# Executive summary

The Dominican Republic, though the fastest-growing economy in Latin America and the Caribbean since 2010, cannot afford complacency. The country has made notable strides over the past two decades in diversifying its trade and investment structure. However, it still lacks a production base that is diverse and innovative enough to create resiliency to external shocks. From 98 trading partners in 2000, the Dominican Republic expanded up to 147 by 2017. The United States remains the principal economic partner, but went from accounting up 75% of Dominican exports to slightly more than 50% between 2000 and 2019. The Dominican Republic has expanded its investment network by receiving investments from new countries and in new industries, such as medical devices. Tourism has come to play a vital role in the economy. From 2000 to 2018, the number of tourists more than doubled from 3.3 to 7.2 million. The country is now the main destination for tourism in the Caribbean, attracting 24.1% of the total number of visitors in 2018, and the fourth most popular destination in the Latin America, after Argentina, Brazil and Chile. The industry poses challenges about energy, water use and waste management, and the COVID-19 pandemic has created an urgent need to cushion the short and medium-term impact on the sector.

Economies that have benefited from globalisation have common traits that the Dominican Republic could emulate. Reducing dependency on a single market, managing complex trade networks, strengthening regional ties, and branding themselves as reliable, high quality trade and manufacturing partners, are some of these characteristics. In the Dominican Republic, FTZs have not yet become a driver of local development and, on average, local sourcing has declined. Between 2005 and 2018, the share of inputs sourced locally by firms located in FTZs decreased from 22% to 18%. In the case of some of the newly installed activities in the FTZs, such as medical devices, there is no ready-made local industrial base from which to source, as the industry is new. Small companies have unexploited potential to drive growth in the Dominican Republic. Micro, small and medium-sized firms are less export-oriented than their peers in OECD countries are. These firms employ 65% of the total work force, contribute to 40% of total value added and account for 23% of domestic exports, while in OECD countries these firms account for 40% of total exports. In addition, the majority of these firms in the Dominican Republic are micro, which increases their fragility and vulnerability to crises.

The COVID-19 crisis may accelerate existing global trends and as such makes more urgent addressing structural weaknesses that lurked beneath the surface well before the pandemic. This situation demands an unprecedented policy effort to ensure a prompt and effective health response, and to guarantee short-term support for workers and firms. Dominican labour costs are competitive at a time when labour costs are no more crucial for location decisions of MNEs. Labour costs are at 6% of those in the United States and are lower than in China, however markets will increasingly value sustainability and social inclusiveness and accountability. In addition, countries worldwide are shifting their attention towards the need to rebuild domestic manufacturing capabilities in their economies, a trend which was present before COVID-19 and which the current crisis is magnifying.

The agro-food industry is a mainstay of the Dominican Republic's economy. Alongside coping with COVID-19, the industry and its stakeholders must grapple with changing demands, as consumers are reorienting choices, with new safety measures in the workplace for small farmers and logistics operators, and with challenges in importing and exporting. Value chains will tend to be shorter, the use of digital technologies for traceability and transparency will increase, and firms will face growing domestic demand as they tap into regional markets. Increasing innovation capacity, improving country branding and enabling small farmers to navigate change through modernised extension services will remain key to success.

As part of the national development vision for 2030, the Dominican Republic has implemented reforms that can underpin a new growth model. It has developed a digital agenda with a budget of USD 133 million mostly to fast track the use of digital technologies in schools. A new online platform offers a one-stop shop for the administrative procedures required to start a business, under the auspices of the National Competitiveness Council. The national quality infrastructure system has also improved. However, the policy mix still leans heavily on indirect financial support in the form of special fiscal regimes. While this has well served the economy to attract investment and foster over time the development of new activities in the economy, including recently the creative industries, the policy mix would require an update to unleash the local entrepreneurial potential and foster innovation.

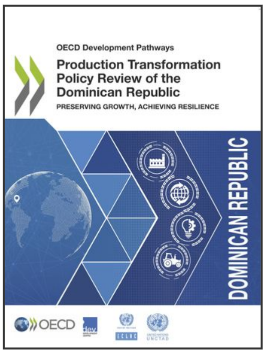
The enduring challenge will be updating the country's development model through targeted reforms. Specifically, the Dominican Republic needs to pursue three goals:

**Strengthening its governance capacity to anticipate and adapt to change**. Planning involves not only the decision on what to do and how do to it. Planning is increasingly linked to the capacity to identify possible outcomes, clarify what is desirable and what is risky, and having back-up plans to act in case of sudden and unexpected changes. National leadership needs to value prospective work and to ensure co-ordination and consultation with stakeholders. The ongoing crisis has shown that even good is not enough. Governments need to communicate their vision effectively, maintain an open dialogue with citizens and stimulate individual responses to challenges in line with collective interest. The Dominican Republic counts with a planning ministry. The country should strengthen its prospective and foresight functions. Strengthening planning would also require shifting towards a place-based approach to policy making and developing a system for territorial development.

**Diversifying its trade and investment base and increasing regional economic ties.** The country would need to align the FDI policy with the national development strategy by complementing incentive packages with targeted tools to foster local industrial development. The country would also benefit from an institutional upgrading. The Dominican Republic counts with multiple bodies that deal with FDI, fully empowering one agency would be a critical step forward. Existing institutions, as the Centre for export promotion and investment attraction, could perform this function if properly modernised and reformed. The agency in charge needs to be able to operate quickly, have timely access to decision-making and needs a qualified staff well aware of private sector's challenges.

**Boosting innovation by filling institutional gaps and mobilising long-term financing.** While there is consensus that innovation matters for development, the country falls short in terms of institutions, funding mechanisms, and overall policy mix to foster start-up development and innovation. The country needs an agile, small and with a clearly assigned budget innovation agency. Innovation funding should be multi-year and the processes for funding disbursement should be fast and transparent. The country needs long-term financing for production development. A properly functioning development bank would be a desirable step forward. Bandex could perform this function if properly reformed to offer long-term financing for production development, innovation and exports. This requires careful due diligence and institutional design and a neat division of labour with existing commercial banks.

The economic outlook for trade, tourism and investment is highly uncertain. The Dominican Republic must prepare for a world in which resilience will be critical. Diversifying economically, innovating, and better sharing the gains of growth are key steps forward. A committed government, a cohesive society and a private business community willing to invest and take risks are essential to succeed.

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