Statement by Murilo Portugal
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**Dominican Republic: Country Assistance Strategy**

During the last two years the Dominican Government and the Bank have engaged in extensive dialogues, focusing on the necessary policy reforms and the desired Bank support for the country’s needs. This CAS is a reflection of the new dynamics between the Bank and the Government of the Dominican Republic. The agenda presented in the document is the result of an exercise in which the Government has been extensively consulted and its views on the economic reform process have been taken into consideration. In the past it was not always easy for my Dominican authorities to convey the message to the Bank regarding the pace of the reforms and the assistance required. So they welcome the change in attitudes under the Bank’s new leadership.

My Dominican authorities are committed to economic reform and to have the benefits of such reform permeating to all segments of the Dominican population, especially the most needed. But while the talk about reform is commonplace in the country, the political context for such reforms is not always ideal. My Dominican authorities welcome the Bank’s assessments in this regard and, while optimistic about the prospects for reform, they are also aware of the difficulties on the road ahead.

The Dominican Government has identified as pillars for reducing poverty; sustainable economic growth; the increase of the number of Dominicans sharing the benefits of growth; the modernization of the state and improved governance; and natural resource management. My authorities also share the views of the Bank for delivering its assistance, specifically the proposed focus on consensus and partnership building, and portfolio management.

**Gradual Transformation Process**

The process of transformation to a diversified economy started gradually in the
Dominican Republic in the late 1960s, shortly after the end of the civil war, when the first export processing zone started operations under a law that allowed only foreigners to operate such businesses. The initial positive effect of the opening of the export processing zone prompted the government and private sector operators to continue investing in export processing parks, including a move by the government to open opportunities in this sector to local investors.

Exchange policy measures introduced in the 1980's, along with the benefits provided by the US Caribbean Basin Initiative, stimulated manufacturing. North American, Asian and European companies set-up operations in the country. Today, the most notorious characteristic of the Dominican export processing zones is the presence of local investors who are increasingly modifying their way of doing businesses so as to generate more value added. In the apparel sector, for example, firms that used to only work in the assembly of garments today own cutting rooms, and perform washing, pressing, packaging, and delivery to their destination markets. This way of doing business re-defined the role of export processing zones debunking the idea that such activities were not self-sustainable.

In the tourism sector, a newer industry for the country, the experience is somewhat similar. First, foreign investors entered the market opening new lines of businesses, providing the technical know-how, training local personnel, and creating linkages to new markets. Today more local hoteliers and restaurateurs are joining the ranks European and North American investors who operate this profitable activity in the Dominican economy. Supporting this industry there are also world class food processing, transport, and telecommunication firms. Today this sector has become the most powerful engine of the economy.

Both these cases are illustrative of the Dominican openness to change. The country modern economic history clearly shows that Dominicans are willing to change when the path for change is defined within acceptable parameters.

Within this context the Bank was called-upon to participate, as a partner, in targeted activities. It further performed a role as a facilitator in policy dialogue also at the request of my Authorities. The Bank is now assisting the Government, the opposition parties, and the civil society to continue the dialogue in order to take the Dominican Republic in the reform path.

Macroeconomic Policy and Reform Proposals

The CAS document is clear regarding the recent economic achievements of the economy. Macroeconomic stability is at the center of the Dominican economic success in the 90s. A small public sector and an un-orthodox budget management process have contributed to maintain that stability. To further strengthen the country's position the Central Bank pursued sound monetary policies. While the outcome of such policies has been positive, my Dominican authorities acknowledge that more needs to be done in the area of macroeconomic management. To proceed along that path, they have mapped a reform agenda that now needs to be taken by the political process.

Fiscal Policy. In the area of fiscal reform, my Authorities believe in increasing
transparency and accountability, and in reducing discretionary spending. The Dominican Government has already taken major measures to reduce discretionary spending and increase transparency. But my authorities are of the opinion that budget flexibility to face unforeseen events is also needed.

The Dominican political arena is a heated one. So often are the reactions of certain groups to shortcomings in the delivery of specific social services. It is commonplace that the Dominican Government has to resort in tapping the discretionary budget to face issues related to social eruptions. A centralized entity may be the only way to speedily respond to those cases. My Dominican authorities are of the opinion that certain levels of discretionarity, to deal with such social eruptions, may be needed even after completing a budget rationalization exercise. The experience of budget decentralization in Latin America and other parts of the world seem to have introduced rigidities in the budget process. Given the recent history of the country, my Dominican authorities attach a high price to social peace. They would not like to go back to the times of civil unrest. For this reason they consider important to retain some degree of flexibility in expenditures.

Financial and Monetary Policy. The monetary authorities of the country are committed to maintaining price stability by managing the monetary aggregates, by prudently using open market operations, by managing the legal reserve requirements, and by limiting financing to the public sector. The authorities have also very successfully intervened in exchange markets to avert panics that could destabilize the local financial system with great damage to the real economy. The role of monetary policy has been easier given the control of public expenditures by the Central Government.

The Central Bank, along with the Superintendence of Banks, has continued to improve the regulation and supervision of the Dominican financial sector, based on the Basle Committee standards. Equity strengthening (capital and reserves) increased by 33.9% last year, while most recent asset assessment and qualification data reflect a capital adequacy of 11%, higher than the locally required 10% and higher than the Basle requirement of 8%. In addition to policy measures, the recent interest of foreign banks in the Dominican Republic can provide a market incentive to improve operations in the sector.

Social Policy

The Dominican Government has made a commitment to improve the way it deals with social services, especially for the less fortunate. In addition to increased budget expenditures for the social sector, my Authorities have defined that efficiency in delivering those services is a goal that needs to be achieved.

Pension Reform. The government has been conducting a dialogue with labor unions, the business community and the opposition parties on the options to reform the pay-as-you-go system. So far there is no clear definition on the preferred choice, but there is consensus that the actual system is unworkable.
Education and Health. Major initiatives to decentralize the provision of both health and education are underway. With the assistance of the World Bank, the IDB and bilateral donors, the Government is implementing measures that are already transforming the way the state provides for such services. While efforts can only show modest results, the gradual approach to transformation is the best choice especially because of cultural preferences and because implementation capacity is not strong. The Government expects the poor to greatly benefit from the reforms in both sectors.

Private Sector Development

The Government of the Dominican Republic has focused the country growth strategy in fostering private sector development. A new foreign investment law that, among other things eliminated restrictions for the repatriation of profits has been a boost for economic activities. Recently, the Government has successfully privatized the electricity sector, and firms in other sectors, with expected major impacts in service provision and fiscal accounts. Furthermore, it is expected that the privatization process would send the right signals to foreign investors. Attempts to reform the hydrocarbon sector have been delayed by contractual agreements signed with foreign firms during past administrations. The Government continues to seek solutions to the contractual impediments to liberalize the sector.

My Authorities appreciate the renovated interest of IFC in the country. After the amicable solution of a dispute involving an IFC-financed project the field is clear for fresh investments. The Dominican private sector is eagerly waiting for the opening of the IFC office in Santo Domingo. It would be ideal for the presence of IFC to be used to leverage instruments and mechanisms of the World Bank Group available to private investors. The Government is also counting with the engagement of IFC in the water and sanitation reform initiatives to be supported by the Bank.

In closing, my authorities would like to convey the message of their commitment to openness and reform. Foreign investments in the dynamic sectors of the economy were welcomed even before the locals were allowed to invest. The reforms have allowed the country to keep a vigorous economy despite the devastating effects of last year's hurricane Georges, and the global financial turmoil. But they would like to stress that reform and openness has to be put within the context of the Dominican political and social framework.

My Dominican authorities would not like to let this opportunity pass without sincerely thanking the World Bank's Management and Staff for their renewed interest in the country. They would like to thank Mr. Wolfensohn, who at their request, altered his itineraries last year to pay an official visit to the country. They were very pleased to see that he took the time to talk to them, to the opposition, to the private sector and other groups, and to have a taste of the part of the Hispaniola he had not visited in his official capacity. They would also like to acknowledge the Vice-presidency of LAC, and the Caribbean Country Management Unit, in the person of Mrs. Kalantzopoulos, for its continued commitment to the country. This commitment is reflected, among other things, by the recent decision to open a resident mission in Santo Domingo. My Authorities look forward to having the Mission become fully operational for further enhancing their relationship with the Bank.