DOMINICAN REPUBLIC

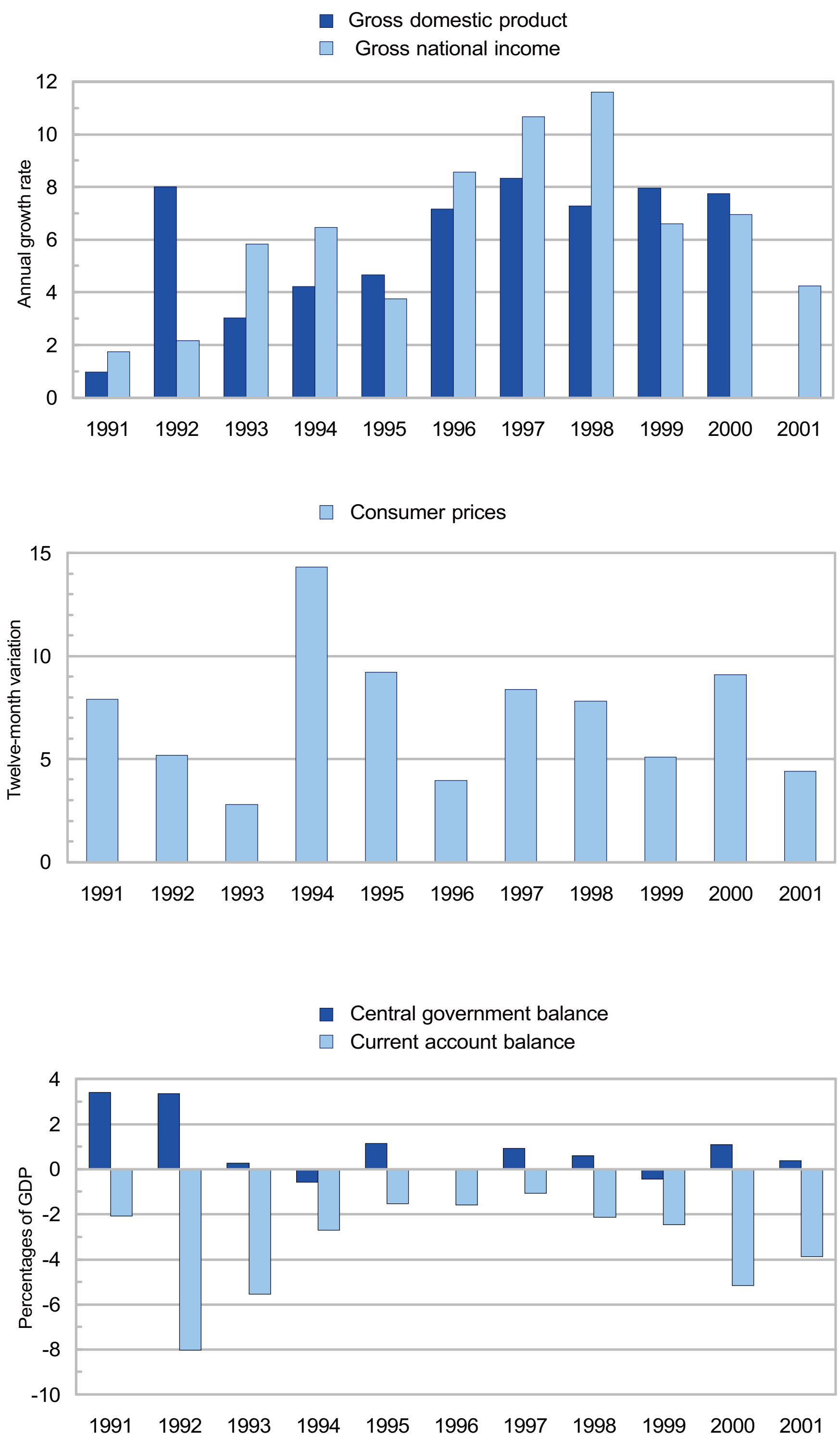
1. General trends

In 2001 the Dominican economy's pattern of rapid growth over the past few years was interrupted. Gross domestic product (GDP) grew by 2.7%, compared to the average of 7.2% over the previous five years, pushing up per capita GDP by scarcely 0.4%. The slump in external demand as a result of the weakening of the world economy had a very negative impact on productive activities. The government responded with countercyclical policy measures that gave rise to a moderate expansion of domestic demand, bolstered by the continuing increase in remittances from abroad and in foreign investment, as well as the favourable effect of the fall in international oil prices. These circumstances failed to prevent an increase in unemployment, but December-to-December inflation dropped to 4.4% and the exchange rate was kept relatively stable. Interest rates also diminished, as did the external and fiscal deficits.

FOR THE FIRST time in more than a decade, exports of goods and services contracted. The maquila industry reduced its level of production, and tourism revenues declined. At the same time, however, the slide in the value of imports as a result of the slowdown in productive activity and the lower oil bill led to a narrowing of the trade deficit. Family remittances continued to increase, helping to bring the balance-of-payments current-account deficit below its 2000 level. Despite the grim international investment environment, foreign direct investment increased and international markets reacted very positively to the country's US$ 500 million sovereign bond issue. The upshot was a strengthening of the position of international reserves, which helped keep the exchange rate and domestic prices relatively stable.

In view of signs of an economic slowdown in the early part of 2001, the authorities adopted a monetary policy designed to jump-start the economy and reoriented their fiscal policy, making it more expansive at the end of the year. The increase in liquidity, stimulated by the monetary authorities, encouraged lending and paved the way for significant interest rate cuts. This, in turn, prompted a rise in consumption and a moderate increase in capital formation. Unemployment, however, rose considerably in 2001

Figure 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

owing to the weakening of activity in very labour-intensive production sectors such as free zones and tourism.

Signs of slack external demand persisted in the initial months of 2002. Tourism activity was still down in the first quarter in comparison to the year-earlier period, though this gap progressively narrowed. The free zones have yet to see clear signs of a recovery in purchase orders. Government authorities are forecasting a moderate recovery of economic activity in 2002. Specifically, they expect a 4% increase in GDP and a 6% to 7% rate of inflation. They have also unveiled a flexible economic policy designed to reflect trends in external demand.

2. Macroeconomic policy

In the first half of 2001, the economy felt the full impact of lower external demand and the public spending curbs, fiscal reform and monetary restrictions adopted in the second half of the previous year. In this context, the authorities took several steps to soften the negative impact of these developments on productive activity and employment, while taking care not to compromise the process of fiscal rehabilitation and the restoration of monetary balances. The macroeconomic results for 2001 reflect the combined effects of these factors.

(a) Fiscal policy

After managing expenditure conservatively for the first nine months of the year, in the last quarter the government adopted an expansive policy. Even so, owing to the positive results of the fiscal reform adopted at the end of 2000, the consolidated public-sector deficit was reduced from 2.2% of GDP to 1% in 2001.

For the second year in a row the central government achieved a budget surplus, equivalent to 0.4% of GDP. Total expenditure rose by 16.6% in real terms, as current disbursements expanded by 9.7% owing to increases in both personnel and wages. More jobs were created in the health and education sectors, and new secretariats of State were established. There were also increases in current contributions to decentralized institutions (15.4%) and in interest payments on the public debt, which represented 5.3% of total current expenditure.

Capital expenditure was up by 22% in real terms, owing to its expansion in the last quarter of the year. Various road works were carried out in the central district, along with health, education and housing infrastructure projects. There was also an upsurge (64%) in capital contributions to decentralized entities.

The tax reform adopted at the end of 2000 brought large dividends. Tax revenues increased by 11.7% in real terms, raising the tax ratio from 13.7% in 2000 to 15% in 2001, despite the revenue losses due to tariff cuts. The tariff structure was also simplified, with the establishment of five tariff brackets. Income tax receipts increased by 30.8% as a result of the Fiscal Amnesty Act, the measures taken to expand the tax base and the introduction of a 1.5% minimum tax on the gross sales of large businesses as an advance income tax payment.

With regard to taxes on goods and services, the amount collected was 38.5% higher than the 2000 figure, so that these receipts accounted for almost half of total tax revenues. Receipts from the goods and services transfer tax increased by 31.8%, owing to a rate increase from 8% to 12%, the elimination of exemptions and the broadening of the tax base. Selective excise taxes also increased (73.1%). In November 2000 the tax mechanism applied to fuels (known as the oil differential) was modified and a fixed per-gallon tax for each product was established to replace the previous system of fixed prices, which had resulted in a sharp reduction in receipts owing to the increase in international oil prices. At the same time, the tax on rum and other alcoholic beverages was raised from 25% to 35%, and the tax on beer, from 20% to 25%.

Owing to the combined effects of tariff reductions and the lower value of imports, external trade suffered a substantial loss of income (-36%). This sector's contribution to tax revenues fell from 28.8% to 17% between 2000 and 2001.

Lastly, although in October 2001 the commission on foreign currency exchanges was reduced by 0.25 percentage points, to 4.75%, this sector continued to generate significant fiscal revenues (5% of the total).

With regard to the public debt, the central government reduced its liabilities with the central bank and the reserve bank, which it had increased considerably in 2000 to finance its external debt payments. At the same time, the placement on international markets of US$ 500 million in sovereign bonds increased the external debt by 12.3%, raising it to US$ 4,137 billion. Nevertheless, the external debt balance represented 19% of GDP and interest payments amounted to just 2.4% of goods and services exports; these ratios were among the lowest in Latin America.

Table 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growth rates [b]								
Growth and investment									
Gross domestic product	3.0	4.2	4.7	7.2	8.3	7.3	8.0	7.7	2.7
Per capita gross domestic product	1.3	2.4	2.9	5.3	6.4	5.4	6.1	6.0	1.0
Gross domestic product, by sector									
Goods	0.8	5.6	3.9	7.1	8.2	6.7	9.2	6.5	0.5
Agriculture	0.6	-1.8	5.2	9.2	3.3	1.1	6.7	5.0	5.4
Mining	-36.0	88.2	9.4	2.4	3.1	-15.9	-1.5	9.2	-15.2
Manufacturing	1.2	3.5	1.3	3.1	7.5	5.7	6.4	9.0	-1.3
Construction	10.1	7.8	5.8	13.4	17.1	19.6	17.7	5.2	1.0
Basic services	7.0	5.5	7.8	10.1	11.5	13.6	9.8	10.6	11.7
Electricity, gas and water	15.5	3.8	-4.1	10.3	10.1	13.9	8.1	11.0	18.4
Transport, storage and communications	5.3	5.9	10.3	10.0	13.5	13.6	10.4	13.5	10.5
Other services	4.1	2.8	4.6	6.4	7.1	6.3	5.8	6.9	2.0
Commerce, restaurants and hotels	7.8	4.0	9.4	10.1	12.2	8.6	9.0	10.8	-1.2
Financial establishments, insurance, real estate and business services	0.1	0.6	1.2	2.1	2.8	3.0	3.2	2.8	2.5
Consumption	-7.9	...	...	9.3	7.6	8.9	2.8	7.1	4.3
General government	-1.9	...	...	10.6	1.3	6.4	3.8	-1.6	14.7
Private	-8.7	...	...	9.1	8.5	8.9	2.9	9.3	3.1
Gross domestic investment	18.7	...	...	9.2	18.4	26.0	13.6	6.9	2.3
Exports of goods and services	134.9	...	...	4.4	9.0	6.5	7.2	7.2	-7.9
Imports of goods and services	100.4	...	...	8.5	12.8	18.1	4.0	6.9	-4.9
	Percentages of GDP [c]								
Gross national income	100.7	102.8	101.9	103.2	105.5	109.7	108.3	107.5	109.1
Gross domestic investment	26.0	24.2	21.9	21.8	23.9	29.1	30.0	29.9	29.6
National saving	21.0	21.8	20.3	20.1	22.8	26.7	27.1	23.7	24.6
External saving	5.0	2.5	1.5	1.6	1.2	2.4	2.9	6.2	5.1
	Percentages								
Employment and wages									
Open unemployment rate	19.9	16.0	15.8	16.5	15.9	14.3	13.8	13.9	15.6
Real minimum wage (index: 1995=100)	93.5	99.5	100.0	100.6	102.0	106.3	111.5	111.4	117.5
	Growth rates								
Prices (December-December)									
Consumer prices	2.8	14.3	9.2	4.0	8.4	7.8	5.1	9.1	4.4
External sector									
Terms of trade (index: 1995=100) [c]	90.7	95.6	100.0	97.7	102.0	103.1	104.0	102.0	103.6
Nominal exchange rate (pesos per dollar)	12.7	13.2	13.6	13.8	14.3	15.3	16.0	16.4	17.0
Real effective exchange rate for imports (index: 1995=100)	106.6	103.1	100.0	94.3	95.6	102.6	107.1	105.3	102.6
	Millions of dollars								
Balance of payments									
Current account	-533	-283	-183	-213	-163	-338	-429	-1,026	-839
Trade balance goods and services)	-730	-584	-406	-656	-720	-1,435	-1,302	-1,888	-1,748
Exports	4,748	5,240	5,731	6,193	7,060	7,482	7,987	8,964	1,332
Imports	5,478	5,824	6,137	6,848	7,780	8,917	9,289	10,852	10,079
Capital and financial accounts [d]	35	-142	251	183	258	351	592	979	1,352
Overall balance	-498	-425	68	-30	95	13	163	-48	513
Variation in reserve assets (- indicates an increase)	-156	387	-131	15	-40	-98	-194	70	-519

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	47.5	37.8	33.5	28.6	23.7	22.3	20.9	18.6	19.2
Net interest (as a percentage of exports) [e]	4.4	3.0	3.2	2.6	1.8	1.6	1.3	1.2	2.0
					Percentages of GDP				
Central government									
Current income	15.9	15.0	14.8	14.2	15.9	15.9	15.3	14.8	15.7
Current expenditure	8.2	7.6	7.8	8.1	10.9	11.1	11.2	11.3	12.1
Saving	7.8	7.3	7.0	6.1	4.9	4.7	4.1	3.5	3.6
Capital expenditure	8.1	8.5	6.5	6.4	4.3	4.4	5.0	3.6	4.3
Financial balance	0.3	-0.6	1.1	0.0	0.9	0.6	-0.5	1.1	0.4
					Growth rates				
Money and credit									
Net international reserves	45.3	-91.4	409.7	1.4	37.9	-6.7	64.0	-70.3	604.8
Net domestic credit	17.4	40.6	11.9	22.9	21.4	21.3	21.6	18.3	10.9
Money (M1)	25.1	2.3	16.9	26.5	22.2	7.8	19.7	-11.6	17.9
Local currency savings and time deposits	30.3	15.8	19.4	13.5	23.6	32.1	25.7	28.3	25.5
M2	27.9	9.8	18.4	18.8	23.0	21.5	23.3	13.3	23.3
Dollar deposits	-71.4	-8.4	101.3	164.0	8.2	-50.6	76.9	-86.4	-51.6
					Annual rates				
Real interest rate (annualized, %)									
Deposit rate	...	...	2.4	8.0	4.8	12.2	9.0	9.3	6.0
Lending rate	...	...	16.2	17.4	11.8	19.9	17.4	17.7	13.8
Equivalent interest rate in foreign currency [f]	...	...	14.2	13.9	14.5	17.5	16.1	17.6	16.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1970 pesos. [c] Based on constant 1995 dollars. [d] Includes errors and omissions.
[e] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. From 1993 on, export figures include *maquila* exports. [f] Interest rate on deposits, deflated by the variation in the exchange rate.

(b) Monetary policy

In contrast to the restrictive monetary policy that prevailed in the latter part of 2000, in 2001 a more flexible posture was adopted, with the clear objective of stimulating domestic demand. The measures taken increased liquidity and encouraged interest rates to fall, after the rise observed in 2000, in line with the trend of that variable on international markets. This reduction was facilitated by the strengthening of public finances, which substantially decreased public-sector demand for net resources from the banking system.

In order to reach those objectives, the authorities built up the country's international reserves and reduced the amount of participation certificates held by commercial banks and the public. The limit on deposit-taking and short-term financing in foreign currency by commercial banks, set at 30% of their capital and reserves, was made more flexible.

Money creation increased by 7.8% in real terms, compared to 5.1% in 2000. The money supply (M1) expanded by 16.6%, which contrasts with the 17.5% contraction in 2000. Broad money showed a real increase of 20.6%, compared to 4.2% the previous year. In particular, quasi-money grew by 22.4%, also influenced by the inflow of dollar deposits from abroad, most of which are held by Dominican residents.

Beginning in the second quarter, interest rates in local currency showed a significant downward trend. By the end of the year, the cumulative reductions were 7.7 points for loan rates and 6.3 points for deposit rates, so that in December the former stood at 21.2% and the latter, at 12.4%. The whole spectrum of loan rates –for mortgage, personal consumer, business, preferential and interbank loans– experienced similar declines. Rates on dollar deposits and loans dipped by only one percentage point, to 10.1% and 6.94%, respectively.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	1999				2000				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of previous year)	5.5	6.1	10.6	9.0	11.6	10.2	5.6	2.7	-1.8	10.2	5.6	2.7	-1.8
Consumer prices (12-month variation, %)	7.7	6.4	5.3	5.1	5.7	7.3	12.7	9.1	11.1	10.2	5.9	4.4	3.9
International reserves (millions of dollars)	457	537	613	694	545	497	431	627	554	668	1,148	1,099	884
Real effective exchange rate [b] (index: 1995=100)	107.1	107.3	108.3	105.8	106.1	106.6	105.6	102.7	101.9	101.9	103.3	103.3	102.2
Real interest rates (annualized, %)													
Deposit rate	10.0	9.1	8.4	8.6	10.3	10.1	7.4	9.2	6.9	6.0	5.2	6.3	-1.1
Lending rate	18.2	17.5	17.4	16.8	17.8	18.2	16.4	18.5	14.9	13.4	13.0	14.8	6.6

Source: ECLAC, on the base of official figures.
[a] Preliminary figures. [b] Refers to exchange rate for imports.

As a result, the loan portfolio increased substantially (by 23% in real terms). Credit to the private sector expanded by 18.5% in real terms, with most of the increase observed in construction, agriculture and manufacturing. The balance for the commercial and hotel sector, to which 36% of total loans were extended, increased by scarcely 2.9%. Meanwhile, the public sector's liabilities, mainly with the central bank and the reserve bank, were reduced by 46.4% in real terms.

In 2001, to improve the banking system's finanial health, the authorities launched a programme of bank regulation and supervision and introduced new standards for the assessment of market risk in the banking system. In consequence, banking entities now conduct monthly evaluations of their degree of exposure to liquidity, interest-rate and exchange risks. The authorities also unveiled a preliminary draft of the new monetary and financial law.

(c) Foreign-exchange policy

The nominal exchange rate remained relatively stable in 2001. Bank exchange rates reached an average of 16.8 pesos to the dollar, which represented a moderate 3% increase over the year. In real terms, however, the peso appreciated slightly in 2001, accumulating a revaluation of 4.5% in relation to the dollar over the past two years.

Among other measures, the monetary authorities sought to align official market rates with private rates by allowing the official exchange rate to move more freely; established a foreign exchange desk to reduce volatility in foreign-currency operations; began to dismantle the commission applied to sales and purchases of foreign exchange, reducing it from 5% to 4.75%; and, at the end of the year, provided that exporters of traditional goods were no longer obligated to hand over foreign currency to the central bank.

3. The main variables

(a) Economic activity

In contrast to the dynamic expansion that characterized exports of goods and services for most of the 1990s, external demand collapsed in 2001 (-7.9%). Although initially this negative external shock had ripple effects on domestic demand and production –a setback in which the impact of tax and tariff reforms also played a role–, domestic demand rebounded in the second half of the year, showing a moderate increase for the year as a whole. Total consumption increased by 4.3%, while investment rose by 2.3%, driven by the increase in public spending.

GDP grew by 2.7%, compared to the average increase of 7.7% over the previous five years. Growth was led primarily by the almost 12% expansion in utilities, particularly communications and electric power, thanks to the steady increase in sales of cellular telephone services and in thermal energy production by private suppliers.

Goods production remained virtually unchanged (with 0.5% growth in 2001, compared to 6.5% the year before), despite the 5% increase in agricultural activity as a result of the higher output of sugar (10%), cocoa (47%) and tobacco (73%) and the recovery in the production of rice (23%), maize (47%), beans (37%) and peanuts (23%). In the final quarter, the construction industry managed to reverse the decline it had suffered in the first nine months, ending the year with an annual growth rate of 1%. There were slippages in mining (-15%) and manufacturing (-1.3%), the latter being due largely to reduced output in the free zones, although there was also the effect of tariff cuts, which necessitated a significant adjustment in manufacturing production. With regard to services other than utilities, there was a contraction in commerce (-1.2%), which includes the hotel industry.

(b) Prices, wages and employment

As a result of the uneven growth rates in the various production sectors, the open unemployment rate rose from 5.8% to 6.5%, while general unemployment expanded from 13.9% to 15.6%. This mainly reflected cuts in the number of jobs in hotels (-7%) and manufacturing (-10.1%), as employment fell in both the free zones and local industries.

Consumer prices increased by 4.4% from December to December, which was half the rate recorded in 2000. The annual average, however, showed an increase of 8.9%, compared to 7.7% the year before. This outcome could be traced in part to the fiscal measures adopted at the beginning of the year, which raised taxes on various consumer items and increased the amount by which prices and charges for various services were adjusted. The rise in prices was mitigated somewhat by the drop in oil prices on international markets, which drove down domestic fuel costs.

Prices in the food, beverages and tobacco sector, which has the greatest weight in the index calculation, climbed by 6.1% as a result of the tax increase on alcoholic beverages and tobacco, whereas food prices themselves changed very little. Other segments that showed increases were hotels, bars and restaurants, and miscellaneous goods and services (13% and 15.1%, respectively). The cost of private education increased faster than the average rate for the year.

After staying at the same level for about 20 months, minimum wages were adjusted in 2001 for workers in both the public and private sectors. The biggest nominal increases went to employees of large private firms (15%) and rural workers (13.9%). In small and medium-sized enterprises (SMEs), free zones and the public sector, nominal increases of just over 10% were introduced. In real terms, minimum wages rose by 5.6% and 4.6% in the first two areas, 1.5% in SMEs and 1% in free zones and the public sector.

(c) The external sector

Owing to the significant fall in exports of goods and services (-7%), export earnings were US$ 632 million lower than in 2000, a figure equivalent to 4.5% of current GDP. The lower level of activity in the free zones and the economic slowdown resulted in an even bigger decline in the level of imports, which brought the trade deficit down to US$ 342 million. This, in addition to the increase in family remittances, reduced the deficit of the balance-of-payments current account to US$ 840 million, or 3.9% of GDP, compared to 5.2% in 2000. Foreign direct investment flows recovered, despite the adverse international situation; thus, the overall balance was in surplus and there was an increase in international reserves.

Merchandise exports reached US$ 5,332 billion, a figure 7% lower than the previous year's level. After more than a decade of steady expansion, sales from the free zones, which account for 85% of total merchandise exports, shrank by 4.9%. The reduction in purchase orders dampened the positive effect of the extension of the benefits of the Caribbean Basin Initiative the previous year. Production, especially of textiles and clothing, suffered the sharpest contraction in the second half of the year.

Exports of locally produced products also diminished (-17.7%), reaching a total of US$ 795 million. Lower international prices eroded earnings from sugar and sugar derivatives (-0.9%), which are the main agricultural export, as well as those from coffee and coffee products (-66.5%) and tobacco and tobacco products (-31.9%). Only cocoa beans showed an increase (75%), reaching a figure of US$ 38 million. Sales of nickel-iron, which accounted for 25% of locally produced exports, plunged by 38.9% as lower export volumes coincided with a 30% drop in price. In view of this situation, the relevant firm temporarily closed down operations in 2001. Sales of fuel and food to airlines and shipping lines also slid (-22.3%).

Merchandise imports contracted by 7%, to a level of US$ 8,815 billion. Inputs and components for the free zones (valued at US$ 2,847 billion and equivalent to 48% of the total) experienced an unprecedented 7% decline. The level of imports to the rest of the country reflected the impact of the 18% decline in the value of purchases of petroleum and petroleum products, which represent 21% of the total, as a result of the fall in both international prices and import volumes. Other intermediate products fell by 8.5% and consumer goods, by 10%, as purchases of both durable goods and food declined.

The travel segment slumped by 6% as fewer tourists visited the country. Over the course of the year, the depreciation of the euro in relation to the dollar had a negative impact on tourism from Europe, which is the biggest source of foreign exchange in this segment. This decline was very pronounced in the last quarter of the year after the September attacks in the United States. The traditional surplus in the services balance was thus reduced from US$ 1,854 to US$ 1,703 billion. Contrary to forecasts at the beginning of the year, inflows of family remittances from abroad continued to climb in 2001 and reached a total of US$ 1,808 billion, which is 7% above the amount for the previous year and represents 8.4% of GDP.

Foreign direct investment inflows rebounded significantly in 2001, reaching US$ 1,198 billion, or 25.8% more than the previous year's level. Investments are continuing to flow into the country for the development of tourism infrastructure and of other sectors such as electric power, communications and trade.