central Bank. The country's precarious economic situation was exacerbated by the Mejía administration's failure to comply with IMF conditions, costing the country millions of dollars in much-need foreign assistance. At the end of 2003, inflation in the Dominican Republic had reached 42%, unemployment stood at 16.5%, and the peso had lost more than half of its value.

Since Fernández took office in August 2004, however, the peso has more than regained its pre-crisis value and inflation has decelerated. In February 2005, President Fernández signed a new $665 million standby agreement with the IMF, and the government's economic and fiscal performance under the agreement appears to be good. Despite high oil prices, economic growth reached 9.3% in 2005 and roughly 10% in 2006 due to expansion in the construction, communications, and agriculture and fisheries sectors. Economists warn that structural problems in the Dominican economy —

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[7] Bacho Perez, "Widespread Blackouts Leave President Scrambling to Boost Power," *Agence France-Presse*, Feb. 8, 2000.

[8] National Advisory of Free Trade Zones in the Dominican Republic. Available online at [http://www.cnzfe.gov.do]; International Confederation of Free Trade Unions, "EPZs in the Dominican Republic and Haiti: Taking on Grupo M," November 2006.

[9] Jose de Cordoba, "Caribbean Cloud: With a Banker Facing Charges, A Nation Questions Its Success," *Wall Street Journal*, June 23, 2003.

including a lack of export competitiveness, institutional weakness, and an ongoing energy crisis — could constrain the country's future economic growth potential.[10]

On November 14, 2006, President Fernández addressed the Dominican public in order to garner both popular and legislative support for his economic reforms. Fernández maintained that to ensure sustainable economic growth, the country needed to cut public spending, raise $1.1 billion in taxes, implement DR-CAFTA, and repay its foreign debt.[11]

Energy. Electricity providers, saddled with dollar-denominated debts, are still struggling to provide service to a Dominican populace angry at high power bills and continued blackouts. They have been unable to collect for some 50% of their production due to delinquent electricity customers (many of which are large corporations), inefficiencies, and technical losses. President Fernández has considered a variety of measures to overcome the electricity crisis, including a national energy-savings plan and construction of a new privately funded oil refinery. His government has announced that it will invest $500 million for solving the country's electricity problems and $111 million for building hydroelectric plants. In June 2005, President Fernández signed a PetroCaribe agreement with President Hugo Chávez of Venezuela that provides for up to 20,000 barrels of Venezuelan oil per day to the Dominican Republic at a partially subsidized price. Some observers maintain that because the Dominican government earns significant tax revenue from gasoline sales, it has been reluctant to diversify the country's energy sources.

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. It is one of the most important countries in the Caribbean, because of its large size, diversified economy, and close proximity to 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. Despite close bilateral relations, ongoing official corruption and the Dominican Republic's failure to implement the DR-CAFTA have concerned policy-makers in the United States. Some observers have also expressed concerns that the number of undocumented Dominicans detained by the U.S. Coast Guard increased from 801 in 2002, to 4,388 in 2005.[12] The United States hopes to assist President Fernández in restoring economic prosperity through free trade, building solid democratic institutions, fighting crime and corruption, and promoting regional stability.

Foreign Aid. The United States is the largest bilateral donor to the Dominican Republic, followed by Japan and Spain. For FY2006, the United States allocated an estimated $27 million to the Dominican Republic. The Administration requested an estimated $35 million for FY2007, but Congress has not yet completed action on the

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[10] "Dominican Republic: Rapid Expansion," *Economist Intelligence Unit*, November 6, 2006.

[11] "Dominican President Calls for Support on Economic Reforms," *Associated Press*, November 14, 2006.

[12] "Migration to U.S. Soared in '05," *Miami Herald*, December 30, 2005.

FY2007 Foreign Operations spending measure. These aid amounts include support for a variety of Development Assistance and Child Survival and Health Programs, a Peace Corps staff of some 176 volunteers, and a small military aid program. The FY2007 request includes some $12 million in Emergency Support Funds, some of which will support efforts to improve the country's business regulatory framework and to ensure that vulnerable sectors benefit from the DR-CAFTA.

Counter-Narcotics Issues. In September 2006, President Bush again designated the Dominican Republic as one of four major drug transit countries in the Caribbean. 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. In September 2004, the Dominican government adopted a new Criminal Procedure Code based on an accusatory system aimed at speeding up the processing of criminal cases.

Trade. The United States is the Dominican Republic's main trading partner. The United States exported $4.7 billion in goods to the Dominican Republic in 2005, with electrical machinery (12%) and mineral fuel (8%) among the leading items. In the same year, the United States imported $4.6 billion in Dominican goods, almost the same value as exports. Some 40% of U.S. imports were apparel and clothing, but this total is some 10% less than in 2004. The Dominican Republic has benefitted from its involvement in the Caribbean Basin Initiative (CBI), a unilateral U.S. trade preference program that will be replaced by the DR-CAFTA. In 2005, 18% of Dominican exports to the United States entered under CBI. 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 U.S. trading partner.

On August 5, 2004, the Dominican Republic signed the DR-CAFTA agreement. On December 8, 2004, President Fernández signed a bill repealing a Dominican tax on drinks containing high-fructose corn syrup, a major U.S. product, which had threatened the country's chances of being included in DR-CAFTA. On August 26, 2005, the Dominican Senate approved DR-CAFTA by a vote of 27-2. The Chamber of Deputies followed by approving the measure on September 6, 2005, by a vote of 118 to 4. The Dominican Republic was scheduled to implement the agreement on July 1, 2006, but that date was postponed. In late 2006, the Dominican Congress approved a package of laws to bring the country into compliance with the DR-CAFTA, but it is still working to finalize compensatory tax reforms needed to recoup the tariff revenues that are likely to be lost when the agreement takes effect. The Dominican Republic is expected to be fully compliant with the DR-CAFTA (and thereby able to implement the agreement) by mid-January 2007.