

Forum Series on the Role of Institutions in Promoting Economic Growth

Extending the Analysis:
Dominican Republic

**An Assessment of the USAID Investors Roadmap and an Alternative
New Institutional Economics Perspective on the Barriers to
Entrepreneurship**

By

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Mercatus Center at George Mason University

Forum 8

New Institutional Economics and Development: Case Studies and Applications

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Executive Summary

The objective of this report is to identify the impediments to entrepreneurship that exist in the Dominican Republic and to assess their relative significance in the light of a comprehensive analytical framework. The framework applied in this study derives from New Institutional Economics (NIE) and theories of entrepreneurship and market processes. The approach applies qualitative, ethnographic research methods. Entrepreneurs are treated as ‘embedded’ within their specific social and cultural contexts.

The key development issue for the Dominican economy is not so much a scarcity in the supply of entrepreneurship per se. Indeed, our general finding is that Dominicans are highly entrepreneurial. Rather, we believe that the central problem is the allocation of entrepreneurial talent to uses that are either blatantly unproductive (e.g. ‘excessive’ lobbying to stave off competition) or that do not make the greatest possible contribution to the creation of wealth in the country over the long-term. A common instance of this in the Dominican Republic is the ‘excessive’ small-scale entrepreneurship in the informal economy where the growth of businesses is less constrained. It should be noted that the ‘flow’ of entrepreneurial talent into unproductive uses and the informal economy is rational and profit-maximizing relative to the existing set of regulations. Our point is that we believe that a superior allocation of entrepreneurial talent – that would make a much greater contribution to Dominican prosperity -- could be induced by a more robust institutional framework. (The existence of a strong entrepreneurial drive is surprising

given that there is a cultural mistrust of competition. Cultural mistrust of competition reinforces pressure to regulate industry and to insulate incumbents from new entry.)

Although the static compliance costs of regulations are high, the key costs of the existing institutional framework are largely dynamic – the stifling of entrepreneurship or its misdirection into low-value activities. These costs are not just borne in the particular markets that are the original target of regulation; entrepreneurship is also inhibited in adjacent markets for complementary and substitute goods and services. Consequently, we reject the general hypothesis of the Investor Roadmap which asserts that static compliance costs of regulations (especially ‘administrative and procedural’ aspects) imposed on ‘investment start-up processes’ are the most critical remaining barriers to entrepreneurship in the Dominican Republic.

This report also emphasizes the systemic nature of the problem. At the heart of the problem is an inefficient public financial management system that also supports corruption. For example, the Dominican tax system is fraught with inefficient tax rules and corruption in tax collection. Arbitrariness in the application of tax rules by the tax collection agency induces entrepreneurs to understate their profits, which in turn means that their official financial statements understate the value of their firms. The understatement of firm value means that outside capitalists (e.g. banks) are unwilling to provide resources to fund business expansion, with the result that entrepreneurial firms tend to be family-owned and focused upon the domestic economy rather than export-oriented. The emergence of sophisticated primary and secondary financial markets that diversify risks and bet on innovative ideas is also stifled (see Appendix Two).

Table 1.1: Major institutional influences on entrepreneurship in the Dominican Republic

Level of institutional analysis	Examples of institutional rules at each level that impede or promote entrepreneurship in the Dominican Republic
Level 1 (social/cultural rules)	<p>There is a “culture of mistrust of competition”, and there is still a very paternalistic culture that carries over from the legacy of colonization and dictatorship.</p> <p>The culture of mistrust of competition is manifested in entrepreneurs trying to use the apparatus of the State to protect themselves from competition.</p> <p>Dominicans are sometimes regarded as being fatalistic or indifferent. Their sense of personal power is tightly interwoven with their place in the family and community.</p>
Level 2 (rules that frame market processes)	<p>Poor design and implementation of public financial management arrangements is at the core of policies that impede entrepreneurship. Many other barriers to entrepreneurship are largely symptomatic of poor core public sector institutions.</p> <p>Lower levels of the judiciary are not free of outside interference. Corruption is still a problem. (The 1994 constitutional reforms have greatly enhanced performance at the higher levels of the court system but have not been embedded at lower levels.)</p> <p>It is very costly and time-consuming to use the court system to settle business disputes.</p> <p>Property rights to land are not always well-defined and searching titles is very costly due to a highly dispersed and archaic documentation system.</p> <p>The registration of new business is time-consuming and costly.</p> <p>Administrative and bureaucratic functions of government divert entrepreneurial energies towards the informal economy. The informal economy involves around 45 percent of the Economically Active Population. Informal businesses outnumber formally registered businesses by 3 to 1.</p> <p>Specific laws to regulate competition or dominant positions in the market tend not to be enforced, so that corporate mergers and acquisitions occur unimpeded in the Dominican Republic.</p>

Table 1.1: Major institutional influences on entrepreneurship in the Dominican Republic (continued)

Level of institutional analysis	Examples of institutional rules at each level that impede or promote entrepreneurship in the Dominican Republic
Level 3 (specific regulatory commands)	<p>Tax rules are arbitrary and create business uncertainty. These tax rules lead businesses to evade tax, and understate their economic performance in their financial statements. This in turn means that firms are limited in their access to long-term sources of finance as banks require transparent and objective financial statements to serve as a basis for investment decisions.</p> <p>Arbitrary, corrupt customs services inhibit competition, raise the costs of importing and exporting, and stifle productive entrepreneurship. The trade policy regime of the Dominican Republic is more interventionist than that of its neighbors. The system of import licensing, consular approval of import invoices, and export controls provides great scope for administrative discretion and corruption. Exporters have to go through 15 bureaucratic steps in order to export.</p> <p>Free trade zones offer exporters significant competitive advantages.</p> <p>The high degree of government intervention to bring about specific market outcomes means that many economic decisions are politicized and businesspersons spend inordinate time ‘lobbying’ the government for favors and privileges.</p> <p>The electricity sector – inefficiency and poor quality of supply (i.e. lack of reliability) -- is a major impediment to entrepreneurship in the Dominican Republic.</p> <p>Legal cartelization of maritime and air transportation inhibits competition and raises costs for entrepreneurs.</p> <p>The cost of capital is a significant impediment to entrepreneurship in the DR.</p>

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1. INTRODUCTION

1.1 Objectives and method

The main objective of this report is to identify the impediments to entrepreneurship that exist in the Dominican Republic and to assess their relative significance in the light of a comprehensive analytical framework. Subsidiary objectives include providing USAID with a diagnostic instrument for assessing the entrepreneurial climate of the Dominican Republic and other countries. In addition, we aim to evaluate the Investor Roadmap in light of our results and analytical framework.

To achieve the above objectives, we have chosen to apply a comprehensive analytical framework that derives from New Institutional Economics (NIE) and market-process theory (theories of entrepreneurship). These are the lenses through which we analyse entrepreneurial and economic phenomena in the Dominican Republic.

The approach applies qualitative, ethnographic-based research methods, including structured interviews with real-world entrepreneurs. The treatment of data focuses on trying to understand entrepreneurial processes in their social context. Entrepreneurs are treated as ‘embedded’ within their specific social and cultural environments. The assumption is that the set of opportunities likely to be discovered and exploited by entrepreneurs depends upon the institutional framework (i.e. political, legal, economic and cultural rules) and their position in the social structure. We examine the constraints under which entrepreneurs operate. We are interested in how entrepreneurs attempt to extract value from their social networks in their struggle to obtain capital and other resources – resources that would not otherwise be available to them.

A qualitative, ethnographic approach is particularly well suited to an investigation in the Dominican Republic because family ties and social relationships are important in obtaining employment and doing business in this country. Business arrangements are seldom made between strangers.

Our analysis is directed towards identifying and explaining the largely unintended consequences of public policies and regulations for entrepreneurial processes in the Dominican Republic. That is, we evaluate the hidden ‘dynamic effects’ of government intervention (i.e. regulatory interferences in Dominican markets), such as the stifling and misdirection of entrepreneurial discovery processes (see Appendix Two).

Our methodology includes:

1. Conducting over 40 ‘broad-spectrum’ structured interviews with entrepreneurs, industry representatives, lawyers and bankers, public officials, and political decision-makers.
2. Gleaning detailed institutional data on legal and regulatory frameworks for specific industries from published material.

Our empirical investigation is focused mainly upon Santa Domingo (the capital with a population of around 2½ million), but we also visited other areas, including Dajabon

which is a small town located near the Haitian border. In addition, the people we interviewed span a range of industries: traditional and non-traditional exports of manufactured goods; traditional and non-traditional services; and key infrastructural industries.

Interviews were conducted in Spanish, English or a mix of the two, and they were recorded with permission. We gave interviewees the option of choosing the language of communication. In this report, we are presenting all interviewees' comments in English – which means that we translated Spanish originals and have made minor editorial changes to some English originals in order to ensure coherence.

1.2 Analytical framework: Institutional economics and entrepreneurship theory

The analytical framework underpinning this project is quite different from that implied by USAID's Investor Roadmap. It derives from the work of North, Kirzner, Boettke and Harper (2003). For the purposes of this project, 'entrepreneurship' is defined as the human propensity to be alert to profit opportunities. It constitutes the economic function of discovering arbitrage opportunities. This conception of entrepreneurship is broader than that entailed in USAID's Investor Roadmap, which equates entrepreneurship with starting up a new firm. The notion of entrepreneurship in this project will also include arbitrage transactions that do not necessarily involve setting up a new business organization.

Similarly, we are not only interested in heroic, large-scale entrepreneurship (such as waves of Schumpeterian "creative destruction") but also entrepreneurship-in-the-small. Thus, our conception of entrepreneurship embraces not only innovators in the data processing industry in the Dominican Republic, for example, but also operators of *guaguas* (economical vans or buses) and pickup trucks that establish new routes between rural villages carrying passengers, animals and cargo. The significance of small-scale entrepreneurial acts for economic development should not be underestimated, since all entrepreneurial acts have unintended consequences and create opportunities for further entrepreneurial endeavors (i.e. they may serve as a seedbed for future ideas).

The notion of ‘institution’ in this context is taken to mean humanly generated constraints that shape economic and social behavior, including the willingness to bet on ideas and the creativity and persistence in finding ways to mobilize scarce resources in order to bring those bets to life (North, Brenner). Institutions in the Dominican Republic are examined at several levels:

1. Level 1: cultural values, social norms, customs and widely held psychological predispositions (e.g. fatalistic beliefs and cultural mistrust of competition)
2. Level 2: institutional rules of the game that *frame* markets (e.g. constitutional rules regarding the executive, legislative, judicial and bureaucratic functions of government, and general economic rules that frame market processes, such as the definition and enforcement of property rights and contract laws)
3. Level 3: specific regulatory commands that *intervene* in market processes and affect how entrepreneurial transactions are organized and unfold.

See Table 1.1.

Our attention is not only directed towards deliberately constructed institutions but also spontaneously generated institutions that have evolved in the Dominican Republic over many years. We are interested in the effects of both types of institutions on entrepreneurship.

Our focus is not limited to legal entrepreneurial activity. We are also interested in black-market and illegal entrepreneurship, such as illegal cross-border trade and movement of human capital. (Less than 8 percent of foreign workers in the Dominican Republic have valid work contracts.) We are interested in examining the extent to which bribery pervades all aspects of trade and how entrepreneurs creatively circumvent the harassment of corrupt officials. Attention to corruption requires us to consider the extent of discretion afforded officials, their accountability arrangements, and the size of the economic rents under their control -- the Investor Roadmap pays inadequate attention to these factors.

1.3 Structure of the report

This report is structured as follows. The next section identifies the most significant events in Dominican history that have a bearing on the current entrepreneurial climate in the Dominican Republic. The underlying hypothesis is that institutional path dependencies exist which might lock the society into particular developmental trajectories. We also try to get a sense of the entrepreneurial content of Dominican culture.

Section 3 examines constitutional and political institutions. Section 4 examines the general economic rules of the game that frame market processes in the Dominican Republic. Both Sections 3 and 4 thus focus upon higher-level institutions that are more enduring than the lower-level economic regulations and policies that *intervene* in market processes. The latter is the subject matter of Section 5. We examine the degree of macroeconomic stability and openness of the Dominican economy, as well as monetary policy, fiscal policy, competition policy, policies relating to key infrastructural industries, human resources and social policy, international trade and investment policy, and the regulation of ownership structures. We examine these policies in terms of their effects on entrepreneurship.

Section 6 examines specific barriers to entrepreneurship and the conclusions are provided in Section 7. We also compare our findings with the Investor Roadmap conducted for the Dominican Republic.

2. CULTURE AND HISTORY

2.1 Key historical events

The Dominican Republic has had a turbulent history that has included successive invasions by colonizing powers and long periods of repressive dictatorship.¹ The effects of that history are still palpable. Since its “discovery” by Columbus in 1492, the region has been characterized by a high degree of centralization of economic affairs, significant levels of state intervention and corruption, but nevertheless entrepreneurship in the

¹ Harvey (2002) was very useful for a brief historical background in the writing of this section.

informal economy has been vigorous. As part of the Spanish Empire, the colony was subject to the system of protected trade imposed by the Castilian Crown. This policy-induced commercial monopoly was designed to benefit powerful interests in Seville, who set artificially low prices for the colony's products. Indeed, Spanish colonists were prohibited from trading with people from other nations.

As already mentioned, another feature that has long-established historical roots is the vibrant informal (or 'black') economy, driven by entrepreneurs eager to exploit opportunities within the interstices of onerous regulations or outside the framework of the formal legal system. Even under the protected fleet system of the Spanish Empire, market entrepreneurship continued to flourish in the form of contraband trade along the northern and western coasts of Hispaniola (supported too by the subversive participation of France, England and Holland who opposed the commercial monopoly that Spain imposed on the Indies). Spanish and Creole traders who were established in Hispaniola bought contraband merchandise, and producers sold their goods directly to the smugglers or foreign privateers who paid higher prices. In 1605, in an extreme and disastrous action known as the "devastaciones", the governor at the time was ordered to raze these towns to the ground -- a policy that crippled the island's economy for years to come.

Indeed, repressive political regimes have punctuated the history of the Dominican Republic. It is easy to see why there is a lack of confidence in formal institutions of government and law. 'Powerful others' have tried to interfere arbitrarily in the private affairs of Dominicans. This has challenged them to stay in control of their own destiny. The new Dominican state in the nineteenth century, for instance, was dominated by caudillos -- strong men based in every region of the country who commanded large armies of local peasants and who were usually more interested in enriching themselves through short-term maneuvers than on managing the country's longer-term interests. Their activities are reminiscent of "stationary bandits" -- their power was based on their ability to stave off the threat of roaming Haitian invaders -- but their time horizons were too short to give them the incentive to create robust institutions that would foster economic growth. Indeed, so strong was the perceived threat of Haitian domination that

many merchants and landowners lobbied for the Dominican Republic to be annexed to an outside power, such as England, France, the United States or Spain. (In the end, President Buenaventura Baez, a former Azua caudillo, concluded negotiations with Spain.) Elected as president in 1882, General Ulises Heureaux (known popularly as Lilis) also aligned himself with the southern caudillos, and the system of bribery and corruption continued.

In the twentieth century, of course, the arch caudillo was Rafael Leonidas Trujillo, who was to maintain totalitarian control over the Dominican Republic for three decades. His self-appointed titles included “Father of the New Fatherland” and “Generalísimo”. His regime was one of the most intrusive and oppressive in Latin American history. Trujillo transformed the entire country into his personal corporation and appointed family members to the highest positions in the government. He operated monopolies in sugar, salt, cigarettes, rice, beef, insurance, milk and cement, and received a percentage of all prostitution revenues. By the end of his regime, he directly employed sixty percent of the Dominican workforce. The twelve years of Balaguer’s presidency (1966 onwards) were also characterized by widespread corruption in government. In 1978, the newly elected president, Antonio Guzman, also set about transforming himself into a new caudillo, appointing his children, relatives and friends to the country’s key political posts.

Haitian invasions have also left their traces on the Dominican legal system. During the twenty-three year Haitian occupation, the government tried to streamline the traditional system of Dominican property ownership called *terrenos comuneros*, by which several owners had simultaneous rights to the large estates created in the sixteenth century by the Spanish Crown (Harvey 2002: 326). The most significant and enduring impact of Haitian invasion, however, has been the foundation of the legal system of this Spanish-speaking country on a French model of government. (The French too have controlled the present-day Dominican Republic during different periods of its history.) During the period 1822 to 1844, when Haiti maintained political control over the whole island, the Haitians introduced the system of laws and statutes known as the Napoleonic code, which for the most part still serves as the foundation of the Dominican legal system today.

Consequently, legal rules in the Dominican Republic are explicitly codified in Civil Law and are not derived from the spontaneous institution of the common law.

2.2 Lack of respect, confidence and trust in formal institutions

The Dominicans and foreigners we spoke to all emphasized a lack of confidence in formal institutions in the Dominican Republic. Corruption in the judiciary and in the legislative and administrative apparatus of government is well known. It is hard for small businesses to obtain an efficient resolution of business disputes in the courts because they usually lack political contacts. One interviewee suggested that this raises questions about the workability of formal institutions in the country (“*pone en entredicho la institucionalidad del país*”). The poor and smaller entrepreneurs may be the worst affected by the absence of reliable formal institutions.

Difficulties in using the judicial system are not limited to small businesses, however. Banking executives commented on the problems they have in dealing with loan defaults through the court system. They suggested that their success in the collection of non-performing loans depends on the type of collateral they have and the “character” of the entrepreneur involved. It is very easy for entrepreneurs to create legal obstacles for the bank in foreclosing assets. Despite these difficulties, the banking executives told us that:

We’ve had cases where we can execute very fast; or where the company is willing to say ‘I am broke, take the property’. But in this case, you depend on the character of the client... the willingness to cooperate. If he can’t pay and you need to foreclose, [you depend on them] not to put any obstacles in your way, because you can do that very easily here through the legal system.²

This was confirmed by an entrepreneur who told us that there are lots of ways to hide assets and sell them without paying debts.

Overall, the lack of trust in formal institutions tends to push individuals to trade with people they already know. A young entrepreneur’s words capture the essence of the

² In order to ensure anonymity, we have not coded responses or identified interviewees. However, where we believe anonymity is not compromised, we have in some cases indicated the context or industry in which the comments occurred.

problem: *“The government is not efficient in enforcing contracts. That is why you do business with people you know”*. Entrepreneurs do business with people they met in school, college or the places they have worked in. Formal legal enforcement of business contracts is not the way people do business. He commented that Dominicans are good at recommending other people in terms of the reliability of their performance. We discuss this later on.

Lack of respect for formal law is prevalent in the Dominican Republic. Poor enforcement of existing legal rules means that entrepreneurs encounter a high degree of legal uncertainty, even when the rules are enacted through legislation or decreed by the executive power. As an example, one exporter mentioned that the government does not even comply with its own laws that require it to return ITEBIS withheld from exporters. (ITEBIS is the kind of sales tax that applies to the transfer of goods -- *Impuesto a la Transaccion de Bienes Industriales*.) Others mentioned arbitrariness in tax collection according to rules that are outside the ambit of existing tax legislation.

2.3 Heavy reliance upon social networks and long-term relationships

As mentioned, lack of confidence in formal institutions leads people in the Dominican Republic to rely heavily on personal trust, social networks and reciprocity-based relations with acquaintances. There is less reliance on impersonal relationships supported by formal institutions (such as third-party enforcement of contracts). The fact that people seldom do business with strangers reduces the extent of the market and opportunities for specialization. A start-up entrepreneur was more emphatic: *“without relationships [to key people], it is almost impossible to start business in the DR.”* He stressed the importance of social networks by saying that the DR is so small that everybody knows each other in the same business and at a similar socioeconomic level. When he and his partners started their venture, almost all the supplies of services were obtained from friends.

A foreign entrepreneur operating in the Dominican Republic reaffirmed this trait of Dominicans:

If you don't “come by the hand” of someone, you can't do business; you need to be referred by a friend, etc. In the US things are different, they pay

attention to business opportunities that come from anywhere, they pay more attention to ideas. In Latin America, if the idea comes from someone you don't know, it is not a good idea.

Small businesses especially rely heavily on informal relationships. Taxi drivers, for instance, use their personal networks to start-up their businesses. As a taxi driver told us, individuals who rent their cars to cab drivers generally do not write a contract. They rely upon a verbal agreement, but they do obtain some basic personal information (e.g. address) on the renter, just in case the eventuality arises. *“It is the problem with Dominicans, that many things are based on the party's word, since here legal claims don't work”*. However, they do sign written contracts with the taxicab firm itself.

The focus upon business relations within a narrow social network tends to reinforce inward-looking cultural values. Small and medium-sized businesses tend to focus their attention on the local business environment. They tend not to consider expansion to foreign markets.

2.4 Strong entrepreneurial drive vs. a culture of mistrust of competition

It is not necessary to spend a long time in the city of Santo Domingo to realize that a strong entrepreneurial drive is a distinctive feature of the Dominican people. Vivid examples of entrepreneurship abound: numerous small street vendors and bustling shops along El Conde; the peddling of “pedicure and manicure” services along Boca Chica beach; “carwash” bars; pottery businesses in Mercado Modelo; or the package of services that taxi drivers usually promote.

Perseverance is another Dominican characteristic, well encapsulated by one interviewee who reported that *“[Dominicans] have a tremendous capacity to persevere in the face of adversity. It is not an easy place to start up a business, but people do”*. An entrepreneur in the communications industry confirmed this view: *“I have been able to develop this business because of my ‘warrior spirit’ (“la vida me dotó de una estructura guerrerista”)*. He believes that if he had been in another country, he would have 1,000

times the wealth that he has right now; *“I have had to struggle and fight from the inception of the company to the present day”*.

However, this strong entrepreneurial drive and perseverance conflicts with a culture of “mistrust of competition”. One academic we spoke to commented that *“the greatest impediment to innovation and entrepreneurship in DR is this culture of anti-competition and mistrust of competition”*. Not surprisingly, he considers that the pattern of colonization that Spain imposed, through entities like the *Casa de Contratación de Sevilla*, was the origin of this anticompetitive attitude. This mistrust of competition has given rise to policy-induced monopolies in key sectors of the economy (such as electricity, maritime and air transportation industries) that impede the entry of new competitors. The situation in these industries is described later in this report. Continuing this theme, another scholar argued that:

The Dominican Republic does not have a cultural tradition favoring the capitalist ethic. The Spanish and African influence was not positive for the development of capitalism [in the DR]. Capitalist culture began [to gain momentum] with Balaguer in the 60's. However, it was a culture of crony capitalism, with paternalism of the government. It wasn't a capitalist culture of competition; it was one of protectionism. The DR [still] suffers from a very paternalistic culture.

This suggests that, even though the Dominican culture is highly entrepreneurial, there is a widespread public mistrust of competitive processes. Businessmen often look for government protection to secure the markets for their goods and services. The whole political structure leads people to allocate their entrepreneurial talents towards unproductive uses of the apparatus of the State. As one economist acknowledged:

We have developed an entrepreneurial class under the protection of the State. And the fact that it [has] developed under the protection of the State is part of a culture of being alert ... to those [entrepreneurial] opportunities generated under that protection given by the State.

As we shall see, this is a recurring theme throughout this report. Poor quality institutions induce entrepreneurs to allocate their energies to unproductive and economically wasteful activities, such as lobbying for special privileges (called “rent seeking” in the academic literature). In a system with vaguely defined property rights, wealth is up for grabs as

parties attempt to redefine property rights. See, for instance, the discussion of the administrative and bureaucratic state in section 3.3.

3. CONSTITUTIONAL AND POLITICAL INSTITUTIONS

3.1 Constitutional rules and political structure

According to the Constitution, the State of the Dominican Republic is organized into executive, legislative and judiciary branches. The president, who is elected for a four-year term, heads the executive power. The legislative power consists of a bicameral congress, formed by a 30-member senate and a 149-member house. Members of congress are also elected for four-year terms, although elections for congress take place halfway through the presidential term. The Supreme Court is at the apex of the judiciary and is in charge of appointing the lower-level judges.

The cultural legacy of Spanish colonial institutions (“a very hierarchical society” – as one economist put it) and the long history of dictatorships have contributed to the centralization of political power in the executive, especially in the hands of the president. The Dominican Republic suffers from a chronic case of “*presidencialismo*” This is reflected in the *political business cycle* which, according to one academic we interviewed, has an adverse impact on the economy. There is a strong correlation between the general business cycle and the political cycle. For instance, the political cycle tends to affect the tax burden (and specifically customs duties), exchange rates and interest rates. For example, “*Current Interest rates are increasing inevitably to avoid the political costs of a depreciation of the exchange rate, since elections are coming*”. Political cycles undermine the continuity and stability of the rules of the game that frame market processes. As one entrepreneur opined:

Rules of the game are unstable. Part of the problem is that when there is a change of administration, everything changes. Even when positive changes have been made, someone else gets into office and then alters the rules to attain his objectives to get money. “Aquí la gente quiere vivir del Estado.” (Here, people want to live from government). They change the rules according to their interests. That’s why there are so many changes.

The central government controls over 90% of the budget of the state. It is in charge of collecting most taxes and it transfers 6% of tax revenues to the municipal governments. In addition, many bureaucratic requirements are handled only by the central government, most often in Santo Domingo.

The executive has power over the *Contraloría General*, the *Procuraduría General de la Nación*, the industry regulator for electricity, customs, and to a lesser degree, the Central Bank, the Monetary Board and banking regulation. For instance, the head of the *Cámara de Cuentas* (the institution in charge of controlling the public finances of the government) is named by the president and ratified by congress. This certainly does not help the fight against corruption. Constraints on executive power are weak.

Some progress in improving the checks and balances on executive power was made with the constitutional reforms of 1994. These reforms reinforced the *Corte de Casación* as a court capable of reviewing any court decisions or administrative resolutions in light of the constitution. With the reform of 1994, any “interested party” may appeal bills, legislation, judicial resolutions, administrative dispositions or any decision of any arm of the state. If such laws or decisions are deemed unconstitutional, they are to be annulled.

Constitutional prohibition for (consecutive) re-election of the president was reformed in 2002. Although at the time the current president, Hipólito Mejía, said he would not run for re-election, it now seems that he intends to run for re-election in 2004.

3.2 The judiciary

An important implication of the constitutional reforms that led to the Constitution of 1994 was the reinforcement of the judicial system. With these reforms, the judicial system gained greater autonomy (both administratively and financially) from the executive branch of government. The *Consejo Nacional de Magistratura* was created, which is to be responsible for appointing judges to the Supreme Court. The Supreme Court was put in charge of appointing judges of lower judicial rank, making such decisions more professional and less politicized. In addition, the *Carrera Judicial*

(National Judicial School) was established, further enhancing the professionalism of judges and reducing political interference. (USAID provided support and assistance for the National Judicial School between 1998 and 2001.)

However, although the judicial system has improved considerably since the new Constitution and the reforms of the late 1990s, it is still plagued by inefficiencies, corruption and politicization of lower-level judges.

Furthermore, although dispute resolution has improved, the system is still very slow and things don't get settled on time. As one entrepreneur put it: *"I have cases which have already been going on for two years or so, and the legal opinion is impossible to predict. Here we have a real problem with the time it takes"*. This was by no means a unique experience. We heard similar comments from several people we interviewed. *"It takes a long time to settle a case, and if you have deep pockets, you face even further challenges."*

Part of the problem is that the judicial reforms have not yet been embedded throughout the court system. According to several sources, reform in the judicial system has considerably improved the superstructure and the top levels of the judiciary (i.e. the Supreme Court), but the necessary changes have not been implemented at lower levels of the court system, especially in those courts that enforce property rights on a day-to-day basis.

One strategy to overcome deficiencies in the Dominican judicial system has been to include contractual provisions which shift conflict resolution to international jurisdictions in the event of a dispute. Of course, this option is only appropriate for a small minority of cases, since the transaction costs are prohibitive for small businesses and those with limited resources. In addition, this strategy is limited by the fact that disputes considered to be of 'public order' – a notion that is not clearly defined – are under Dominican courts' preemptive jurisdiction. Furthermore, foreign judgments or awards are not enforceable in the country until a Dominican court declares that such a decision is valid and enforceable

in the Dominican Republic. This process can involve protracted and costly litigation, thus defeating the whole purpose of trying to shift dispute resolution to foreign courts and international arbitrators. (Note too that the Dominican Republic is not a member of any international convention on arbitration or conciliation.) Private arbitration within the Dominican Republic is also limited by provisions regarding ‘public order’ of disputes.

3.3 Administrative and bureaucratic functions of government and the allocation of entrepreneurial talent

Corruption in public agencies is widespread, giving rise to a culture of patronage and nepotism. A recent survey revealed that 85% of the population perceives there to be a high degree of corruption in the Dominican Republic (*Diario Libre*, 23 July, 2003). Corruption impacts every stage of the entrepreneurial process, including start-up. As one entrepreneur of a new venture commented:

To get the approval for the plans of construction, we paid 5,000 pesos [approx. US\$ 167]³ as a bribe. Once you have the relationships with the government, it is very easy. But it is like a network of corruption, because the people you pay must themselves pay other government officials.

Arbitrariness and lack of transparency are prevalent in public administration, especially in tax collection and customs (see section 5). Regarding bureaucratic and administrative processes in general, one entrepreneur in the communications industry claimed:

Here entrepreneurs want to work, want to survive but nobody helps them. We have old-fashioned governmental agencies. If you are looking for a service to modernize your business, they put you through a lot of hurdles that make it impossible to develop your enterprise.

In general, people consider the government as a vehicle for becoming wealthy. One interviewee suggested: “[P]eople want to be related to the government, if not directly involved, at least have friends there, because they see it as a source of wealth”. For instance, incumbents with key political connections use customs to block the entry of new competitors or to make it more costly for potential competitors to obtain imports.

³ The exchange rate use in this paper is DR\$30 to US\$1.

Incoming governments use posts in customs to ‘pay’ individuals who supported their campaigns. According to one source, it is even possible to buy some appointments in customs. *“A good way to visualize it is through a conversation between two college students ‘The only thing I need is six months in customs, and I don’t have to worry anymore’.”*

In addition, some administrative procedures, like the registration of a new business, take a long time and this provides incentives for entrepreneurs to allocate their energies towards the informal economy. Sometimes it is not clear what the registration steps are, and the whole process is usually transaction-cost intensive. One expert we interviewed claims that: *“The average amount of money necessary to register a new company is twice the average initial investment of the micro-, small- and medium-size business.”* Similarly, one start-up entrepreneur, speaking from personal experience, complained that *“we began a process of constituting a new company nine months ago and we still don’t have a resolution.”*

Given such high levels of compliance costs, it is no wonder that a tremendous amount of economic activity is not captured in official economic statistics. Indeed, the informal economy is estimated to involve around 45% of the Economically Active Population (EAP). According to a private database, there are around 467,000 unregistered firms but only 125,000 registered firms. This means that roughly 4 out of 5 firms in the Dominican Republic operate in the informal economy.

Informal businesses have many competitive advantages. Since they do not pay taxes, tariffs and bribes, they can sell their goods and services at lower prices. *“If you do everything by the book, you can’t compete against informal businesses, especially if you import.”* In the electronic appliances industry, for instance, the lower prices offered by informal vendors force their formal competitors to undervalue their merchandise in customs declarations. *“The rule is: the one who cheats without been caught will make the profits.”*

The costs of bureaucracy and government intervention are such that entrepreneurs may shift out of highly regulated activities. One entrepreneur in our sample explained his move out of one line of business and into a less regulated area:

[I was looking for a business] that wasn't as painstaking as the other business I was in before: taxes on entry, taxes on exit, tariffs, commissions for exchanging dollars... I mean, everything was a problem, every time I wanted to move a product... taxes on sales, taxes on everything... and, of course, corruption... because there are always people who look for ways to avoid paying those taxes. Then competition isn't only about your product anymore, it has an imponderable element... But in my current business, where I manage information, I don't pay taxes regarding the product any more because information is intangible -- there is no importing or exporting [of goods]. I don't have inventory -- everything is electronic -- I reduced the amount of documentation, you have no idea how much you accumulate, especially when you have to keep all those documents for 10 years. When you keep documents for 10 years, you end up having a storehouse twice the size of your offices... and office space is expensive... And we have to add the cost of the fire insurance... It is endless the amount of problems that this involves.

3.4 Public financial management

The public financial management system was identified by one of the most insightful interviewees as a serious impediment to entrepreneurship in the Dominican Republic. Many other barriers to entrepreneurship that we have identified are largely symptomatic of poor core public sector institutions. Our own analysis confirms that public financial management in the Dominican Republic is a major impediment to entrepreneurship in this country. Among other things, poor public financial management is related to systemic corruption that is embedded in the hierarchical structure of the Dominican bureaucracy. Current public sector institutions provide great latitude for self-serving action and inaction at all levels of the bureaucracy. “Corruption is a symptom of other underlying problems rather than an independent variable” (Rose-Ackerman 1997: 36).

The public sector in the Dominican Republic is characterized by poor performance incentives for public decision-makers, insufficient competitive pressure (or a lack of “contestability”) in service provision, lack of responsibility and accountability of departmental heads, insufficient specification of outputs of government departments, lack of transparency of the financial results of decisions by the executive branch of

government and the bureaucracy, and poor information systems to assess the performance of agencies. The result is that bureaucrats have a high degree of discretion in the allocation of privileges and economic benefits (called ‘rents’ by economists). Under the current system, it is not possible to determine whether bureaucrats are producing the outputs of services agreed to and whether they do so efficiently. In general, public officials have little incentive to do their jobs well because of low pay, inadequate monitoring and a short time horizon.

The problem of getting agents in organizations (whether a firm or government department), such as managers and employees, to pursue the interests of their principals is known as an “agency problem” in the economic literature. Politicians and bureaucrats can be regarded as agents of the population (voting public) for the provision of a range of services. The agency problem has two facets: that between the public and the executive (or minister) on the one hand, and that between the executive and the bureaucracy on the other (Scott and Gorringer 1989).

The current public financial management system in the Dominican Republic give rise to specific agency problems, including the following: payments of illegal bribes to public agents with the goal of obtaining a benefit or avoiding a cost (“rent-seeking” and “capture” of politicians and agencies by special interest groups); budget maximizing behavior leading to inefficient public expenditure; year-end spending sprees; a disregard for the efficient use of capital assets and cash, including the maintenance of the value of capital assets; “creative” end-of-year accounting; an unduly short-term focus in financial planning; hiding decisions and their results by the use of cash accounting; a strong bias towards producing in-house rather than contracting-out to least-cost private-sector suppliers; and excessive employment in the public sector (i.e. bloated bureaucracies and “empire building”). The Dominican Republic’s system of financial accountability and reporting in the public sector does not accurately identify who makes a decision involving the use of resources, what those resources are and what outputs those resources are supposed to produce.

Government departments in the Dominican Republic are neither efficient nor responsive. Top executives of government departments and ministries are politically appointed. Appointments often do not reflect merit (such as knowledge of a policy area or managerial skills) but rather patronage. There is no well-developed career public service as such with well-qualified personnel with years of experience. Ministers are not sufficiently accountable for the administration, output and efficiency of their departments.

There is insufficient emphasis upon accurate measurement of outputs in the public sector. In the current system, there are no detailed contractual agreements for the supply of outputs by government departments that specify in detail the nature, quality, delivery time and place and price of the output. Furthermore, some agencies conduct both policy (or production activities) and regulatory functions. The failure to separate production and regulatory functions increases the likelihood of capture by special interest groups.

In spite of the severe difficulties that remain in public financial management in the Dominican Republic, we would like to mention that there has been some progress in recent times in defining the core activities of the public sector and separating them from the trading activities of government. For example, the electricity sector was privatized a few years ago (though the lack of competition in the privatized electricity generation sector gives rise to poor quality and reliability of service).

4. GENERAL ECONOMIC RULES OF THE GAME THAT FRAME MARKET PROCESSES

4.1 Definition and enforcement of property rights

Poorly defined and insecure property rights in the Dominican Republic leave scope for others to opportunistically redefine property rights and to redistribute wealth. A foreign entrepreneur operating in the DR told us that:

It is the case here that we are in the middle of a financial crisis. The government has intervened [in the operation of] some companies without following the legal procedures, and it is not going by the book. You find yourself [in a situation where] you don't see tremendous legal security as

an investor doing business in the DR. My opinion has changed significantly since I came here. My feeling today is quite different from what it was a while ago. Now I see a much more authoritarian attitude on the part of the government.

Property rights to land property in particular are very problematic in the Dominican Republic. Titling has always been a significant problem: “*You sometimes wonder how the tourism sector has been able to develop.*” Another interviewee was more explicit in his comments about the land titling system:

The system of property rights is woefully antiquated, Byzantine and ponderous. There is a number of major business deals that I’ve been seen gone bad precisely because of disrupted titles. For instance, there was one... a very big scandal of Bahía de las Águilas close to Barahona; there was a dispute of a title that goes back to Trujillo.

The *Registro de Propiedad* (Title Register Office) follows the Torrens system method of recording property. This system was introduced by the Americans during the US occupation of the early twentieth century. After the Torrens system was imposed⁴, there was not supposed to be any land without clear formal ownership but that is not the case. If there is conflict between the State and the occupants, the land is presumed to belong to the possessor of the title. By law, if there are tracts of land that do not have formal private owners (i.e. non-titled land), the land is presumed to belong to the State. “*The Number One landlord in the DR is the State*”.

There is a lot of land without formal property title, especially in the poor areas (the “*barrios*”) surrounding the city. As one interviewee said: “*In large barrios at the periphery of the city, there are no formal property titles to land (e.g. Capotillo)*”. Another interviewee estimated that approximately 70% of the small landholders in the *barrios* outside of Santo Domingo lack formal title to their land. The government has granted some of those lands, but without giving them a formal title.

A person who lives or possesses a piece of land without (them or anybody else having) a legal title to, will only have a right of possession. In order to acquire a property title of

⁴ The Americans brought this method during the US occupation of the early twentieth century.

that land, the person must prove that they have lived there for 20 years and that there is no title to the land. After doing so they must go through a complicated bureaucratic procedure (*Procedimiento de Saneamiento*) that takes about 1 year in addition to lawyer fees, and other transaction costs.

There are high transaction costs in searching (i.e. investigating the legitimacy and soundness) of titles to land. Legal fees related to doing a title search range from RD\$2,000 (approx. US\$65) to RD\$6000 (approx. US\$200). In addition, there are travel expenses and many delays involved in finding the required information and obtaining the necessary certificates. If the property is in a remote part of the country, it may be necessary to travel several hours from Santo Domingo in order to visit the local registry office where the title is held. There is no centralized database. Titles are stored as physical documents; there is no back-up system. Furthermore, one interviewee mentioned that if a judge is working on a case, he will have the files on his desk (including the titles). If you want access to the titles in that file, you will have to wait for him to finish with it and return the titles to the registration office. The process of obtaining a *Certificado de Cargos y Gravámenes* can take up to one month. The whole process is cumbersome and bureaucratic and is basically inaccessible to the layperson. Lawyers are required at every step. For small businesses, this represents a big problem as they need to pay lawyers to make sure that property titles are legitimate.

The legal costs plus the high taxes (approx. 4.68%) and agent commissions (5-6%), make for high transaction costs in transferring property. According to one legal expert, the high transaction costs are a major reason why commercial banks lack a good mortgage portfolio. We have already mentioned that the judicial system is incapable of efficiently settling disputes to property titles. Poor definition and enforcement of property rights is a significant impediment to access to credit, as it means people – including prospective entrepreneurs -- cannot offer guarantees to creditors by using their homes as collateral.

Regarding intellectual property, there seems to be no major impediments. Entrepreneurs in general consider the legislation on intellectual property as relatively efficient; in fact,

they believe that government has made good efforts in enforcing the laws. However, improvements are needed in the computer software and broadcast industries. On the patents side more enforcement is necessary, particularly on the pharmaceutical industry.

4.2 Contracts and contract enforcement

Most small and/or informal businesses do not rely on formal contracts. What formal written contracts there are, tend to be entered into between parties at higher socioeconomic levels. The enforcement of contracts can turn into a complicated and lengthy process – even when it is clear that one party’s contractual rights are being infringed. As mentioned earlier, corruption and inefficiency in the judicial system is a major part of the problem: *“it is expensive and takes time: 5-10 years sometimes, or until you get tired. Sometimes the outcome [of a contractual dispute] depends on who bribes more.”*

Banks face significant costs and delays in executing their contractual rights under a mortgage: *“if the company wants to put obstacles in the way, it is very hard [to execute collateral]... it could take five years to execute a mortgage.”* This situation is not limited to mortgages. It is also very easy for businesspeople to put obstacles in the way of a bank foreclosing and recovering collateral:

We have had equipment that we are not able to find, that somehow you can’t locate the item. We have a case that has been in court for 2 years and the lawyers of the company have been putting up one impediment after another, which doesn’t make any sense... they are not willing to have the property executed, and that’s a problem here. The lawyers ... sometimes say it’s better for you to negotiate something with the [bank] customer and have them hand the property to you, than to go through the legal process, because it could take several years.

5. SPECIFIC REGULATIONS AND POLICIES THAT INTERVENE IN MARKETS AND ENTREPRENEURIAL TRANSACTIONS

5.1 Monetary policy and banking supervision

The DR economy has been severely affected by the bankruptcy of one of its biggest commercial banks at the beginning of 2003. Even by Latin American standards, the collapse of Baninter, as the bank was known, amounts to an unusually large scandal. *The*

Economist (June 12th, 2003) reports that the bank was reported to have accumulated losses of US\$2.2 billion (a sum equal to 13% of the country's GDP). To confront this crisis, the government is negotiating a stand-by agreement with the IMF. In this regard, a public officer pointed out:

We have to admit that there was a [banking] supervision problem. In order to regain our credibility, get fresh money, and to audit the financial system, we need the agreement with the IMF... In the Baninter case, the Central Bank is committed to paying depositors, incurring a fiscal deficit that will be covered by the government.

The banking crisis has bruised public confidence in the financial system and the local currency. As a result the Dominican peso (RD\$) has suffered a significant depreciation relative to the US dollar (66% since January 2003). Not surprisingly, the dramatic increase in the exchange rate has affected the level of prices. In the 1995—2001 period, the inflation rate remained at single-digit levels, averaging 7% p.a. However, by the end of the current year, the inflation rate could be above 25% (some household products, such as milk and bread, have increased more than 200% to date). This relatively large increment in prices is also explained by the significant growth in the money supply.⁵

The cost of capital is a significant barrier to entrepreneurship in the Dominican Republic. Some business people we spoke to suggested that it is “*the single biggest impediment to entrepreneurship*” in the country. According to the Central Bank, commercial banks currently charge interest rates as high as 29% for commercial activities (as at July 2003); 34% for personal loans (i.e. consumption) and 30% for mortgages and development projects. Even the developing banks charge extremely high interest rates, a weighted average of 38.46% for the current year, reaching a level of almost 41% in April 2003. Lack of confidence in the financial system is doubtless contributing to the high level of interest rates. An exporter in our sample attributes the high level of the interest rate to the reserve requirements for the banks.

⁵ The monetary supply increased 75.5% during the June 2002-03 period, and 60.7% in the December 2002-June 2003 period (Banco Central de la Republica Dominicana. www.bancentral.gov.do).

In future years, the Central Bank plans to move gradually towards an inflation-targeting system. Further reform is also needed to secure the independence of the Central Bank from political interference. In the past, the *modus operandi* of the Central Bank has been in line with Calvos's academic paper on "The Fear of Floating": the monetary authorities react to disequilibria by open market operations, freezing commercial banks' loan portfolios, using up foreign exchange reserves, and raising reserve asset requirements (this one as a temporary mechanism). In the future, the monetary officials want the intra-banking interest rate to fluctuate in the middle of a band, and they intend to use it as an indicator of the level of liquidity in the market. During the year 2002, the interest rate increased to levels not registered since 1991. In January 2002 the active interest rate was 22%, and in March 2003 it reached 34%.

There is also a dual exchange-rate regime, the *official rate* determined by the Central Bank that applies to certain transactions, and the *market rate*. The effect of this on exporters is discussed below.

According to an economic analyst, the dramatic depreciation of the RD\$ is partly due to the "*political uncertainty generated by the upcoming elections... There is a component of expectations — overshooting — in the current exchange rate situation*". In section 3.1, we referred to the macroeconomic instability generated by politically-induced business cycles.

5.2 Fiscal Policy and Taxation

According to the figures of the Central Bank, since 1990 the result of the government budget has been positive (including the first semester of 2003), except in the years 1994, 1996, and 1999. The ratio Public Spending/GDP has stayed relatively stable since the 1990s (at 15%-16%), decreasing from 16% in 2001 to 12% in 2002.

The official figures however might not be reflecting the real situation of the government budget. Indeed, an economic analyst refers to what he considers a "hidden deficit". He claims that government officials, trying to show well-managed public finances, declared

that they had achieved a RD\$1.6-billion surplus for the first half of the year [approx. US\$ 53 million). According to him the numbers show something else. Firstly, the government has withheld RD\$4 billion (approx. US\$ 1,333 million) produced by the Hydrocarbon Law, which should have been turned over to the Central Bank to pay the foreign debt. Assuming that the Central Bank paid its debt service charges, the government has underestimated its expenditures by the amount it fails to give the Central Bank.

The economist also points out that the government has been a very active client of the local banks. As of 11 June, according to Central Bank data, government loans from the commercial banks had increased by RD\$920 million (approx. US\$ 31 million). Since December 2000 to date, however, the government has taken on RD\$8.5 billion (approx. US\$ 283 million) in loans from these banks. If the adjustments are made for the debts with local banks and the money is not handed over to the Central Bank, it would seem that the government operated with a deficit of RD\$3 billion (approx. US\$ 100) during the semester of January to June of 2003. Government expenditures increased by 11.1%, rather than the decrease of 1% presented by government officials (*El Caribe*, 8 August, 2003). In addition, in a personal interview he mentioned that as a consequence of the rise in public spending there is a clear crowding out effect on the private investment.

Tax collection system:

The tax policy in the Dominican Republic is highly discretionary. Bribing and corruption are common at different levels of the tax collection process. The high degree of evasion in the past motivated the government to modify business taxes in an ad hoc manner. At one stage, businesses used to pay 25% of net profits. Today, they pay 1.5% on anticipated sales or 25% on net profits, whichever is *higher* (in practice this represents a minimum tax).

Although there have been some improvements in fiscal policy, uncertainty and arbitrariness are still prevalent. One scholar argues that:

Tax rules seem to be very arbitrary. Taxpayers have almost no rights against the Dirección de Impuestos Internos (DII) [Dominican Inland Revenue Service]... The appeal mechanism is very bad and corrupt. The taxpayer's case is almost hopeless.

Current tax policy was often cited as a major barrier to new entrepreneurial initiatives. For instance, one financial manager emphasizes that:

The [tax] law is not always bad but the enforcement depends on the judgment of whoever is currently in government. ... [T]his is a big obstacle. This year we decided not to [undertake] new investment. You can't really invest with these tax policies.

5.3 International trade policy: Tariffs, customs and export measures

Our findings show that customs and trade restrictions are major impediments to entrepreneurship in the Dominican Republic. Despite recent efforts to reduce tariffs, Dominicans still face high levels of tariffs when compared with similar countries. According to the 2003 Index of Economic Freedom, the Dominican Republic receives a score of 5 (highest possible level of protectionism) in the category of trade policy, compared with scores between 2 and 3 for Central American countries. The relatively high tariffs for the Dominican Republic limit the extent of the market to a very small economy, which in turn limits scope for increasing the division of labor and specialization and capturing increasing returns from engaging in specific activities.

In addition to tariffs, importers also have to pay an “exchange commission” (*comisión cambiaria*) tax of 4.75% as well as the recently imposed 2% tax on imports that originated with the IMF agreement. Furthermore, importers face the uncertainty of a Dominican Government characterized by being “*altamente fiscalizadores*”. Whenever there is a need to increase revenues, new taxes are created and that usually means new or higher tariffs. In the last 3 years, after a revision of tariffs was made, there was a 10% tax on all imported finished goods. This was an extraordinary and temporary tax that lasted for about 6 months. Now, as a result of the agreement with the IMF, they have issued a 2% tax on all imports. This year, since it is a pre-electoral year, authorities have been *fiscalizing* a lot and all shipments are being closely supervised in order to increase revenues. This increase in *fiscalization* translates into delays and slower processes for getting goods through customs. A manager of a firm told us that this year they will probably double what they pay in late fee charges (e.g. for container use) as a result of delays in customs caused by higher *fiscalization*.

Importers also face uncertainty and the arbitrariness in changes in customs rules. As an entrepreneur said: *“Not only do they retain the containers, but sometimes they issue resolutions overnight... You import [on the basis of] a certain rule that exists and then they come up with a [new] resolution when the container is already on its way...”*

Corruption, bureaucracy and inefficient administrative procedures of the customs service are major impediments with hidden and severe consequences for entrepreneurship. For instance, to import agriculture products you need to get permission from the Minister of Agriculture. They claim they always give the permission but sometimes it takes a couple of months, and in the meantime the goods deteriorate and get damaged. A manager in a multinational corporation mentioned that, although customs procedures should take 2-3 days at most, they have to plan on the basis that it will take two weeks for their products to clear customs.

There is a lot of bureaucracy... It takes too long to go through all the required steps... That's why we program 2 weeks [for customs clearance] because even if we wanted to handle it in a different way and make it more agile, we would have to bribe and that goes against our code of ethics.

This raises the cost to firms who import, because in addition to the late-fee charges for the use of containers, they also have to increase their inventory levels, which means higher working capital needs and higher financial costs.

Importers are not the only ones confronted by significant hurdles to their entrepreneurial activities. The average exporter too faces administrative barriers and bureaucratic processes to clear goods through customs as well as taxes and administrative charges. *“It is very cumbersome to be a Dominican exporter outside of a Free Zone”* – a sentiment expressed by several entrepreneurs. (Free Trade Zones or Free Zones are parks or conglomerates of exporters that have special fiscal and administrative benefits.) The conditions of exporters within and outside of free zones are very different, and this helps explain the success of free zones as well as the difficulties exporters (outside of free zones) face.

In addition to income taxes and tariffs on imported inputs, exporters (outside of a free zone) have to pay an ‘exchange rate commission’ of 4.5%, and 12% of ITEBIS (*Impuesto a la Transaccion de Bienes Industriales*). The government is supposed to reimburse ITEBIS to exporters, but it usually takes a long time to make these repayments. As one exporter said:

Here in the DR there is a principle saying that “the old debts don’t get paid, and the new ones are left to get old” (“las cuentas viejas no se pagan y las nuevas se dejan envejecer para tampoco pagarlas.”) The government never reimburses you; the government doesn’t even return greetings (“El gobierno no devuelve ni los saludos”).

In addition, according to the exchange-rate regulations, exporters (outside of a free zone) are forced to sell their dollars from export receipts to the Central Bank at a predetermined official exchange rate (through an exchange agent), and then they must buy back dollars (e.g. to buy imported inputs) at a higher market exchange. In contrast, exporters inside a free zone are not subject to taxes. They do not have to pay income tax, ITEBIS, tariffs or ‘exchange commission’ (since they do not have to sell their dollars to the Central Bank). One export representative recognizes the importance of these differences:

The local exporters [that operate outside free zones] are subject to taxes that don’t allow them to be efficient. They have high costs that make it inefficient for them to compete in international markets.

Fiscal benefits for firms operating within a free zone are an important benefit, though by no means the only ones. Another significant benefit is the reduction in bureaucratic barriers and administrative procedures. Customs and administrative procedures are highly complex, time consuming and burdensome for exporters (outside free zones) as well: they have to go through about 15 bureaucratic steps, they face delays and they must pay administrative charges and bribes estimated at about RD\$2,000 (approx. US\$ 66) (not taking into account transportation costs). One source mentioned that “*customs officials make up problems with the [export] merchandise as a way of looking for bribes*”. Similar points were made by other entrepreneurs:

For instance, you go to customs and they tell you: “The container has 500 others ahead of it. Come back in 2 weeks.” It is very complicated because the process may take a long time. When I have [undertaken] the

commitment to deliver certain merchandise by a specific date, I can lose my clients because of delays in customs processes... And it is very hard to re-establish relationships [with disappointed customers].”

In a free zone, customs operates more efficiently: “*it clears goods in 24-48 hours*”, as the process is done within the free zone itself. Shipments of imported inputs coming into free zones are not verified at the dock/airport; rather the containers are dispatched immediately for the free zone where they are inspected. Since entrepreneurs in free zones do not have to pay tariffs, they avoid the valuation procedure which sometimes leads to disputes with customs officials over the valuation of merchandise. The only role customs officers play regarding imports into free zones is to verify that the imported goods are to be employed for their FZ export-specific purposes and are not destined for the local market.

Similarly, customs procedures for exports are much faster and efficient because customs services are available inside the FZ industrial park around the clock.

These fiscal and administrative benefits are considered the main reason why the FZ sector has grown significantly. According to one exporter outside a free zone:

The [FZ] conditions are totally different. In the past, companies in free trade zones faced the same problems we are facing now. The law 8-90 eliminated all the obstacles [they faced]. According to the law they don't have to pay taxes or sell their dollars to the central bank. They were exporting like RD \$ 485 million in 1988 before the law. After the law was introduced, they [companies in FZs] developed and increased their exports substantially [beyond the levels that we have been able to achieve].

During the last 10 years the level of exports has grown 173%, in spite of a moderate contraction in the last 2 years. In 2002, the FTZ exported almost 84 times the amount that the national exporters did.

Protectionist policies of trading partners exacerbate the barriers encountered by entrepreneurs in the Dominican Republic. One entrepreneur mentioned that:

We were exporting oriental vegetables to the US, and the US made up that our product had an insect [infestation] and suspended our exports for four years. They verified afterwards that the insect came from the US. But after four years we lost all our clients; they were already buying from other countries.

Similar problems were encountered with textile exports to the US. Quantitative limits on exports to the US acted as a bottleneck to growth. That changed somewhat with a bilateral agreement with the US. Now, textile products that are manufactured with American inputs are not subject to quotas and/or tariffs.

5.4 Key infrastructural industries

The lack of efficiency and reliability of electricity supply is without a doubt one of the greatest impediments to entrepreneurship in the Dominican Republic. According to one manager of a market-place, *“It is chaos. In the old days, nobody used to pay electricity. Nowadays there are meters and more people pay. Because of electricity blackouts, every stall has its own generator or batteries... This is a big economic obstacle for them.”* According to a recent survey, the duration of the blackouts for an average customer of EDESUR (the company of the South) is approximately 300 hours per semester; and for the average customer of EDENORTE and EDEESTE (the companies of the North and East), blackouts were about 583 and 531 hours per semester, respectively (*Listin Diario*, Julio 20, 2003). The frequent blackouts force businesses to invest in their own generators, which adds significantly to their fixed costs (approximately 5%).

In addition, there is a longstanding culture of non-payment. When the government owned the distribution companies, it did not charge poor consumers for political reasons. For the newly privatized distribution companies, EDESUR and EDENORTE, 38% of residential users did not pay for the electricity they consumed during January-October 2002. Nonpayment rates were high for other groups too: 18% of customers in the commercial sector, 4% in the industrial sector and 17% in the government sector. In the case of EDEESTE, in the period January-August 2002, the nonpayment rates were 27% of residential users, 19% of commercial users and 95% of government users (mainly local governmental offices) (USAID survey cited in *Listin Diario*, July 20, 2003).

One expert in the electricity sector points to important technical problems:

A significant amount of energy is lost between distributors and consumers -- about 20%. This is mainly due to technical flaws in the transmission network and to people stealing energy in some urban areas with large populations and bad control mechanisms.

Many of the inefficiencies in the electricity sector arise because an inadequate regulatory framework was set up before the privatization process. This experience is not unique to the Dominican Republic. Governments, keen to maximize the value of the state-owned enterprises they intend to sell, do not pay much attention to the regulatory framework which might reduce the value of the firm that is up for sale. As one industry analyst put it:

[When we] privatized, we went from a public monopoly to a private oligopoly. The same mistake has been done in other countries in Latin America. Without adequate regulation and enforcement. ...[t]here are generators owning distributors, and therefore they have a lot of market power.

Prior to 1998, there was only one state-owned electricity company (*Corporación Dominicana de Electricidad -- CDE*) which was responsible for the generation, transmission, and distribution of energy through different subsidiary companies. In 1998, as a result of a crisis in the system, the government implemented a “capitalization” — “semi-privatization” — process as a means to inject capital into the industry. In addition, the reforms separated out the generation, transmission, and distribution activities of the industry.

Transmission services are still provided by a legal monopoly, a state-owned company. The transmission grid is in general very old and it is the main source of energy losses. The generation sector is now structured as a semi-state oligopoly (50% state participation in the two largest companies). The government signed an agreement, *Acuerdo de Madrid*, with the generators two years ago. In this agreement the government committed itself to guarantee the price (in US\$) at which the generators could sell energy for a period of 15 years. As a result, generators lack the incentive to translate more efficient technologies into lower prices. There are also important regulatory restrictions that limit the

emergence of economies of scale through vertical or horizontal integration. For instance, distributors cannot generate more than 15% of the total industry supply of electricity.

As for the distribution of electricity, the industry is typified by regulatory capture. The “capitalization” process was accompanied by an exclusive long-term legal concession for each of the three distribution companies in their respective regions. Prices are also regulated based on prices for energy, value added in transmission and distribution and are indexed to monthly gas prices. In addition, the government still gives subsidies to distributors to serve poorer areas. According to one interviewee, managerial problems are most widespread in the electricity distribution sector:

The main problem distributors face is bad management. They don't register the whole amount of power that they receive from the generators (around 20-30%). And they probably don't show in their financial statements all the subsidies they receive from the government.

The electricity industry is not the only infrastructural industry to pose significant barriers to entrepreneurship in the Dominican Republic. High prices for maritime and air transportation services are also a constraint. In maritime transportation, there is a legal cartel supported by overseas legislation. In this respect, one economist said:

Anticompetitive practices come from a major law in the US. This law supports a legalized cartel (the Shipping Law Conference) that allocates numbers of vessels and routes. According to the World Bank, this cartel increases the price of shipping costs by 24%, which directly affects trade liberalization.

On the other hand, air transportation to the Dominican Republic is dominated by a legal oligopoly which constrains competition. This explains the relatively high prices of airfares to the Dominican Republic.

5.5 Financial and capital markets

As in many developing countries, the financial system in the Dominican Republic is not fully developed. It has a nascent financial system with a fairly recent banking system. Private banks began operating in the 1960s, and there is almost no secondary capital market, only a commercial paper market. The financial system is not deep; it is relatively

short term. If you need funds for more than one year, banks need to get funds specifically for that purpose, probably from a multilateral agency. Savings & Loans provide some long-term loans but only for housing projects (10-20 years), and they fund with short term funding (180 days maximum).

Several factors limit the depth and sophistication of the financial market in the Dominican Republic. One factor is the size of the market (demand) as the Dominican Republic is a small economy. Another factor is the lack of private pension funds that would spur a greater demand for longer term instruments and would provide longer term funds. This might start to change in the not-too-distant future with reform of the pension industry. In addition, regulations have limited the use of subordinated debt as part of a bank's capital base, thus providing disincentives for using long-term sources of funds. This might also start to change relatively soon. With the introduction of new monetary and financial laws, banks will be able to use long-term subordinated debt as part of their capital base with the result that they are starting to look at longer term financing instruments and securitizations.

Another significant issue is the lack of transparency of financial statements which makes equity valuation very difficult and thereby limits access to a secondary market and venture capital. The arbitrary nature of the Dominican Republic's tax system accounts at least in part for poor financial disclosure. A senior bank officer told us that:

About 2 years ago the government implemented a "fiscal amnesty" so that financial statements became more transparent. All of a sudden, inventories and assets revalued, the numbers began to change, they looked huge... Gradually people were saying "we have to be more transparent". ...Two years ago or maybe a year and a half ago, the government decided to levy a tax -- which was supposed to be an advance, but in the end it is a minimum tax -- where the companies have to pay 1.5% of sales or 25% of net income, whichever is larger ... Suddenly the companies that were beginning to provide more accurate financial statements (suggesting greater sales and profits) were badly affected, especially their cash flow [position]. They had to pay in cash 1.5% of the estimated sales for the year, while they were selling on credit. Basically, it was a perverse incentive [that led businesspeople] to underestimate sales in their accounts.

Tax policy and resulting poor financial disclosure also lead to distortions in companies' financing arrangements. Inadequate financial statements mean that entrepreneurs do not apply for longer term financing. There are cases where clients use short-term lines to finance long-term investments. In other cases, clients use overdraft facilities (with a significantly higher interest rate) to finance inventory. In these cases, although they pay a higher interest rate for using short-term finance, the savings in taxes (from the understatement of revenues) more than compensate.

The main source of funds for many businesses is bank debt and retained earnings. Debt instruments are limited to the largest companies and multinational corporations. One entrepreneur remarked:

Since you need to get your taxes up to date in order to be able to offer paper in financial markets, people prefer to continue operating with banks and there is no incentive for anyone to issue commercial paper and start disintermediating. The only companies that issue commercial paper are the big foreign companies [because they have their taxes up to date anyway].

Informality of business and bad accounting systems impede objective assessment of credit capacity, especially of micro and small businesses. Bank regulation is biased against micro enterprises and businesses. Loans of less than RD\$30,000 (approx US\$1,000) may be given without proper documentation, just based on credit history, without a penalty being imposed on the financial institution (in terms of capital requirements or an adverse loan portfolio classification). Any loan higher than that requires proper documentation (the firm must be registered or provide adequate collateral) or the lending institution incurs a penalty in terms of higher capital requirements (adverse loan portfolio classification and high reserve requirements). Furthermore, financial regulations adversely affect microfinance entities. These organizations usually begin as NGOs but as they grow, it gets more and more difficult for them to obtain funding as they cannot obtain funds through deposits. Their options then are either to become a bank (subject to costly financial regulation that makes it hard for them to keep lending money to micro-enterprises) or to refrain from growing, relying on commercial and multilateral banks as expensive sources of funds.

6. CONCLUSIONS

Our findings are considerably different from those described in the Investor Road Map (IRM). We consider that the impediments to entrepreneurship in the Dominican Republic go beyond the compliance costs of regulations on the investment start-up process, which is the main argument of the IRM. Rather, the impediments are deeply rooted in the institutional arrangements and the political structure of the Dominican Republic.

The Dominican Republic is a highly entrepreneurial society. The problem is not a lack of supply of entrepreneurial talent. The problem is that the country lacks the institutional arrangements for directing people's talents towards long-term productive activities. In fact, we consider that the current structure of incentives diverts entrepreneurship towards unproductive activities (i.e. graft in customs), and it prevents politicians from promoting long-term reforms. The centralization of power in the executive (and the ample discretion it enjoys in changing policies willy-nilly) makes reforms less credible, as there is no continuity in the policies implemented by different administrations. It also generates uncertainty and instability in policy rules.

Conceptually, we can divide the major impediments to entrepreneurship in the Dominican Republic into two categories: *short-run or transitional difficulties* and *long-term or structural problems*. It is clear that the current banking crisis and its effect on the exchange rate, inflation and interest rates is a more or less transitory phenomenon. However, it has sparked off a crisis of confidence in the financial system that may have more wide-ranging repercussions.

The long-term impediments to entrepreneurship in the Dominican Republic are by far the most challenging difficulties. A poor public financial management framework and widespread corruption have systemic consequences that both inhibit and distort entrepreneurial behavior. "The taint of the greased palm" is diffuse in its effects. Corruption has both winners and losers -- the current situation represents a type of "truce" or "political equilibrium" among existing political and business interests. Cleaning up

corruption will disrupt that political status quo -- resistance can be expected from current players. Reforms in the custom system and tax collection aimed at reducing corruption will be ineffective if the reforms are not credible, if the politicians themselves don't have the incentives to promote such reforms and commit to them (i.e. if they do not have the political will) and if the losers from such reforms are not neutralized or compensated (i.e. customs inspectors who earn bribes under the current arrangements). To solve these problems it is necessary to encourage limits on the arbitrary discretion and power of the executive branch. Increased professionalization of the bureaucracy would also help. Experience in other developing countries suggests that combating corruption can involve some combination of streamlining regulations so that there are fewer administrative steps, less administrative discretion and less opportunity for theft and bribery, banning the hiring of officials' relatives (nepotism), licensing of customs brokers, facilitating the organization of independent watchdog groups, improving civil service wages (and making them more performance-based), and opening the country's borders to increased international trade (giving successful businesses an interest in effective and stable government).

Even though the judicial system could be more autonomous, it has become relatively more independent and efficient as a result of recent reforms. This experience serves as a positive model of how institutional changes can be implemented in other areas of the public sector. In addition, it shows that the Dominican Republic is not necessarily locked into a low-growth trajectory because of a cultural legacy from the colonial period. However, more needs to be done to improve the judiciary, especially in enforcing contracts. We realize that in general, Dominican entrepreneurs don't do business on an impersonal basis (i.e. arms-length transactions with strangers) because they lack confidence in judicial enforcement of their contracts. This limits the scope of trading to familiar or friendship networks and it thereby limits the extent of the market, the division of labor and specialization.

Thus, we have identified some key areas where USAID is likely to have a positive impact in the long-term economic growth in the Dominican Republic. In the selection of these

areas we took into account: a) the extent to which it constrains entrepreneurship; b) the relevance of the policy to achieve better outcomes; and c) the opportunity of reform or political feasibility. Some of those areas include:

1. Strengthening the process of political decentralization and reinforcing a system of checks and balances.
2. Bolstering the public financial management system (stronger accountability arrangements and transparency, more explicit contracting for the delivery of outputs, more stringent financial oversight, elimination of nepotism).
3. Improving the definition and protection of property rights, especially of land; Improving contract enforcement by the judiciary (and hence confidence in formal law and institutions).
4. Improving the efficiency of regulatory and ownership structures in the energy sector, especially electricity.
5. Combating corruption in tax collection and customs (including streamlining existing tax and customs rules).
6. Reducing compliance costs for company registrations.
7. Reducing uncertainty and instability of policy rules.

In all of these areas, however, reform is currently constrained by the lack of credible commitment on the part of political decision-makers. In many cases, politicians simply lack the incentives to engage in reform. This is a strong reason why reforms proposed in the Investor Road Map have not been undertaken.

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APPENDICES

Suggested Methodology

Step	Objective
1	To identify major constraints to entrepreneurship as reported in published sources (before arrival)
1(a)	<p>Obtain country data in:</p> <ul style="list-style-type: none"> Economic Freedom of the World Annual Report (Gwartney/Fraser Institute) Index of Economic Freedom (Heritage Foundation) Freedom in the World Survey World Competitiveness Report Global Entrepreneurship Monitor Report (where available) World Bank International Monetary Fund World Trade Organization OECD UN International Country Risk Guide <u>Economist</u> Magazine's Economic Monitoring Group reports Investor Roadmap Annual Country Commercial Guide (US Embassy/US Department of Commerce -- US Commercial Service) American Chamber of Commerce in the country ("Guide to business in") Guides for foreign investors put out by local banks and law firms National Competitiveness Strategy (Annual)
1(b)	<p>Summarize data.</p> <p>What general patterns emerge about the major constraints on entrepreneurship?</p> <p>Are the main constraints in the:</p> <ul style="list-style-type: none"> Legal structure and security of property rights? Monetary regime? International trade? Imports/Exports? International capital flows (including exchange rate)? Regulation of credit, labor and business? Government expenditure, taxes and ownership of enterprises? Other? Specify
1(c)	Expand briefly on what are the main constraints -- providing empirical evidence and examples, where possible.

	<p>What are the main government agencies that are connected with those constraints? (e.g. Customs in the case of international trade)</p> <p>What is the nature of the intervention:</p> <p>Ownership?</p> <p>Regulation?</p> <p>Purchase?</p> <p>Taxation?</p> <p>Setting the general rules of the game (e.g. property rights definition as in pollution rights)?</p>
1(d)	Specify initial hypothesis (about the main source of entrepreneurial constraints) to be tested by preliminary interviews with experts in country and establish research objectives of the project.
2	To generate survey instrument (i.e. subject headings for brief questionnaire) to be used in testing initial hypothesis
2(a)	Develop structure of survey instrument -- key headings not specific questions
2(b)	Are there specific questions which stand out as worthy of attention (on the basis of preliminary review of literature discussed in 1 above)?
2(c)	Draw upon whatever survey instruments have been used in similar studies (e.g. studies of transition economies, studies to measure governance, firm-level surveys etc). Search World Bank website and other Internet sources.
3	To obtain list of experts and contacts in country in order to test initial hypothesis
3(a)	Contact and conduct initial interview with USAID mission and key personnel What research and other work has been done before? What areas do they consider to be the priority? What is their current strategy?
3(b)	Obtain from USAID mission a list of key public agencies and contact details of key personnel to be interviewed (also use Annual Country Guide for this purpose)
3(c)	Obtain from USAID mission a brief list of key private-sector participants and contact details of key personnel to be interviewed.
3(d)	Identify and contact relevant private-sector associations for suggestions on key entrepreneurs to contact and other players. (In the case of the Dominican Republic study, for example, Fundación para el Desarrollo Integral de la Sociedad was a great private-sector contact for helping in setting up interviews. Another important contact is the Executive Director of the local American Chamber of Commerce.) Conduct brainstorming session to try to obtain wide variety in sample:

	<p>Geographical spread (not just capital and/or main business center). Traditional, established industries (sugar) vs. non-traditional and sunrise industries (e.g. high tech) Goods/services Export/import/domestic (nontradeable)/import-substitution Rural/urban mix. Entrepreneurial stars vs failures Young/old Conventional vs. Enterprise Free Zones Major infrastructural industries, both private and state-owned (e.g. electricity, gas, water) State-owned versus newly privatized industries Large corporate vs medium-sized vs small firm vs street vendors Official vs unofficial and informal (black) market Ethnic background (e.g. are any immigrant groups recognized as particularly entrepreneurial?)</p> <p>Prioritize list of contacts generated above: Who are the two or three contacts that are most important and could provide a good strategic overview of the issues?</p>
3(e)	Obtain list of key politicians that might be worth talking to at both the national, state and local level.
3(f)	Visit key academics for overview (economists, business scholars, anthropologists, sociologists, political scientists, linguists).
3(g)	Visit nonprofit organizations involved in financing and advising micro and small firms (e.g. in the case of Dominican Republic, Directora de Proyectos of ADEMI, and Director Ejecutivo Centro de Apoyo a la Micro, Pequeña y Mediana Empresa (CAMPE) de la Universidad INTEC.) They are also especially good on getting contacts in the informal economy and on getting contacts in more remote regions outside main urban centers.
3(h)	Visit key journalists who report on economic affairs for the major newspapers and magazines (e.g. in the case of Dominican Republic, the Editor Económico of Diario Libre.)
3(i)	Use contacts and guidebooks to find out location of key local markets
3(j)	Talk to taxi drivers for contacts in informal economy
4	Preliminary fieldwork (“soak and poke”)
4(a)	Visit local markets and talk to vendors and market organizers
4(b)	Visit entrepreneurs
4(c)	Visit industry associations
4(d)	Visit banks
4(e)	Visit lawyers (specialists in corporate law, property, competition policy)
4(f)	Visit key cultural institutions (museums etc)

4(g)	Visit local bookstores especially second-hand bookstores
5	Undertake extensive ethnographic fieldwork (one or two case studies)
	Try to find an academic who has previous experience of conducting ethnographic and other research in that country (e.g. in the Dominican Republic study, we received a great deal of assistance from the Coordinara General Proyecto Mejoria de las Enseña del Español at the Universidad APEC).
6	Assessment of institutional and policy environment for entrepreneurship

APPENDIX TWO: Major impediments to entrepreneurship in the Dominican Republic

	Extent that it currently constrains productive entrepreneurs hip	Key finding(s) relevant to entrepreneurship
	1=none 2=slight 3=moderate 4=high 5=extreme	
1 Culture	3	
1.1 Technical aspects of culture (level of literacy, sophistication of decision-making and management)	3	functional level of literacy is low (52%); management skills are scarce; as economy grows, this scarcity will become more binding
1.2 Philosophy of state paternalism	3	history of high central government regulation ("la cultura autoritaria" Persinal 2001); widespread passivity to economic circumstances
1.3 Alertness of members of society	2	reasonably high degree of alertness
1.4 Ethnic fragmentation	2	some tension between Haitian immigrants and Dominicans, but generally few problems
1.5 Confidence and trust in formal institutions (e.g. to facilitate trade with strangers)	5	very low level of trust in public institutions; access dependent upon "deep pockets" and social contacts
1.6 Attitudes towards successful entrepreneurs, high-performers and competition (prevalence of a "tall poppy syndrome")	2	"There is a culture of mistrust of competition"
1.7 Moral commitments	3	
1.7.1 <i>Commitments to tell the truth</i>	3	opportunism and deceitfulness in business dealings are commonplace
1.7.2 <i>Respect for other people's property and interests</i>	4	in general no
1.7.3 <i>Respect for formal law and regulations</i>	5	very low respect for formal law
1.7.4 <i>Respect for informal customs</i>	1	much greater respect for informal relationships and customs
1.7.5 <i>Cultural conception of selfhood</i>	1	central tendency of cultural values is towards a group orientation, but not extremely so; cultural conception of selfhood does not appear to constrain entrepreneurship
1.7.6 <i>Lack of outward-looking values</i>	2	not particularly focused on opportunities outside the country
1.7.7 <i>Lack of ongoing social relationships and networks</i>	2	emphasis on long-term informal networks in business (partly as a means to overcome poor formal contract enforcement)
1.8 Ethics of achievement	3	a problem
1.8.1 <i>Low performance norms</i>	3	moderate levels
1.8.2 <i>Self-confidence in own abilities (ie personal efficacy beliefs)</i>	3	moderate levels

1.8.3	<i>Perseverance in overcoming obstacles</i>	2	perseverance and working together in the face of adversity mentioned (Hurricane George response; overcoming many government regulations)
2	Constitutional and political institutions	5	a major source of the problem
2.1	Constitutional-political rules (including frequency of changes)	4	Constitutional changes have been common
2.2	Lack of political freedom	2	Democratic institutions in place; recent history of repressive dictatorship
2.3	Lack of economic freedom (formal vs informal/de jure vs de facto)	4	a major source of the problem
2.4	Adherence to rule of law (how arbitrary is the law?)	4	a major source of the problem
2.4.1	<i>Certainty of legal and regulatory rules</i>	5	rules are constantly changing
2.4.2	<i>Generality and equality of legal and regulatory rules</i>	4	arbitrariness is a hallmark of laws and regulations as well as selective enforcement of formal laws
2.5	Degree of codification of the law (e.g. Napoleonic code, statutes) rather than spontaneous common law (case law)	4	heavy codification (outdated Napoleonic commercial code)
2.6	Political structure (degree of centralisation, federal vs unitary state, balance of powers)	4	history of "presidencialismo"
2.7	Executive activities of government	4	high level of capture of executive; arbitrary; lack of transparency
2.8	Legislative activities	3	operate poorly
2.9	Judicial activities	4	some improvement in the appointment and training of judges (e.g. school of magistrates) but corruption and inefficiency in processing of cases remains a significant problem
2.10	Administrative/bureaucratic activities	5	a major source of the problem: nepotism and patronage, wholesale personnel changes with each change of president which gives rise to inexperienced staff who are focused upon maximizing short-term gains from holding public office
2.11	Public financial management	4	a major source of the problem: very poor accountability arrangements, very weak contracting for the delivery of outputs by government departments (weak output specification etc), poor financial oversight, not an accrual system, poor transparency
2.12	Degree of corruption in public sector	5	rife
2.13	General level of crime (including threat to one's own person)	1	surprisingly not a factor: DR regarded as one of the safest countries in Latin America
3	General economic rules of the game that frame market processes	4	a major source of the problem
3.1	Definition and enforcement of property rights	5	

3.1.1	<i>Property rights in land (titles etc)</i>	5	poor titling for rights to land, 70% of land in barrios is untitled, major impediment to large entrepreneurial ventures in tourism (Amcham case); DFI in tourism (e.g. hotels) constrained by poor property titles in land and prohibition on payments of bribes (e.g. US companies) required to get permission to go ahead with construction projects
3.1.2	<i>Property rights to other resources</i>	3	Radio spectrum allocation via auctioning organized by INDOTEL, rights are transferable to some extent, but can be revoked if not exercised; some radio spectrum rights were in the past allocated as privileges by politicians
3.1.3	<i>Intellectual property rights (copyright, trademarks, patents)</i>	2	copyright and trademarks OK; signatory to TRIPS; patents more of a problem
3.2	Contracts and contract enforcement	4	poor contract enforcement in terms of recourse to the courts
3.3	Macroeconomic stability	4	had shown improvement in recent years (single-digit inflation) but in the last year, price level is rising again and high interest rates and the rapid depreciation of the peso causing problems
3.4	Openness to international trade and international flows of capital and ideas	4	border controls on imports are restrictive, poorly designed and administered, and corruption in customs is rife, processing is slow, can prevent emergence of competition (e.g. mega appliance outlet)
3.5	General regulatory environment (extent of entry and exit restrictions, arbitrariness and unpredictability of government intervention)	4	arbitrariness is a hallmark of regulations as well as selective enforcement of formal laws; competition policy is fairly liberal.
3.6	Transaction costs of economic exchanges	4	high transaction costs
3.7	Compliance costs	5	high compliance costs in formal sector; informal sector emerges as way to avoid regulations and costs of compliance; little opportunity to appeal bureaucratic decisions
4	Specific economic regulations and policies that intervene in market processes and entrepreneurial transactions	4	regulation of banking sector makes it difficult for informal businesses to obtain credit; tax regulations are a major problem; but few, if any, price controls
4.1	Monetary policy (Central Bank independence, inflation rate, interest rates)	3	high real interest rates driven by monetary policy; two-tier exchange rate policy
4.2	Fiscal policy	5	expansive fiscal policy crowding out private investment; taxation is a major problem too
4.2.1	<i>Government expenditure (% of GDP)</i>	2	not high in absolute terms, but government payroll is a very large percentage of total government expenditure
4.2.2	<i>Taxation policy (rates)</i>	5	tax on revenues rather than profits is hurting many businesses (especially where margins are slim, as in retail and supermarkets)
4.2.3	<i>Tax collection and administration</i>	5	many people don't pay tax; imposed taxes on businesses are "negotiated" with the tax department; penalties and bribes are common
4.3	Ownership, regulation and funding of key infrastructural industries (central and municipal) (pricing and quality of service too)	4	
4.3.1	<i>Energy -- especially electricity</i>	5	electricity is an extremely big problem; outages are common; poor reliability and quality of supply (outages, spikes in voltage etc); own provision of generation plant is a necessity (adding 5% to fixed costs); even stalls at a market have their own battery back-up

4.3.2	<i>Transport (maritime, air)</i>	4	industrial concentration in maritime and air industry causing problems
4.3.3	<i>Telecommunications</i>	1	has always been private; some local competition; generally OK though prices are high
4.3.4	<i>Water</i>	2	poor water quality; locals don't even drink tap water and have to buy bottles of purified water
4.4	Competition/antitrust policy (mergers & takeovers and restrictive trade practices)	1	not a problem: very little antitrust law on the books and even less is enforced
4.5	Human resources and social policy	2	public education is delivering poor outcomes (in terms of literacy and business training); safety net is minimal; social security reform is pending
4.5.1	<i>Labour markets (e.g. minimum wages, hiring, firing)</i>	2	not a significant problem, though some costs involved with severance packages for underperformers
4.5.2	<i>Education policy (access to education and outcomes)</i>	3	public education is delivering poor outcomes (in terms of literacy and business training)
4.5.3	<i>Immigration policy</i>	2	not a problem, though some published material refers to bureaucratic procedures for bringing expatriate workers into the DR (but immigration law is weakly enforced)
4.5.4	<i>Social welfare policies (unemployment, retirement)</i>	2	Minimal
4.6	International trade and investment policy	4	still pervasive controls on international trade -- both imports and exports; quantitative restrictions on some goods; high levels of duties on some imports
4.6.1	<i>Customs and border control</i>	5	a huge problem, especially corruption; emphasis on products being on the list, which are often outdated and include either high prices or exclude new products
4.6.2	<i>Capital controls</i>	1	convertibility restrictions (e.g. tourists can only change back 30% of their peso holdings)
4.6.3	<i>Exchange rate</i>	4	dual exchange rate system
4.7	Miscellaneous regulations	4	very poor in general
4.7.1	<i>Regulation of ownership structures (including company registration)</i>	5	company registration requirements are slow, unclear, and costly
4.7.2	<i>Regulation of financial markets</i>	2	cost of capital is very high
4.7.3	<i>Regulation of markets for land (including zoning restrictions, rent controls)</i>	1	whatever zoning regulation there is appears not to be strictly enforced (often industrial and business sites in largely residential areas)
4.7.4	<i>Regulation of information, R&D, technology and innovation</i>	1	problem of enforcement of patents is a bit of a problem