Preliminary Version

Inclusive and Job-Rich Growth in the Dominican Republic–An ILO-IMF Contribution

1. Introduction

The collaboration between the International Labour Organization (ILO) and the International Monetary Fund (IMF) originated in the aftermath of the global economic crisis, which has had a harsh impact on workers around the world. In September 2010, the ILO and the IMF organized together with the Norwegian authorities a high-level conference on the challenges of growth, employment, and social cohesion (The Oslo Conference). The main objective was to tackle the difficult policy questions posed by the steep rise in unemployment and the setbacks to growth and poverty reduction, and to improve the integration of employment and social protection policies with international and national macroeconomic policy strategies.

The Oslo Conference agenda for cooperation between the two organizations included three deliverables – namely joint pilot projects in three countries on enhancing social dialogue and recognizing the crucial role it can play in building the consensus needed to tackle the challenges of a job-rich and inclusive growth economic strategy. The first two social dialogue pilots were conducted in Zambia and Bulgaria in 2012. They provided a useful springboard for further dialogue in those countries on concrete national growth strategies for employment, decent work, and development.

The ILO-IMF social dialogue pilot in the Dominican Republic is the third of these initiatives. Its purpose is to encourage an informed national policy debate—supported by the respective expertise of the ILO and IMF—that can help identify the main obstacles to sustained and inclusive growth in the Dominican Republic, and address them with coherent actions from government, employers, and unions.

From a broader perspective, the continuing uncertainty surrounding the global economic outlook has heightened the importance of jobs and inclusive growth as a key policy concern both in the developed and the developing world. This has triggered a reconsideration of traditional policies for growth and development and the search for new practical solutions. We hope that the outcomes of this project in the Dominican Republic contribute ideas and evidence to that wider important debate.

2. Patterns of growth and employment in DR

Over the past 20 years, the Dominican Republic has experienced high and sustained economic growth, with an annual average increase of GDP per capita of 4 percent, compared with 1.8 percent for Latin and Central America and the Caribbean. Remarkably, relatively high economic growth has been sustained in the wake of the global financial and economic crisis, and, in 2011, the country attained upper-middle income status, a performance well above that of most other countries in the region. This strong long-term economic growth performance, however, did not translate into equally significant improvement in living standards for all.

High GDP-per-capita growth during the past twenty years was rooted in fast-growing labor productivity. Changes in the employment rate and in the working-age population also contributed to output growth, but had a small (and declining) role. This strong economic performance has largely been driven by above-average growth in the manufacturing, transportation, and communication sectors. The contribution to employment growth of these sectors, however, has been steadily declining, leading to a progressive reduction in the employment intensity of the country's economic growth.

Employment rates in the Dominican Republic have been traditionally low compared to other countries in the region. In addition, even though the unemployment rate based on the job search behavior of non-employed individuals (referred to as *open* unemployment) is relatively low, the *broad* official unemployment rate, which includes discouraged workers, remains quite high at about 14.7 percent.[1] The difference between these two indicators makes also evident the existence of a large stock of "underutilized" workers, as also reflected by the share of the underemployed who actively seek additional hours (about 5 per cent of total employment).

The weak overall employment performance of the economy can be explained by sectoral developments. The jobs lost in manufacturing over 2001-2011 were absorbed primarily through a strong increase of employment in "other services", mainly comprising low-productivity jobs in personal services. In absolute numbers, "other services" alone account for over 40 percent of the net increase in employment in that period. Those sectoral shifts were mirrored by a shift in the composition of employment by status. From 2000 to 2010, the percentage of wage and salaried workers decreased by about 10 percent of total employment. Correspondingly, the number of non-wage workers increased markedly over the last decade. This included some increase in the number of employers and self-employed (independent) professional and technical workers, which was mainly driven by the increase in non-professional, non-technical, and non-administrative independent occupations. In sum, employment increased more significantly in those sectors associated with low productivity, precarious working conditions, and informality.

Stagnant quality of overall employment in the Dominican Republic is also captured by the recent dynamics of real earnings. After the banking crisis in 2003, when the annual inflation rate reached about 40 percent, the growth rate of real earnings largely stalled, especially, for workers with less-than-tertiary education. Over the past decade, real earnings have declined uniformly across income groups—with somewhat stronger decline among private sector employees in the highest earning deciles—, and industries—particularly in wholesale and retail trade, hotel, bars and restaurants, and other services. While during the last five years, small earnings growth can be observed in some of those sectors with higher labor productivity, real earnings growth still lags behind growth in labor productivity.

In parallel with the decline in real wages, the number of poor households increased strongly in the mid-2000s, as a result of the domestic crisis and the subsequent high inflation that reduced the real incomes of the most vulnerable. According to official national estimates, poverty levels in 2010 were the same as in 1990. The persistency of poverty in the Dominical Republic is made more severe by a

[1] The Dominican official definition of unemployment differs from international statistical standards because it includes among the unemployed a large share of so-called discouraged workers, i.e. people who do not have a job, are available to work, but have not taken any distinctive step to search for it in the week of the labor force survey interview.

historical legacy of underinvestment in public goods and highly inefficient delivery of public services in health, education, and electricity supply (Sanchez and Senderowitsch, 2012). In fact, social spending in the Dominican Republic (hovering at less than 10 percent of GDP) lies at the bottom of regional comparative rankings, ranking 19 out of 21 countries (Ondetti, 2012). A decisive upturn, however, has started to take place in the second half of the 2000s as a result of stronger social development policies, including reforms in health care and pension coverage.

3. The current outlook and risks

Economic growth declined in the last three years, from 7.8 percent in 2010 to 4.5 percent in 2011, to an estimated 4 percent in 2012. Under the baseline scenario, growth is projected to slow further to 2.2 percent in 2013 and to strengthen to 3.4 percent in 2014. This slowdown is consistent with the projected moderation in global growth (IMF World Economic Outlook, October 2012) as well as a policy tightening to reduce fiscal and external imbalances. Going further, and in the absence of additional shocks, growth is expected to steadily converge to its potential level of about 5 percent by 2016. Following the contraction in economic activity, labor market conditions also weakened in the last three years, with unemployment increasing from 14.3 percent in 2010 to 14.6 percent in 2011, to an estimated 14.7 percent in 2012. This contrasts with trends in Latin America and the Caribbean where unemployment rates reached an historical minimum in 2012 (ILO, 2012).

Under the baseline growth scenario, labor market conditions are expected to weaken further. In particular, using estimates of employment-growth linkages (Crivelli et al. 2012, Ball et al. 2013) and net labor force entrance over the period 2012-2017 (ILO-Laborsta), the baseline growth assumptions imply an increase in unemployment of about 1½ percentage points over the medium term: from about 14.6 percent in 2011 to about 16.3 percent in 2017 (Table 1).

Table 1. Dominican Republic: Medium-term employment scenario

		Projections 1/					
	2011	2012	2013	2014	2015	2016	2017
Labor force (millions) 2/	4.58	4.66	4.74	4.82	4.89	4.97	5.04
Real GDP growth (%)	4.5	4.0	2.2	3.4	4.6	5.0	5.0
Unemployment rate	14.6	14.7	15.6	16.1	16.2	16.3	16.3

Source: Dominican authorities and Fund staff calculation and estimates.

1/ Projections based on rolling-window employment-growth elasticity estimates (period 2001-2011) of 0.3.

2/ Dominican authorities; and ILO-Laborsta projections.

Short-term risks are tilted to the downside, and are strongly linked to those for the United States—which is the Dominican Republic's main export market and source of remittances and tourism revenue and where growth is likely to remain subdued in the medium term—and in other advanced economies. The materialization of these risks could reduce short-term growth and lead to a higher increase in unemployment over the medium term. Against this background, and given the limited space for macroeconomic policy to boost demand in the short term, the urgency of growth-enhancing structural reforms has therefore increased in the Dominican Republic.

4. Key policy challenges

Despite remarkable growth performance in the last two decades, the Dominican Republic is still characterized by persistently high levels of inequality and poverty, a large informal labor market, and low participation rates. These weaknesses have been exacerbated by a deterioration of the macroeconomic framework in the most recent years. To tackle them requires an integrated and balanced set of economic and social measures.

The IMF contribution

Setting the economy on a sustained- and more inclusive-growth path requires actions on two main fronts: (i) reducing fiscal and external vulnerabilities; and (ii) fostering productivity growth and improving the quality of jobs.

i. **Securing macroeconomic and financial stability sets the foundation for growth and job creation.** Over the past two years, economic activity has been supported by expansionary fiscal and monetary policies, while private sector confidence has declined. In these years, economic performance deteriorated, while weak policy implementation has led to a build-up in fiscal and external imbalances. Addressing these imbalances is essential to restore private-market confidence, support business development, and reduce vulnerabilities to external risks. In this context, a substantial tightening of macroeconomic policies in 2013 is needed to help reduce risks to fiscal and external stability. In particular, reducing fiscal deficits is crucial to alter the debt dynamics, restore fiscal space, facilitate external adjustment, and allow resumption in private sector credit. In the fiscal policy area, this will require efforts to rein in current expenditures, improve expenditure efficiency, and mobilize additional revenues, while protecting social expenditure and minimizing the burden for the most vulnerable. On the monetary policy front, priority should be given to strengthening the international reserves position and keeping inflation low.

ii. **Fostering productivity growth and improving the quality of jobs is crucial to raise potential and inclusive growth.** Progress in this area can be achieved by far-reaching reforms that eliminate distortions and boost competitiveness, enhance the business climate, and improve the functioning of the labor market.

- **Competitiveness**. Enhancing competitiveness is key to foster productivity growth across a wide set of industries, especially those making disproportionately higher contribution to job creation. Two areas appear of particular importance. First, improving the reliability and efficiency of the public electricity sector and lowering energy costs will provide a major boost to private sector development. Second, eliminating tax exemptions and other special tax regimes would be another important step toward enhancing competition and leveling the playing field for domestic business. Additionally, linking lagged industries more closely with high-productivity industries could facilitate productivity spillovers through the sharing of knowledge, technology, process innovation, and capital. This would improve job quality in these industries and make employment opportunities in current job-rich industries more attractive by raising market wages.

- **Business climate**. Lowering bureaucracy costs, facilitating tax compliance, and fighting corruption would lower the cost of doing business, bolster business creation, and reduce informality. Progress in these areas would help achieve both higher employment and productivity growth.

- **Labor market**. Improving the quality of the labor force through medium- and long-term reforms is crucial to fulfill the needs of an economy with more widespread productivity growth and higher-quality jobs. Measures targeted at improving the match between market demand and labor force skills would also raise the participation of young workers and prime-working-age women, thus improving the job content of growth in the country. In this context, mechanisms to improve the school-job transition are also important, including through a tighter collaboration between technical schools and private sector employers.

The ILO contribution

The Dominican Republic faces two main policy challenges. First, the country should engage in productive upgrading, stimulating business investments in high-value-added activities, and strengthening the firms' range of export capabilities. Should this not take place, the country might run the risk of prematurely entering a "premature deindustrialization" phase, where long-run growth is determined by low-productivity growth in traditional services. Avoiding this middle-income trap will require a deliberate policy effort to promote a diversified, sophisticated, and non-standard export basket, as shown by the experience of countries that made the transition from lower to upper income in the past.[2] Second, sustained investments are needed to upgrade education and training, and health and social protection to develop human capital and narrow inequality of opportunity and poverty to remove impediments to higher living standards, productivity, and social cohesion.

There are win-win opportunities and complementarities between the policies to upgrade competitiveness and those aimed at promoting inclusion and equity. The fundamental drivers of growth should increasingly rest with local productive capabilities, innovation, and a skilled and well-remunerated workforce. Sound governance and transparent decision-making are needed to move in that direction, manage trade-offs, and stimulate the investment that each side must make—government, business, and workers. Given its external current account vulnerabilities, its weak tax base, and the pressure for fiscal consolidation, a carefully designed growth strategy needs to balance the need for protecting macroeconomic and financial sustainability over the medium-term without undermining investments in productive capacities and human capital. Social dialogue provides a consistent way to find such a balance.

The ILO report highlights a number of suggestions for action in five key areas to promote economic diversification and improve the quality of jobs and living standards.

i. **Enterprise promotion** should address bottlenecks in infrastructure and energy and encourage capabilities for product development and innovation. Special attention should be paid to micro, small and medium-sized enterprises by means of improving access to finance services and

[2] According to Felipe et al. (2012), the Dominican Republic is among a group of 52 countries at risk of getting into the so-called middle-income trap. For a review of the literature on this matter, see Williamson (2012).

extending business support services to improve management skills and workplace practices. Strengthening public private dialogues, both at sectoral and territorial level, could also contribute detecting new business opportunities. Measures aimed at improving the productivity of smaller enterprises should be combined with steps to prevent violations of legal provisions and workers' rights and to promote a gradual transition out of informality.

ii. **Education and training** should be coordinated with the needs of business, particularly in those sectors with higher potential for job generation. The objective should be to develop a "virtuous circle" of coordinated policies linking education, skills formation, productive transformation, employment and decent work.

iii. **Labor market policies and regulations** can be used to improve job opportunities, especially for women and youth, by facilitating participation, encouraging entrepreneurship, supporting transitions (from school to work, out of unemployment or between jobs) and ensuring protection from discrimination and unfair treatment.

iv. **Wage setting policies** should ensure that remunerations keep pace with gains in productivity. A review of the minimum wage setting, which can act as a benchmark for guiding wage bargaining for both salaried workers as and in informal jobs, could encourage wage growth in line with productivity. Ensuring an appropriate degree of collective bargaining including at the sectoral level, is another important step in order to ensure flexibility and fairness of wage-setting policies.

v. **Social protection**. The introduction of a nationally defined social protection floor—a basic set of guarantees of essential health care and income security based on a careful assessment of the financial sustainability and weaknesses of the existing system, would help complete the extension of the social protection system.

5. Conclusions - Achieving a balance between productive transformation, fiscal sustainability and an inclusive society

Despite the remarkable growth performance recorded over the past decades, the Dominican Republic's social indicators have remained weak. Addressing persistent and widespread labor market informality, relatively low labor force participation, rising unemployment, and high levels of inequality and poverty represents a key challenge.

Achieving higher and more inclusive growth will require productive transformation and reforms aimed at improving the business climate and enhancing competitiveness. It will also require a well-performing labor market and significant investments in education and training, health and social protection to upgrade human capital and narrow inequality of opportunity. This cannot be attained without balancing macroeconomic stability (including in the form of low price uncertainty, competitive exchange rate, sound financial system, and sustainable fiscal positions) with the need for increased and more efficient expenditure for public investment and social needs.

A productive transformation cannot be successful unless it is debated with and supported by all stakeholders, as should be greater coherence of public policies. While the ILO and the IMF can contribute to this debate with their respective technical experience and their international perspective, significant change can only be brought about by national actors. In this context, a sustained open and informed tripartite policy dialogue can play a role in promoting reforms that balance economic and social goals, thus sharpening policy design, building up pressures for implementation, ensuring regular monitoring of progress, and keeping the focus on a given issue when national decisions about regulatory reforms and macroeconomic and fiscal policies are taken.

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