

Dominican Republic: Politics: News analysis

12 Nov 2003

Strike portends more social unrest

COUNTRY BRIEFING

FROM THE ECONOMIST INTELLIGENCE UNIT

As economic and social conditions in the country deteriorate, the Dominican Republic is at risk of increased social instability. A general strike on November 11th called to protest the policies of the unpopular government, led by President Hipolito Mejia, led to the deaths of at least seven people. The president's decision to militarise the country and to arrest more than 100 activists and union leaders ahead of the strike will add to the popular anger with his government and over the economic crisis, the most severe in the country's recent history.

A high-growth performer in the 1990s, the Dominican Republic fell into economic trouble last year, caused in large part by strains within the financial system and deteriorating confidence in the Mejia administration's fiscal management. In April of this year, the government was forced to take over the second-largest bank, Baninter, which collapsed because of widespread fraud. The rescue provoked public outrage following revelations that many leading politicians during the past three administrations (including Mr Mejia) had received illicit payments and gifts from the bank.

The president was already unpopular because of sharp increases in the cost of living resulting from the severe depreciation of the currency since 2002. Prices have shot up, while salaries have stagnated and jobs have been lost. The devaluation - with the peso losing more than one-half its value in the last year - has also exacerbated the longstanding crisis in the electricity sector. An increase in blackouts has provoked public protest, sometimes spilling over into violence.

These problems, and the resulting need to tighten monetary policy and implement austerity measures, have pushed the economy into recession. Overall GDP is expected to contract by 3.2% this year, according to Economist Intelligence Unit forecasts. This is the first shrinkage since 1990. Inflation is expected to reach 38% by year's end.

On-again, off-again IMF deal

The IMF stepped in to help the country recover from the banking crisis, approving in August a two-year, US\$618m loan agreement. The financing was to help the government to absorb the cost of the Baninter rescue, estimated at US\$2.2bn, or 12-15% of GDP, and stabilise the foreign-exchange market.

However, this standby accord was suspended in October after the government in September, without IMF consent, took over full control of two electricity distributors that had been privatised in 1999. The Spanish owner, Union Fenosa, was undergoing financial difficulties and proved incapable of managing the firms and supplying electricity, contributing to the serious energy shortage in the country. The cost to the government of the takeover - estimated to be as much as US\$700m - was not factored into the original IMF accord, which now must be revised. A Fund mission is to arrive in the country during the week of November 10th, coinciding with the strike.

Protesters demand change

Protesters are demanding a change in government policies, including an end to IMF-sponsored austerity. They want lower petrol prices (up by 150% in the last three years) and more government spending on deteriorated public services such as hospitals. The chronic electricity shortages - which leave parts of the country without power for up to 12 hours per day - are another constant irritant that is fuelling discontent. Yet the government's controversial decision to return to state control the two distribution companies is unlikely to stop the blackouts or provide a viable long-term solution to the crisis.

Despite the dismal approval ratings of his government and the severe economic situation, Mr Mejia is determined to seek re-election in May 2004 elections. Because of opposition to his candidacy from various factions within the ruling Partido Revolucionario Dominicano (PRD), he has not yet received his party's

official nomination. Even if he does, his chances of winning are extremely low. The frontrunner is the former president who preceded him, Leonel Fernandez of the Partido de la Liberacion Dominicana (PLD). According to voter polls, Mr Fernandez will probably win more than 50% of the ballots next May.

Nonetheless, with the election approaching, Mr Mejia may be loath to take some of the steps that will be required to stabilise the economy and retain IMF support. He will resist greater spending restraint, especially demands to reduce the bloated public-sector workforce. Indeed, a lack of spending control and the large increase in the government payroll since the government took office has been a key factor in the loss of confidence.

The original IMF agreement calls for tight monetary policy to control inflation and fiscal adjustment to offset a surge in the costs of servicing the public debt. In the short term, fiscal adjustment is to be achieved by tightening spending and through temporary revenue measures. In the medium term the programme envisages a thorough reform of the tax system and public spending, and privatisation as the means of ensuring sustainability of the public debt dynamics, following a doubling of the public debt/GDP ratio to around 50% in 2003.

In the current political environment, the Mejia administration will find it difficult to comply with all of these conditions. Even if the IMF assistance is resumed, we do not expect the government to meet the target for the consolidated public sector of a deficit of 3.5% of GDP in 2003 and 2.5% of GDP in 2004. If the Fund permanently withdraws its support, the situation will be worse still. Loss of aid could result in a renewed spiral of currency depreciation and inflation, and could trigger debt default in 2004.

No respite in sight

The crisis, both economic and social, is likely to persist well into 2004. Additional protests, perhaps even deaths, are likely before the May elections. These will send a message to the outgoing government as well as a warning to the one that follows. The next president, who will take office in August 2004, will struggle immediately with the conflicting demands of Dominican citizens -- including those in his party who expect jobs in the new government -- with those of the IMF. This will make his early months in office extremely tough.

Economic recovery is unlikely next year. The Economist Intelligence Unit expects further GDP shrinkage in 2004 as inflation erodes real purchasing power, and high interest rates and low confidence curb investment. If the next government manages to restore confidence, modest economic growth is in prospect for 2005. But this will hinge on greater fiscal discipline and continued IMF backing, none of which can be taken for granted. If these ingredients are not present, and particularly if popular protests escalate, the Dominican Republic could be headed for a prolonged period of negative economic performance and heightened social tensions.

SOURCE: ViewsWire Latin America ([full publication](#))

An Economist Group business The Economist Intelligence Unit, the business information arm of The Economist Group, is the world leader in country intelligence.

© The Economist Intelligence Unit Limited 2003. All rights reserved.