II Trade Reform Continues

During the early 1990s, the Dominican Republic undertook a number of important reforms to liberalize its trade regime. The most significant reforms took place in September 1990 as part of the New Economic Program, when the protectionist regime, which shielded domestic producers with high tariffs and cumbersome nontariff barriers, was largely dismantled. These reforms were consolidated in 1991–92, when the authorities simplified the exchange rate system and introduced a series of tax reforms that eliminated several important trade-based taxes, including all export taxes.

In tandem with these tax and tariff reforms, the Dominican Republic has also sought to improve trade relations with its neighbors through a series of multilateral and bilateral trade arrangements. This has included membership in the World Trade Organization (WTO), the Association of Caribbean States (ACS), CAFTA, CARICOM, and the concession of parity with the North American Free Trade Agreement (NAFTA) for access to the U.S. market.

This paper examines the trade reforms undertaken by the Dominican authorities during the 1990s. While the Dominican Republic has made significant progress toward liberalizing its trade and exchange system, further reform is necessary to harmonize its trade policies with those of its neighbors and to lower import tariff barriers. The openness of the trade regime is effectively increased by an extensive network of free-trade zones, but hampered by multiple currency practices, including a 5 percent foreign exchange commission.

The Trade Regime Prior to the 1990 Reforms

Like many countries in Latin America, the Dominican Republic had by the mid-1980s developed a restrictive trade system, with high import tariffs, a system of pervasive exemptions, prohibited export lists, export taxes, exchange restrictions, and multiple exchange rate arrangements.[24] This system sought to develop import-substituting manufacturing industries. In addition, periodic balance of payments crises prompted the authorities to introduce further measures, which increased both the overall restrictiveness and the administrative complexity of the system.

Beyond creating vast economic inefficiencies, the system invited rent-seeking activities and, in some cases, outright corruption. The complexity of the system ensured that serious monitoring of customs administration was impossible. The array of exemptions and overvalued multiple exchange rates made misclassification and wrongful valuation of imports and exports commonplace. Groups or individuals with special interests pursued personal advantages arising from restrictive licensing and nontariff barriers.

The trade system also created a strong anti-export bias. This bias has most seriously affected traditional agriculture, where heavy export taxes were levied on sugar, bananas, coffee, and cocoa, and export receipts had to be surrendered at the official exchange rate. In addition, all exports were subject to a foreign exchange commission of 1½ percent of revenues. The tariff system was particularly restrictive and lacked transparency. It included both specific and ad valorem tariffs, which were cumulative. In some cases, nominal tariff rates in excess of 200 percent were imposed. This system was extremely complex to administer.

In line with the import-substituting objective, tariff exemptions also helped to greatly increase effective protection for domestic industries. Firms that were registered as import-substituting could obtain tariff exemptions for their imports of raw materials and intermediate inputs. Individual enterprises often obtained total or partial exemptions through special contracts with the government. The government also passed a series of laws and decrees which provided further specific exemptions on an ad hoc basis.

[24]The World Bank Country Study, *Dominican Republic: Economic Prospects and Policies to Renew Growth* (1985), provides an extensive survey of the trade regime and resulting impediments to economic growth.

Import prohibitions and other nontariff barriers were widespread. As part of a series of measures introduced to resolve the balance of payments crisis of 1979, the authorities introduced a list of prohibited imports covering more than 150 types of consumer goods such as certain garments, furniture, and light industrial goods. In 1982, the list was expanded to cover a further 200 items.

Throughout the 1980s, the central bank maintained a multiple currency system, with several overvalued official exchange rates.[25] Inevitably, a parallel exchange market emerged. These exchange arrangements heightened the anti-export bias, as manufacturing exporters were also required to surrender a proportion of their receipts at disadvantageous official rates. In contrast, importers of tariff-exempt goods could exchange domestic currency at advantageous overvalued rates.

The authorities made several attempts to unify the exchange rate. Unfortunately, these efforts were short-lived, as frequent balance of payments crises forced the authorities to use administrative measures to maintain the supply of foreign currency needed for official use. The exchange system became extremely restrictive after a crisis in June 1987, when the central bank requisitioned foreign exchange from all commercial banks, to become the sole provider of foreign exchange.

Trade Reforms in the 1990s

Poor export performance during the 1980s, coupled with persistent balance of payments problems, prompted the authorities to reevaluate their import-substituting development strategy. As part of the New Economic Program, the Dominican authorities undertook a wide-ranging reform of their trade system.[26] The tariff system was simplified by reducing the number of import taxes. Most import quotas, import licensing requirements, and import prohibitions were abolished. Agricultural export taxes were suspended. In an attempt to provide a more neutral tax regime, all tax incentives and ad hoc measures, except those specifically applying to the free-trade zones, were eliminated.

In January 1991, the authorities began the process of reforming the exchange system. While still formally maintaining a dual exchange rate system, they introduced a freely determined interbank rate. In practice, the official rate is revalued fairly often and the spread between the official and interbank exchange rates has narrowed.[27] In 1993, the central bank started to reduce the number of export items that were subject to surrender requirements.

The initial trade liberalization was further consolidated during the tax reform of 1992. The import surcharge was reduced from 15 percent to 10 percent, and a program was announced for its eventual abolition by 1995. By 1993, most export restrictions, such as export licensing, minimum export prices for agricultural products, and all export taxes were abolished. Furthermore, the export administration system was greatly simplified when most special registration and documentation requirements were eliminated and only minor obligations kept for statistical purposes. Customs administration has benefited from the automation of customs documentation, which has reduced the discretion allowed to customs officers. However, the customs department maintains that significant undervaluation of imports remains a problem that it is determined to address by rigorously applying the law to value imports at their true commercial value, using updated valuation schedules.

The latest tariff reform, which came into effect in January 2001, has narrowed the tariff structure to five from nine non-zero rates and reduced the maximum from 35 percent to 20 percent, levied on all imports on an ad valorem basis (Table 4). As a result, the simple average tariff is estimated to have decreased to 10.7 percent from 17.7 percent. The most common rate was 10 percent for about 28 percent of all tariff lines; it is now 3 percent and 20 percent, each affecting 38 percent of all lines. A consumption tax (*Impuesto Selectivo al Consumo*) of between 5 percent and 80 percent levied at customs on certain luxury goods was also reduced to a range of 25 percent to 75 percent, applicable to a much smaller number of consumer goods, including passenger cars. This has brought the simple average tariff down to 11.4 percent, from 18.6 percent. Taxation is based upon the c.i.f. value and the amount of prior taxes and duties.

The current system maintains a number of import tariff exemptions. Most notably, products used in the agricultural sector, for example, insecticides, herbicides, and pesticides, remain exempt, as are certain goods regarded as socially critical, like medicines. A

[25]In addition to maintaining a multiple currency system, the Dominican Republic also maintained many other exchange restrictions, most notably a limitation on the level of permissible profit remittances.

[26]Initially, the tariff reform was conducted by means of presidential decrees (339–90 and 340–90). These decrees were subsequently ratified by congress in 1993 (Law No. 14–93).

[27]On various occasions the spread between the official and interbank rate has become substantial. Under the draft Monetary and Financial Code, under consideration in congress, the exchange rates would be fully unified through the elimination of all surrender requirements.

Table 4. Import Tariff Structure[1]
(Excluding selective consumption tax)

Pre-2001 Import Tariff Schedule			2001 Import Tariff Reform		
Tariff Bands (percent)	Number of Lines	In Percent of Total Lines	Tariff Bands (percent)	Number of Lines	In Percent of Total Lines
0.0	8	0	0.0	353	6
1.5	19	0	1.5	19	0
3.0	345	6	3.0	2,397	38
5.0	648	10	8.0	561	9
10.0	1,749	28	14.0	586	9
15.0	561	9	20.0	2,355	38
20.0	586	9			
25.0	827	13			
30.0	970	15			
35.0	558	9			
Total	**6,271**	**100**	**Total**	**6,271**	**100**
Memorandum item:					
Simple average import tariff		17.7			10.7
Simple average import tariff[2]		18.6			11.4

Sources: Dominican authorities; and IMF staff estimates.
[1]Does not include contingent tariffs that may be applied to beans, chicken, garlic, milk, onions, rice, corn, and sugar.
[2]Including selective consumption tax on imports.

number of export prohibitions are also maintained to supply the domestic food market. Exports of unprocessed wood, charcoal, and certain animal species are forbidden on environmental grounds.

The tariff system still offers important effective tariff protection to many domestically produced goods. According to the WTO, significant tariff escalation exists, especially for the more processed products. The WTO argues that tariff escalation is particularly pronounced for textiles and leather products.

While the majority of formal nontariff barriers were abolished, certain quotas were maintained on eight important basic consumption goods—beans, chicken, corn, garlic, milk, onions, rice, and sugar. During the Uruguay Round of multilateral trade negotiations, the Dominican Republic agreed to eliminate all nontariff barriers and introduce a maximum tariff bound of 40 percent. However, it also sought a waiver on its WTO obligations with respect to these eight products, which allows it to introduce tariff rates above the agreed bounds and maintain nontariff quotas. The issue remained unresolved during the Uruguay Round. In early 1999, the WTO accepted the Dominican authorities' proposal to amend their WTO schedule of concessions (through the procedures outlined in Article XVIII of the WTO Agreement). This permits the Dominican Republic to set a two-tier tariff structure for each of the eight products. The authorities may charge tariffs, ranging from 5 percent to 25 percent on imports below a specified import volume, while maintaining a maximum tariff bound of 40 percent. Imports in excess of the specified limits (Table 5) could be subjected to higher tariff rates, known as contingent tariffs, ranging from 60 percent to 137 percent in 1999 (Table 6). The authorities have also announced a schedule under which these contingent tariffs will be reduced to between 40 percent and 99 percent by 2005.

In March 1998, a number of nontariff barriers, which had been created by either presidential or administrative decree, were abolished. While many formal nontariff barriers have been abolished, importers may still face serious administrative trade barriers. For example, in a backlash against alleged pervasive undervaluation of imports, some importers complain that customs valuations are discretionary, while arbitrary customs clearance procedures can delay the importation of merchandise, according to the U.S. Department of Commerce. Import permits that are required for certain agricultural items are also sometimes delayed or withheld.

The Dominican Republic still maintains surrender requirements for selected exports of goods and services. Foreign exchange proceeds from traditional agricultural products have to be surrendered in full to the central bank at the official exchange rate, as must

Table 5. Initial Import Level Before Contingent Tariff Applies
(In metric tons)

Product	1999	2000	2001	2002	2003	2004	2005
Rice	11,898	12,410	12,943	13,450	14,028	14,632	15,261
Garlic	3,600	3,750	3,900	4,050	4,200	4,350	4,500
Sugar	24,000	25,000	26,000	27,000	28,000	29,000	30,000
Chicken	8,500	9,000	9,500	10,000	10,500	11,000	11,500
Onions	3,000	3,125	3,250	3,375	3,500	3,625	3,750
Beans	14,400	15,000	15,600	16,200	16,800	17,400	18,000
Milk	32,000	32,000	32,000	32,000	32,000	32,000	32,000
Corn	858,200	897,000	935,800	974,600	1,013,400	1,052,200	1,091,000

Source: Dominican authorities.

Table 6. Schedule of Contingent Tariffs[1]
(In percent)

Product	Basic Tariff	1999	2000	2001	2002	2003	2004	2005
Rice	20	114	111.5	109	106.5	104	101.5	99
Garlic	25	111	109	107	105	103	101	99
Sugar	20	94	93	91	90	88	87	85
Chicken	25	137	131	124	118	112	105	99
Onions	25	97	97	97	97	97	97	97
Beans	25	95	94	93	92	91	90	89
Milk	20	84	79	74	70	65	60	56
Corn	5	60	57	54	50	47	43	40

Source: Dominican authorities.
[1]Tariffs only apply when imports exceed a pre-specified amount, as specified in Table 5 above.

those from certain services such as telecommunications, credit card transactions, and remittances from insurance claims. Passage of a new Monetary and Financial Code would abolish these discriminatory obligations.

Despite significant progress made during the early 1990s, and with the new import tariff rates in effect, the Dominican Republic maintains a trade regime that is still more restrictive than those of its major regional neighbors, as measured by the IMF's Trade Restrictiveness Index[28] (Table 7). The Dominican Republic also has higher import tariff rates on a simple average than these countries, but trade dispersion is relatively low (Table 8).

Following up on the reduction of import tariffs at the beginning of 2001, further legislation is pending to initiate the second stage of trade liberalization. This would reduce the number of tariff rates to four, while the new maximum rate would be 15 percent. More specifically, the tariff structure would be as follows: a zero tariff rate for raw materials not produced domestically and all capital goods, 5 percent for domestically produced raw materials and intermediate goods not produced domestically, 10 percent for domestically produced intermediate goods, and 15 percent for final consumption goods.

The diffuse nature of trade policymaking is regarded as a major weakness of the trade regime,

[28]For further information on the construction of this index, see *Trade Liberalization in IMF-supported Programs* (1998). This index should be interpreted carefully in the case of the Dominican Republic because it only refers to tariffs paid on imports to the domestic economy; it excludes the tariff system that applies to imports into the free-trade zones.

Table 7. Index of Trade Restrictiveness
Selected Caribbean and Central American Countries, as of end-2000

	Tariff Barriers	Nontariff Barriers	Overall Trade Restrictiveness
Belize	2	2	5
Costa Rica	1	2	4
El Salvador	1	2	4
Guatemala	1	2	4
Haiti	1	1	1
Honduras	1	1	1
Jamaica	1	2	4
Trinidad and Tobago	1	2	4
Dominican Republic[1]	**2**	**2**	**5**

Sources: Dominican authorities; and IMF staff estimates.
[1]As per 2001, taking into account the reformed tariff structure.

tending to slow the pace of trade reform.[29] While the Ministry of Industry and Trade determines trade policy, the Ministry of Foreign Affairs has the responsibility for negotiating and concluding international treaties and agreements. However, the National Sugar Institute has direct responsibility for all issues relating to sugar, including trade, while the Ministry of Agriculture has various technical responsibilities related to the management of the agricultural trade regime. Matters are further complicated by the existence of a number of special commissions and interministerial committees in charge of coordinating, of reforming trade policy, or of regulating certain sector activities—for example, the Foreign Trade Commission, the National Free-Trade Zones Council, the National Council for Development, and the Tariff Study Commission.

The authorities have tried to resolve coordination difficulties with respect to new trade agreements. In line with a WTO recommendation, the National Trade Negotiation Commission was created in 1997. It has ultimate responsibility for negotiating all new trade arrangements. However, technical discussions still remain the responsibility of the relevant ministry or government body. At various times, the authorities have also considered creating a new ministry that would be responsible for all trade policy issues.

[29]WTO, *Trade Policy Review*, 1996.

Free-Trade Zones

Over the last 30 years, the Dominican Republic has developed an extensive system of industrial free-trade zones (FTZ). Their rapid growth in terms of employment, export value, and the number of firms has been remarkable. In 2000, there were 46 industrial parks, containing around 500 enterprises, employing almost 200,000 employees inside the FTZ (8 percent of total employment), and providing possibly twice as many jobs outside the FTZ. The FTZ attract-

Table 8. Import Tariff Rates
Selected Caribbean and Central American Countries, as of end-2000

	Simple Average	Minimum	Maximum	Trade Weighted Average	Standard Deviation	Description of Bands
Belize	9.2	...	25.0	8.6	13.3	...
Costa Rica	7.2	...	253.0	...	13.8	...
El Salvador	5.6	...	40.0	8.5	7.9	12 bands
Guatemala	7.3	...	27.0	...	8.1	4 bands of 1, 9, 14, and 19 percent
Haiti	9.0	...	15.0	...	...	4 bands of 0, 5, 10, and 15 percent
Honduras	7.8	1.0	55.0	...	8.0	13 bands
Jamaica	8.9	0	75.0	...	12.4	...
Trinidad and Tobago	9.1	0	45.0	16.7	11.6	10 bands
Dominican Republic[1,2]	**10.7**	**0.0**	**20.0**	**...**	**7.4**	**6 bands ranging from 0 to 20 percent**

Sources: Dominican authorities; and IMF staff estimates.
[1]As per 2001, taking into account the reformed tariff structure.
[2]Does not include the selective consumption tax or the contingent tariffs applied to beans, chicken, garlic, milk, onions, rice, corn, and sugar.

ed important amounts of foreign direct investment and generated gross exports of an estimated US$4.8 billion, accounting for 83 percent of total exports; net export receipts were US$1.7 billion. Since 1994, net FTZ export receipts (in U.S. dollar terms) have grown, on average, by 15 percent a year (Table 9). Local expenditure of enterprises in the FTZ in 2000 has been estimated at US$1 billion.

The FTZ's rapid growth can be explained by three main factors. First, the regulations governing operation and activity are generally regarded by both domestic and foreign investors as stable and transparent, in contrast to the legal framework applying to "domestic" exports.[30] Second, the tax incentives offered to enterprises located in FTZ are considered attractive.[31] Finally, the advantage of close location to the United States and Puerto Rico, coupled with participation in several preferential regional trade arrangements, has facilitated growth. These arrangements allowed the Dominican Republic to strengthen the competitive advantage of its FTZ through regulated market access, but resulted in a strong orientation of FTZ exports toward the U.S. market and hence a potentially heavy dependence on the U.S. business cycle. However, this is partially compensated by other sources of foreign exchange, such as tourism, which are derived mainly from Europe.

Trade Agreements

As part of the outward reorientation of trade policy, the Dominican Republic has actively promoted closer formal trading relations in the region and with

[30]FTZ are considered extraterritorial with respect to the Dominican economy, but they can trade with the "domestic" economy, subject to applicable tariffs and regulations.

[31]Enterprises locating to FTZ are exempt from corporate income tax, construction taxes, fees relating to the registration of loan agreements, charges related to transfers of real estate, and VAT. Furthermore, they are exempt from standard import duties, including duties on materials and equipment used in the establishment and operation of the company. For a full description of the tax incentives offered to enterprises locating in free-trade zones, see *Legal Guide to the Free Zones of the Dominican Republic* (Pellerano and Herrera, 1999).

Table 9. Free-Trade Zone Activity

	Number of Firms (Units)	Number of Employees (Thousands)	Foreign Exchange Generated[1]	Gross Value of Exports	Textile Exports of Which
			(In millions of U.S. dollars)		
1980	71	16.4	45	276	...
1981	77	18.3	58	358	...
1982	87	18.7	61	379	...
1983	101	19.3	62	384	...
1984	120	25.7	52	323	...
1985	136	30.9	45	277	...
1986	156	51.2	89	549	...
1987	199	66.0	98	609	...
1988	220	83.8	130	807	...
1989	299	122.9	191	1187	...
1990	331	130.0	196	850	...
1991	366	135.3	250	1053	...
1992	404	141.1	306	1195	...
1993	462	164.3	401	2609	1,458
1994	467	176.3	441	2716	1,616
1995	469	165.6	512	2907	1,787
1996	436	164.3	545	3107	1,802
1997	446	182.2	698	3596	2,273
1998	496	196.0	827	4100	2,395
1999	473	191.1	887	4332	2,385
2000	491	206.3	1,018	4771	2,571

Sources: ONAPLAN; National Council of Exports Free-Trade Zone; and BCRD.

[1]On March 20, 1992, surrender requirements for FTZ foreign exchange earnings were abolished. Thereafter, foreign exchange generated is an estimation of local expenditures of FTZ enterprises.

the rest of the world. Its accession in March 1995 to WTO membership provided a particularly strong incentive to accelerate trade liberalization and pass new legislation to comply with the organization's requirements. These included legislation on foreign investment and telecommunications, which provided a boost to these activities.

During the 1990s, the Dominican Republic joined a number of regional organizations and it participates in the Free Trade Area of the Americas (FTAA). It was a founding member of the Association of Caribbean States (ACS), a body launched in January 1995. The ACS promotes trade liberalization and regional economic integration within the Caribbean basin. The Dominican Republic has observer status with the CARICOM, which aims to deepen economic integration among its member countries through establishing a common market, coordinating and regulating commercial and economic relations, and defining a common position in other regional trade initiatives, such as the FTAA. In February 2001, congress ratified a trade agreement with CARICOM (excluding Haiti, which joined CARICOM after trade negotiations between the Dominican Republic and CARICOM members had begun). In 1999, the Dominican Republic joined the CAFTA, which aims to deepen and diversify trade relations among its member countries; an agreement with its members has just received congressional approval.

The Dominican Republic enjoys important preferential access to the U.S. market. The Caribbean Basin Initiative, which was introduced in 1984 to promote trade relations and foreign investment between the Caribbean and the United States, provides duty-free access for most products, except petroleum, footwear, canned tuna, and certain watches. Since 2000, the United States has provided free access for Dominican textile products with minimal or no U.S. components, provided they do not contain any third-country components. This will allow the Dominican textile industry to diversify further within the sector through increased production of intermediate goods and raw materials and to integrate vertically, adding cutting, weaving, and spinning to its production process. General quotas are maintained for access to the U.S. market of certain textile products, but the arrangement allows for yearly negotiations among competing Caribbean partner countries to determine their respective market shares. New WTO rulings establish, however, that all quotas be phased out by the end of 2004, challenging Dominican textile exporters to compete in a deregulated environment and the country to diversify its export base even more.

The Dominican Republic benefits from preferred access to U.S. markets through the generalized system of preferences, which gives duty-free access to a wide range of products, and to the European Union through the Lomé Convention and its successor agreements. In October 2000, the Dominican Republic was granted parity with NAFTA members Canada and Mexico for access to U.S. markets, with respect to all goods. This is expected to give another boost to textile exports in particular, which face strong competition from Mexico. However, negotiations between the United States and other countries for NAFTA parity may over time reduce the benefits of this advantage for the Dominican Republic. Not being an initial signatory to the EU's Lomé Convention, and in order to gain membership in the group of African, Caribbean, and Pacific countries (ACP), the Dominican Republic had to unilaterally revoke certain preferential provisions of the convention relating to export products such as sugar, bananas, and rum.[32]

Conclusion

During the early 1990s, the Dominican Republic made significant progress in liberalizing its trade system. Much of the old system, which aimed at fostering domestic import-substituting industries, has now been dismantled. Most important, tariff rates have been simplified and reduced, most nontariff barriers have been eliminated, and export taxes have been abolished. Much of the administrative complexity that characterized the old system has disappeared. There is still some unfinished business, however, as some restrictive and interventionist elements of the pre-1990 system have survived.

Gradual trade liberalization with respect to the domestic economy, comprising agriculture, mining, and nontradable goods, and a completely free trade and tax regime favoring the emergence of high-growth, outward-oriented industrial production in free-trade zones and tourism has resulted in a dualistic economic structure. In order to address these differences, which are also reflected in growing regional and social differences, and to generalize the efficient use of resources, the Dominican authorities intend to conclude their tariff reform by further reducing tariff levels and dispersion, to streamline administrative procedures, and to reduce the foreign exchange commission. Approval of a new Monetary and Financial Code, which has been with the congress for quite some time, would eliminate persisting multiple currencies practices by abolishing remaining foreign exchange surrender requirements and unifying the exchange rate, two other objectives of the current government and indispensable elements

[32]For further details on trade relations between the Dominican Republic and the European Union, see *Libro Verde sobre las Relaciones Entre la Unión Europea y los países ACP en los albores del siglo XXI* (European Commission, 1996).

for establishing a consistent and efficient trade and foreign exchange regime.

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