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

Rebecca G. Rush and Clare Ribando Seelke
Analysts in Latin American Affairs
Foreign Affairs, Defense, and Trade Division

Summary

President Leonel Fernández of the Dominican Liberation Party (PLD), who served as president previously (1996-2000), took office again on August 16, 2004 and is running for reelection on May 16, 2008. Since taking office, President Fernández has presided over a period of rapid economic growth, enjoys continued popular support, and has a majority in both legislative chambers. He has enacted fiscal reforms and restored investor confidence in the Dominican economy, but also suffered setbacks stemming from an alleged financing scandal and criticism of the government's response to two tropical storms in late 2007. Fernández is the favored candidate in the May 16, 2008 presidential race, enjoying a significant lead over his chief opponent, Miguel Vargas Maldonado of the Dominican Revolutionary Party (PRD). With the March 2007 implementation of the U.S.-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR), observers expect a rise in foreign investment in the Dominican Republic in 2008. 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 almost 9.4 million occupies an area about the size of New Hampshire and Vermont combined. With a per capita income of $2,850, 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, Danilo Medina. He lost support, however, by spending excessively and deciding to bail out all deposit holders after three massive bank failures in 2003. Mejía seemed to focus 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. During his time in office, he has helped to restore a strong economy in the Dominican Republic by increasing investor confidence and enacting fiscal reforms recommended by the International Monetary Fund (IMF). In addition to pursuing economic and political reforms, President Fernández also initiated an interagency strategy in October 2007 to curb crime related to drug trafficking, criminal organizations, illegal immigration, and social violence. Concurrently, the new Specialized Border Corps (Cesfront), with support on the Haitian side from UN forces, has begun operating along the Dominican-Haitian border, a key location for trafficking of drugs, people, and contraband.

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 improved, however, when the PLD captured a majority of seats in both chambers of Congress in the May 2006 legislative elections. Despite the PLD's majority in the legislature, Fernández has not pushed for any major reforms in the past few months as his focus has been on the presidential campaign.

Upcoming Elections. The three main candidates for the May 16, 2008 presidential elections are incumbent Leonel Fernández of the PLD, Miguel Vargas of the PRD, and Amable Aristy Castro of the Social Christian Reformist Party (PRSC). A March 2008 opinion poll reveals that Fernández, whose campaign is strengthened by substantial economic growth, but weakened by corruption allegations, remains the frontrunner by some 24 percentage points. Some attribute this recent increase in popular support to the international acclaim he received as host of the Rio Group Summit in March 2008.[1] While many observers were predicting a runoff election between Fernández and Vargas, who is his main opponent, most sources now predict that Fernández could secure a victory in the first round. Miguel Vargas' campaign has been undermined, in part, by his association with former President Mejía, under whom he served as minister of public works (2000-2004), while the PRSC candidate trails in a distant third. The primary issues of this election cycle continue to be crime rates, power outages, economic conditions, and the status and treatment of Haitian migrants and Dominican-Haitians.

Corruption. Transparency International's 2007 Corruption Perception index ranks the Dominican Republic among countries in which corruption is perceived to be

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[1] "Fernández Set to Win in Dominican Republic," *Latin News Daily*, March 20, 2008.

"serious," a slight improvement over its 2006 ranking.[2] In December 2007, the PRD alleged that the administration was involved in a corruption scandal involving a $130 million public works contract, although the allegations have not been substantiated. This accusation followed months of growing criticism that the Administration was not doing enough to clamp down on official corruption. Although the Fernández government has charged some former government leaders, business officials, and police officers with corruption, trials have been subject to delays and resulted in few successful prosecutions.

Human Rights. According to the State Department's Country Report on Human Rights Practices covering 2007, although the Dominican government has improved its human rights record, some significant problems remained. Reforms of police tactics and increased punishments of officers accused of misconduct have led to a decline in extrajudicial killings carried out by security forces, but 13% of all violent murders, as of August 2007, are still attributed to the police. Unlike in 2006, where "a number of deaths" were reported as a result of negligence in the prison system, the prison director did not report any such deaths in 2007. While prison conditions continued to range from "poor to extremely harsh" in most prisons, prisoners in newer facilities experience better living conditions. Finally, despite the enactment of an anti-trafficking in persons law in August 2003, the Dominican government has struggled to arrest and prosecute those accused of human trafficking, particularly in cases involving public officials.

Status of Haitians and Dominican-Haitians. The Dominican government continues to receive international criticism for its treatment of an estimated one million Haitians and Dominicans of Haitian descent living within its borders.[3] 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.

In February 2008, the Organization of American States called for closer relations between the Dominican Republic and Haiti and development of the border region in order to combat corruption and human and drug trafficking. A bilateral commission to work on border security, trade, environmental protection, and other issues was relaunched in March 2006 between Presidents Fernández and Rene Préval of Haiti. Relations remain somewhat strained, however, due to Dominican policies toward Haitian immigrants and a recent ban on Dominican poultry products by Haiti after a strand of the bird flu was found in some Dominican fighting cocks. During this Dominican election season, the treatment of Dominican-Haitians is becoming a much larger issue than in previous

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[2] Transparency International, *Corruption Perceptions Index 2007*, August 2007, Available at [http://www.transparency.org/policy_research/surveys_indices/cpi].

[3] "Haitian Migrants Denied Basic Rights in Dominican Republic," Amnesty International, March 21, 2007.

elections, mostly due to the activism of Rubén Jean-Baptiste Latorti, who has begun a movement to represent the 5% voting block of Dominican-Haitians.[4]

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 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.[5]

After taking office again in August 2004, President Fernández inherited an economy that had been wracked by banking scandals and economic mismanagement. The country's public finances were placed under enormous strain after then-President Mejía bailed out the country's third largest bank, Banco Intercontinental (Baninter), which collapsed in May 2003. The Baninter scandal occurred after bank executives defrauded depositors of U.S. $2.2 billion worth of account holdings — an amount equal to almost 67% of the Dominican Republic's annual budget.[6] The country's precarious economic situation was exacerbated by the administration's failure to comply with IMF conditions. 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.

Economic recovery has occurred under Fernández, and the peso has more than regained its pre-crisis value, while inflation has decelerated. In February 2005, President Fernández signed a $665 million standby agreement with the IMF, which expired in January 2008. In the IMF's official review of the three-year package, it lauded the government's ability to bounce back from the economic crisis and efforts to bring public spending under control. The IMF criticized the government's failure to enact some financial market regulations and meet benchmark standards in the electricity sector.[7] It is unclear whether the Dominican government will seek a renewal of the IMF aid package, although it is likely that the IMF would agree to an extension, given the government's success in carrying out its previous recommendations. Despite high oil prices, economic growth reached roughly 10% in 2006 and approximately 8% in 2007 due to expansion in the construction, communications, and agriculture and fisheries sectors. Economists predict that a slowdown in the U.S. economy and structural problems in the

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[4] "Dominican-Haitians Set for Bigger Role in Elections," *Latin American Caribbean and Central American Report*, January 25, 2008.

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

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

[7] US Fed News, "IMF Executive Board Completed Final Review Under Stand-by Arrangement with Dominican Republic," February 4, 2008.

Dominican economy, including a lack of export competitiveness, institutional weakness, and the electricity crisis, could constrain the country's future economic growth potential.[8]

Energy.[9] Electricity providers are still struggling to provide adequate service to a Dominican populace angry at high power bills and continued blackouts. Debt in the electricity sector, including governmental debt, totals close to $500 million. Although the government provides major electricity subsidies, the rising price of oil could send subsidies soaring past the government's $650 million subsidy budget in 2008. The Dominican Republic has been able to find some relief from rising oil prices through PetroCaribe, an agreement promoted by Venezuelan President Hugo Chavez that provides oil to Central American and Caribbean nations at subsidized costs. In June 2005, President Fernández signed a PetroCaribe agreement with Chávez that provides for up to 50,000 barrels of Venezuelan oil per day.

President Fernández has considered a variety of other measures to overcome the electricity crisis and reduce its dependence on foreign oil, including promoting the use of alternative forms of energy and providing tax breaks to the private sector for installing energy efficient technology. In 2007, the Dominican legislature passed two important energy sector laws, one that establishes a regulatory framework and tax incentives to promote energy production from renewable sources and another that criminalizes electricity theft and fraud. The former seems to be succeeding, as the nation continues to attract foreign investment interest for solar power, natural gas, biomass and wind energy projects. The latter has yet to be fully implemented.

Relations with the United States

The Dominican Republic enjoys a strong relationship with the United States, 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. The United States has been an avid supporter of the democratic and economic development of the Dominican Republic, and is currently assisting President Fernández's efforts to improve Dominican competitiveness, fight corruption, and reform the country's tax system. The implementation of DR-CAFTA-DR will also ensure close relations between the two nations.

Foreign Aid. The United States is the largest bilateral donor to the Dominican Republic, followed by Japan and Spain. The United States allocated approximately $34.3 million to the Dominican Republic in FY2007 and an estimated $37.6 million in FY2008. The Administration requested approximately $32.2 million for FY2009. These aid amounts focus on strategic Millennium Challenge Corporation indicators and include support for a variety of Development Assistance and Child Survival and Health Programs, a Peace Corps staff of some 196 volunteers, and a small military aid program. The

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[8] "Dominican Republic: Country Report," *Economist Intelligence Unit*, February 2008.

[9] United States State Department, "Background Note: Dominican Republic," November 2007; "Dominican Republic warns about high oil prices,"*Reuters*, March 2008; and "Dominican renewables law generates dividends as investors tap new incentives," *Renewable Energy Report*, March 3, 2008.

FY2009 request includes $11.2 million in economic assistance, some of which will support efforts to improve the country's business regulatory framework and to ensure that vulnerable sectors benefit from the CAFTA-DR.

Counter-Narcotics Issues. In September 2007, President Bush again designated the Dominican Republic as one of four major drug transit countries in the Caribbean. According to the U.S. Joint Interagency Task Force South, the number of drug smuggling flights from Venezuela to Hispaniola increased by 38% from 2006 -2007. Two-thirds of those flights landed in Dominican territory. To counteract those illicit activities, the Dominican government continued drug-related deportations and extraditions, and increased drug-related arrests by 60% in 2007. It also implemented a multiagency Drug Flow Prevention Strategy designed by the U.S. Drug Enforcement Agency to disrupt the flow of drugs, money, and criminals.[10] The Dominican Republic did not receive any U.S. assistance for counter-narcotics operations in FY2007, but received an estimated $.99 million in FY2008 through the International Narcotics Control and Law Enforcement (INCLE) fund. The Administration requested $1.15 for FY2009 through the same fund.

Trade. The United States is the Dominican Republic's main trading partner. The United States exported $6.0 billion in goods to the Dominican Republic in 2007, with electrical machinery (18%) and mineral fuel (11%) among the leading items. In the same year, the United States imported $4.2 billion in Dominican goods. Some 25% of U.S. imports were apparel and clothing. The Dominican Republic has a U.S. sugar quota of 180,000 tons, the largest of any U.S. trading partner. Since the mid-1980s, the Dominican Republic has benefitted from its involvement in the Caribbean Basin Initiative (CBI), a unilateral U.S. trade preference program and expanded trade benefits of the Caribbean Basin Trade Partnership Act (CBTPA) of 2000. Both the CBI and CBTPA have been replaced by the CAFTA-DR.

On August 5, 2004, the Dominican government, along with the governments of Costa Rica, El Salvador, Honduras, Guatemala, and Nicaragua, signed the CAFTA-DR with the United States. In July 2005, after a contentious debate and a close vote, both houses of the U.S. Congress passed implementing legislation for the CAFTA-DR, which President Bush signed into law on August 2, 2005 (P.L. 109-53, 119 Stat. 462). The Dominican Congress ratified the agreement in September 2005 and implemented it on March 1, 2007. The U.S. Chamber of Commerce reports that CAFTA-DR is providing real benefits for workers, farmers, and businesses, and many observers are hopeful that CAFTA-DR will continue enhancing investment, trade and competitiveness in the Dominican Republic. Others, however, predict that CAFTA-DR will only partly offset the country's free trade zones (FTZs) difficulties, which are struggling to compete with less expensive textile goods exported from Central America and China. Over the last two years, the Dominican Republic has lost some 50,000 jobs in this sector. While Dominican businesses are hopeful that these trends can be reversed by the recent entry into force of CAFTA-DR, FTZs posted a decline in 2007, while the service sector drove economic growth.[11]

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[10] U.S. Department of State, *International Narcotics Control Strategy Report 2008*, March 2008.

[11] "Dominicans: Business Hopes Trade Pact Will Aid Free Zones," *Inter Press Service*, March 2, 2007; "Dominican Republic's GDP Expands 8.5% in 2007," *Global Insight*, March 4, 2008.