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Dominican Republic
Public Expenditure Review
Reforming Institutions for a More Efficient Public Expenditure Management

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Latin America and the Caribbean Region

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DOMINICAN REPUBLIC
PUBLIC EXPENDITURE REVIEW

EXECUTIVE SUMMARY

Background

1. The Dominican Republic is a middle-income country with an income per capita of US$1,820, a population of about 9 million, and a poverty rate of 28.6 percent (1998).[1] It shares the Island of Hispaniola with Haiti – the poorest country in the Western Hemisphere. Its economy depends largely on tourism, free trade zone exports and workers remittances. With a trade openness ratio averaging 96 percent since the mid-1990s, the Dominican Republic is on average relatively more opened to trade than other middle-income and Latin American countries (whose respective average trade openness ratios were 84 percent and 91 percent during the same period).[2] Much of its trade is with the United States, though tourism is well diversified toward European markets as well. It recorded a commendable economic performance throughout the 1990s: the economy grew at a rate of 5.9 percent on average during 1991-2000 and per capita income increased at 4.1 percent in real terms during the same period, making the Dominican Republic one of the fastest growing economies in the Latin America region.[3] The growth achievement of the 1990s was backed by a series of reforms initiated in the mid-1980s and deepened in the early 1990s.

2. The economic performance of the Dominican Republic over the past three years has been less impressive than in the 1990s (Table E.1). During 2001-2002, economic growth slowed down to 3.5 percent per annum on average, due to the combination of external factors (the global economic slowdown and high oil prices) and domestic policy weaknesses. The Government responded to the growth slowdown with increased public spending, which led to high deficits largely financed by foreign borrowing.

Table E.1: Selected Macroeconomic Indicators

	1997	1998	1999	2000	2001	2002	2003
Growth Rates							
Real GDP	8.2	7.3	7.8	7.3	2.9	4.1	-1.3
Real Consumption Per Capita	5.3	6.2	3.5	7.0	1.3	0.5	-7.8
Export Volume (GNFS)	10.9	0.8	6.7	12.1	-6.3	-1.7	11.4
Import Volume (GNFS)	10.2	15.9	3.9	20.4	-7.0	3.0	-5.0
Inflation (CPI), period average	5.4	8.3	6.5	7.7	8.9	5.2	27.4
Ratio to GDP							
Gross Domestic Investment	19.5	23.1	23.8	23.7	23.1	23.1	22.8
Gross National Savings	18.7	21.4	22.0	18.8	19.7	19.1	28.4
Fiscal Balance (Central Government, excluding Grants)	-1.4	-1.0	-3.2	-2.1	-1.9	-2.2	-2.4
Fiscal Balance (Overall Public Sector, including Central Bank)	-2.1	-2.1	-3.0	-2.0	-2.1	-2.6	-5.2
Public Debt	29.5	28.4	24.8	24.7	22.8	27.0	58.2
External Current Account Balance	-163	-338	-429	-1026	-752	-807	891
Exchange Rate (DR Peso per 1 US$)	14.3	15.3	15.8	16.3	16.9	18.6	31.3

Source: World Bank staff calculations.

[1] See World Bank Dominican Republic Poverty Assessment, 2001. This report uses the cost of basic needs method. Using a multivariate analysis, the National Planning Office (ONAPLAN) derives poverty rates of 55 percent (20 percent for extreme poverty) in 1991 and 52 percent (15 percent for extreme poverty) in 1998. According to the Central Bank, the latest ENGIH (household) surveys conducted between October 1997 and September 1998 show that 25.8 percent of Dominicans live below the poverty line.

[2] Trade openness ratio is calculated as the sum of export and import of goods and services divided by GDP.

[3] Per capita GDP growth is calculated based on a population growth of 1.8 percent on average during the period.

3. In 2003, economic performance worsened further due to a massive banking crisis epitomized by the collapse of the third largest commercial bank, *Baninter*, amidst mismanagement, fraudulent banking practices and inadequate banking supervision. To avoid the spread of a crisis of confidence to the rest of the financial sector, the Central Bank stepped in by guaranteeing all of *Baninter*'s deposits. In the months following Central Bank intervention, two medium-size banks (*Bancredito* and *Banco Mercantil*) experienced large deposit withdrawals and also received liquidity support from the Central Bank. In parallel with the banking crisis, the country suffered a deepening of the long-standing electricity sector crisis. In September 2003, the Government bought out private investors' shares in two of the county's three electricity distribution companies (*Edenorte* and *Edesur*) on the grounds of averting a bankruptcy.

4. With the banking crisis, the electricity crisis and the deterioration in market sentiment, real GDP growth fell to negative 1.3 percent in 2003. Central Bank assistance to the troubled banks is estimated to have amounted to 21 percent of GDP by end-December; since part of the liquidity support was not sterilized, the higher monetary expansion fueled a sharp depreciation of the Peso and inflation. Total public debt as a percentage of GDP more than doubled to 58.2 percent at end-2003 from 27 percent at end-2002. The quasi-fiscal cost of liquidity assistance provided to banks is estimated to have reached about 2.5 percent of GDP in 2003 (and projected at 3.9 percent for 2004). Between 2000 and 2002, interest payments on public debt averaged about 1 percent of GDP for central government and 1.2 percent for the consolidated public sector; they are estimated to have reached 1.9 percent for central government and 4.3 percent for the consolidated public sector in 2003.

5. Although it is too early to assess the full social impact of the crisis, early indications are that this has increased the vulnerability of households and worsened the condition of the poorest. According to the 2001 Poverty Assessment, during the preceding fifteen years economic growth had been the overarching force behind poverty reduction in the Dominican Republic, while persistent disparities in the distribution of human, physical, and financial assets had prevented a faster decline in poverty. With low economic growth in 2001-02 and negative economic growth in 2003, poverty and economic vulnerability are likely to have increased in Dominican households. In fact, food, medicine and transportation costs are becoming prohibitive for larger segments of the population; and the reduction in fiscal revenues and in public investment in real terms, combined with the increase in the prices of consumer goods, is affecting the provision of basic social services and social programs.

6. Fiscal adjustment, with a view to stabilizing the public debt, is central to the authorities' macroeconomic program supported by an IMF Stand-By Arrangement. The authorities have adopted expenditure reduction and tax measures in the 2004 budget to reduce the consolidated public sector deficit from more than 5 percent of GDP in 2003 to 3.5 percent of GDP in 2004, with a further reduction in 2005 after a comprehensive tax reform has been put in place.

7. The recent deterioration in the Dominican Republic's economic performance resuscitates the old question of Government's reliance on limited public resources to provide safety nets to large segments of the population. The origins of the crisis and its management also reinforce concerns over the regulation of an increasingly modern economy with a centralistic and clientelist system of governance – a method that appears increasingly incompatible with the changing structure of the Dominican economy.

The evolving role of Government

8. The role of Government in the Dominican Republic has evolved significantly since the 1930s although much has also remained relatively unchanged. Under the Trujillo regime, the Chief Executive alone determined, assessed and addressed citizens' needs and therefore personified the attributes and functions of Government. Throughout much of the ensuing decades, the Government in the Dominican Republic has exercised the functions of the largest landowner, provider of jobs, and the most important producer and manager of key goods and services. It has never paid much for the input components (such as land) in its production and delivery of goods and services. The general public came to expect the poorly remunerated government jobs and tolerated the poor quality of government services because they were free. The management of public enterprises, in particular, became a financial burden for Government because of the demand for increased services from a growing population and the generalized access of the poor and non-poor alike to subsidized or free public goods and services. Government deficits were also fuelled by the costs of infrastructure spending for a bourgeoning urban middle-class without the requisite mechanisms and structures for quality control, cost-management and cost-recovery.

9. By the mid-1990s, the institutional limitations of this model of Government as producer of goods and services for all had caught up with a generation of political leaders whose constituencies expect Government to be a more efficient provider of basic services and a better regulator in a high-growth economy that is largely dominated by the private sector. However, some of the enduring characteristics of the Dominican Republic's public institutions and public expenditure have not facilitated the transition to the new role of government. First, the Judiciary and the Legislature remain subservient to the Executive, including in matters related to prioritizing, allocating and disbursing public resources. Second, select institutions and agencies consume the bulk of fiscal resources, often on politically motivated projects and at the expense of broad-based investments in human capital formation and adequate support services to the private sector. Third, existing accounting methods and auditing practices do not comply with the norms of a transparent and rational public service. Finally, the mechanisms to monitor policy performance and gauge budgetary impact are virtually non-existent.

10. The main messages of this Report can be summarized as follows:

- Prudent fiscal policy contributed to the Dominican Republic's solid macroeconomic performance throughout the 1990s. However, given the intensification of fiscal pressures in the aftermath of the recent economic crisis, the mounting debt services, and the growing needs of the poor and vulnerable groups of the population, the Dominican Republic will need to decisively improve the allocation and efficiency of its public expenditures in order to resume economic growth and poverty reduction.
- Although public spending on social sectors (including education, health and social assistance) has received increased attention in the recent past, there is room for selective expenditure increases provided the inefficiencies that affect public expenditure in these sectors can be eliminated.
- Although the Dominican Republic has taken good steps to put in place a relatively good budget formulation process including recent efforts to introduce a medium-term expenditure framework and capital budgeting, little progress has been made in translating these into improved budgetary outcomes. Steps should be taken to deconcentrate and professionalize decisions affecting budget preparation, execution and control, introduce aspects that would help better inform policymakers and support better policy choices, and improve the monitoring of public spending.

- Efforts should be made to professionalize the civil service and accelerate the decentralization process while following a sequence and putting in place the conditions that guarantee sound public expenditure management at the local as well as central levels of Government.

The benefits of prudent aggregate fiscal policy are now yielding to fiscal pressures

11. Throughout the 1990s, prudent aggregate fiscal policy prevented the Dominican Republic from accumulating large public sector debts, unlike many other Latin American countries. Debt service expenditures declined markedly as a result of a deliberate policy to reduce the debt burden of the public sector. In fact, once debt service and social securities spending (two areas where the Dominican Republic spends significantly less than other LAC countries) are removed, the Dominican Republic's central government expenditure as a ratio of GDP is comparable to that of other LAC countries. Increasing interest payments for the consolidated public sector in the Dominican Republic (reaching an estimated 4.3 percent of GDP in 2003 and projected at about 6 percent in 2004) compared with just over 1 percent per year over the past three years, and social security spending (estimated at over 0.6 percent of GDP in 2003 and projected at 0.8 percent in 2004) will rapidly increase fiscal imbalances to LAC levels unless expenditure cuts are implemented in other areas and/or revenue mobilization is strengthened.

12. In order to re-establish its tradition of prudent fiscal policy, the Dominican Republic needs to address the recent and emerging fiscal pressures, including the fiscal cost of social security reforms and required changes in the electricity sector as well as contingent liabilities emerging from the banking sector, in the face of salutary trade liberalization that nonetheless will constrain fiscal revenues. Measured by the ratio of budgetary taxes to GDP, the tax burden of the Dominican Republic is low, partly owing to numerous exonerations and exemptions – often given on a discretionary basis – that have weakened the system of direct taxation. In the past, a combination of borrowing from domestic and international financial institutions and, more recently, from international capital markets have been used to fill the financing gap left by weak fiscal revenues. However, the fiscal costs of recently initiated reforms in the health and pension sectors, the fiscal cost of the collapse of *Baninter* (the third largest commercial bank), and the cost of reforming the electricity sector in the future, will further increase the financing needs of the Government at a time of uncertainty in the international financial markets and high interest rates in the domestic markets. To respond to recent increases in financing needs, the authorities have chosen to increase their borrowing from international financial institutions. However, this will require serious internal adjustments as well, including tighter expenditure control and more efficient revenue mobilization.

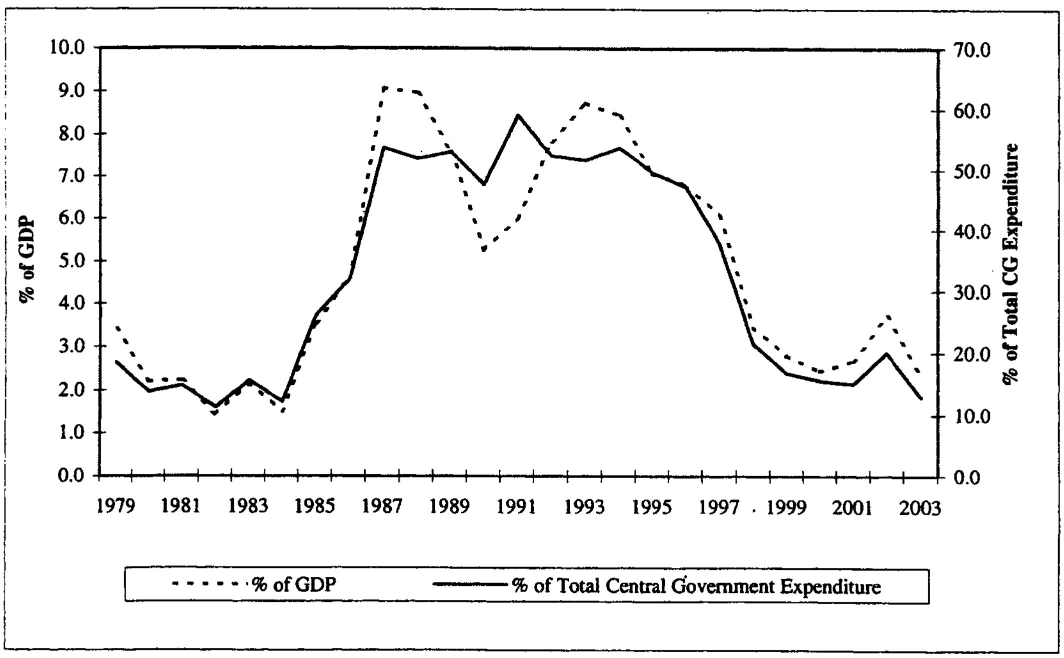
Allocation of public expenditures has traditionally been driven by political considerations, exacerbating inefficiencies over the years

13. The structure of public expenditure in the Dominican Republic has two distinctive features. First, compared with other Latin American nations or with countries with similar income levels, the Dominican Republic's central government expenditure is small. Second, from a historical perspective the allocation of spending in the Dominican Republic deviates significantly from that of comparator countries in that it overemphasizes public capital expenditures and private goods and underemphasizes social expenditures. This is partly explained by two factors. First, the political economy framework tends to generate excessive spending on investment projects or private goods instead of on human capital investments or other public goods, because the former type of spending can often be used to reward party faithful

and sponsors. Second, the tradition of misaligned incentives between the Office of the President and either the Legislature or the Cabinet has led to low central government spending as a ratio of GDP because the Legislature, in the face of weak control mechanisms, is reluctant to give higher spending authority to the Office of the President; and the Office of the President, in turn, is reluctant to seek a larger budget for fear that a higher budget would give more spending authority to some Cabinet members who may have personal political agendas. This is reinforced by the Office of the President's ability to capture a large share of government budget through Presidential Special Account 1401 (even within a small overall budget envelope).

14. Public expenditure allocation has traditionally favored powerful spending ministries. In the 1980s, five spending agencies (the Office of the President, the Ministries of Finance, Education and Culture, Agriculture, and Defense) absorbed 74 percent of public expenditures. After a worsening in the 1990s (when the top five institutions averaged about 83 percent of central government budget), the distribution of spending authority improved somewhat, with the top five spending agencies (the Office of the President, the Ministries of Finance, Education and Culture, Public Health and Social Assistance, and Internal Affairs and Police) controlling 70 percent of public expenditures in 2002. The main driver of high concentration of spending authority has traditionally been the large proportion of public resources spent by the Office of the President. This pattern reached a high point in 1991 when the Office of the President spent 60 percent of the central government budget (Figure E.1). Recently, there has been an encouraging trend in the reduction of the share of central government budget that is directly spent by the Office of the President. In 2003 spending by the Office of the President declined to 12.9 percent of central government expenditures, the lowest since 1985. The share of expenditure for the Ministry of Finance jumped to 33 percent in 2003 from 19 percent the year before, reflecting the higher debt service largely caused by the sharp depreciation of the Peso (85% during 2003).

Figure E.1: Executed Expenditure of the Office of the President, 1979-2003



Source: World Bank staff calculations based on ONAPRES and Central Bank.

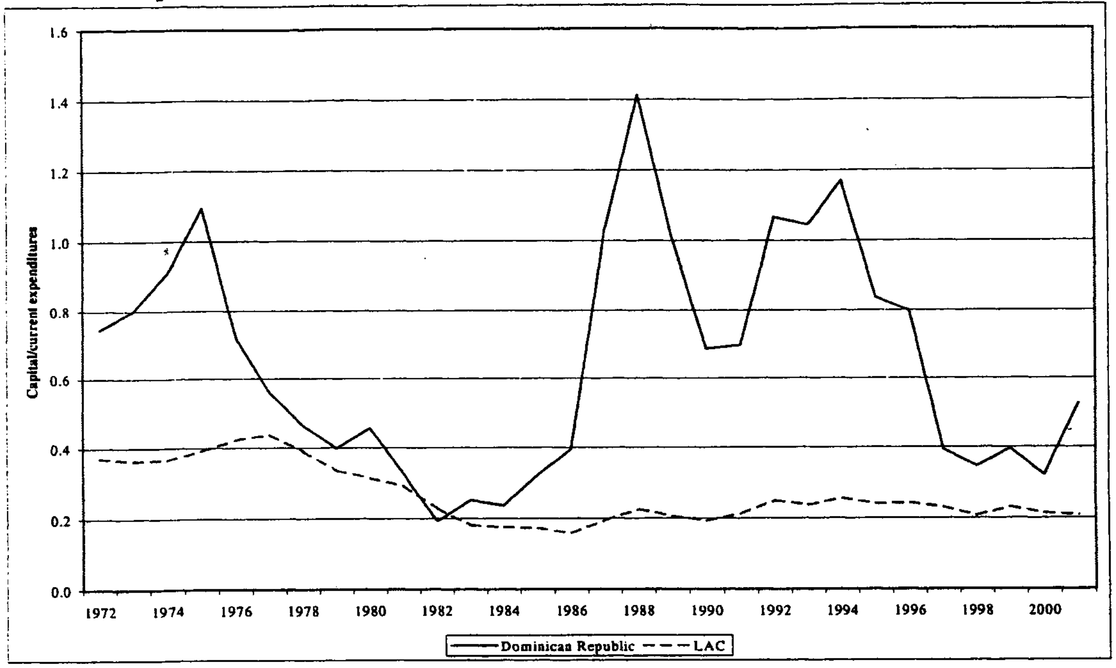
15. In recent years, almost one-third of the budget has been allocated to wages and salaries, greatly reducing the flexibility with which public resources can be allocated to poverty-reducing

expenditures or relied upon to deal with unforeseen events. The Dominican Republic's central government expenditure on wages and salaries, as a percentage of GDP, was 5.7 percent in 2000, above the LAC average of 5.2 percent. After a significant decline in the share of wages and salaries in total public expenditure during 1990-94 as a result of the macroeconomic adjustment measures taken in the early 1990s, the share resumed an upward trend, reflecting the increasing importance of the State in the labor market. In fact, general government staff increased from 266,000 in 1994 to 386,000 in 2003 (an average annual growth rate of 4.4 percent). Moreover, the share of wages and salaries for temporary staff in total expenditures has increased steadily since the mid-1990s (after a reduction in the early 1990s) and by 2001 had more than tripled the 1990-94 average level. The issue of temporary civil service staff is not new and it is well known that this category includes politically motivated appointments that fuel and sustain the culture of clientelism. In addition to their direct fiscal impact, the creation of unauthorized positions and the attendant bloated payrolls have weakened the quality of recruitment as well as compromised the quality of public service delivery. Going forward, great discipline is required to keep a lid on public sector job growth especially on the eve and in the aftermath of the May 2004 presidential elections.

16. The Dominican Republic has a relatively high level of subsidies. Data collected in preparation for this report suggest that subsidies in the Dominican Republic represented 1.3 percent of GDP in 2001, a considerable level when compared with the rest of LAC countries. Subsidies increased markedly between 1995 and 1998 in the Dominican Republic, reaching 1.7 percent of GDP or 11 percent of central government expenditure. Starting in 1999, subsidies declined as a ratio to GDP, mostly as a result of the reduction of the electricity subsidy. On the other hand, even though transfers to local governments, as a share of total expenditure, have been increasing during the last few years, they are still among the lowest in Latin America.

17. Despite a readjustment in the relative share of capital and current expenditures, with the former declining from 56 percent of total central government expenditure in 1987 to 33.5 percent during 1998-2003, the Dominican Republic still maintains a significantly high level of capital expenditures compared with other LAC countries (Figure E.2). The relatively large size of capital expenditure requires the careful and efficient management of public investments in order to reduce waste. However, project selection has often been based on historical expenditure allocation, and driven by the relative political weight of heads of beneficiary ministries and agencies or the representatives of the beneficiary regions, or by other political considerations. Perhaps as a result of the political economy set-up, the heavy emphasis on capital expenditure and infrastructure projects has not been matched with sufficient allocation of resources to operation and maintenance since it is often more rewarding to allocate public funds to new investments than to spend resources on maintaining existing investments that are associated with previous administrations. In selecting future capital expenditures, the authorities will need to more strictly apply efficiency criteria, take into account budget constraints, focus on investment in critical areas where private financing will be difficult to mobilize as well as on basic infrastructure for the poor, and develop public-private partnership in areas where public financing can leverage private financing. They will also need to ensure adequate funding for the completion and maintenance of worthwhile investments regardless of political affiliation.

Figure E.2: Central Government Capital versus Current Expenditures
Dominican Republic and LAC, 1972-2001



Source: Government Finance Statistics database of the IMF.

18. Although social sector expenditures (education, health and social assistance) have received greater attention, they remain below LAC averages and are characterized by inefficiencies. Central government spends barely 5 percent of GDP on the above-mentioned sectors compared with nearly 6 percent on average for the LAC region. The creation of the Social Cabinet (*Gabinete Social*) in 2001 is a positive step toward a better coordination of social spending. It is hoped that the Social Cabinet will contribute to improving the efficiency of social spending (by fostering accountability and the links between performance information and social expenditures) and ensuring sound progress toward the achievement of the millennium development goals.

19. The allocation of education expenditures to primary education benefits the poor. However, public spending on secondary and higher education are likely to benefit the rich more than the poor; extremely limited resources are allocated to pre-school programs; universities receive more public resources than secondary institutions; and life-long learning is yet to be fully integrated into the broader educational system. Moreover, education resources are spent largely on teacher salaries, leaving little or no resources for curriculum development and teaching materials. The inefficiency of public expenditures on education has been historically very significant: it takes public schools on average 15 years of public expenditure per student to produce an elementary school graduate and 32 years to produce a high school graduate. Going forward, more resources should be spent on well-trained teachers and on teaching materials so as to reduce the high repetition rates. If successfully implemented, the Decadal Education Plan (2002-2012) can enhance the distribution of education investment, increase cost recovery, improve accountability, facilitate private sector participation and improve sector regulation and standards.

20. In the health sector, few public resources are spent on preventive care and awareness; and public health facilities hardly fulfill their role as service providers to the poor, many of whom

have to turn to expensive private facilities. Central government expenditure on health and social assistance averaged 2.0 percent of GDP between 1966 and the present. Over 70 percent of public funds are spent on curative care and on the purchase of pharmaceutical products. The disbursement of funds and the management and use of personnel are inefficient and inadequate. Some NGOs receive subsidies without delivering services; the Essential Drugs Program has not delivered on its mandate to sell generic and essential drugs at reduced prices to the poor; and quality control and procurement procedures remain opaque. With the Dominican Republic's access to the global fund for HIV/AIDS and other international funding sources, resources are likely to be available in sufficient amounts to address the HIV/AIDS challenge. However, two institutional weaknesses may constrain the Dominican Republic's ability to achieve the MDG goal for HIV/AIDS: (i) the lack of coordination between the respective roles and functions of COPRESIDA, the Ministry of Health and other sector partners, and (ii) the weak absorptive capacity of NGOs.

21. A new social security system that was approved by Congress in 2001 sets to extend pension, healthcare and accident insurance coverage to workers in the formal and informal sectors as well as to the poor and elderly. The impact of the new system on government finances will originate from the fiscal costs associated with the transition from a pay-as-you-go system to a funded pension scheme and with the expansion of pension coverage, including potential liabilities generated by new minimum pension promises. Although expenditures on housing (which mostly provides private benefits to middle-class urban dwellers) have declined markedly in the past decade, further decline would be desirable in order to create fiscal space to meet the Government's financial commitments in the social security sector.

22. Agricultural spending mostly goes to input subsidies that benefit large farmers in the crop sector at the expense of public goods such as research.[4] Public expenditure on agriculture declined markedly over the past decade and a half. At the same time, the public goods orientation of government spending in the agriculture sector has been declining in favor of the provision of private goods: project categories corresponding to public goods provision account for only 8 percent of project spending and are not effectively targeted. To maximize the return on investments in the sector, efforts should be made to rationalize the efficiency of the network of autonomous agencies and affiliates and discontinue the use of agricultural spending as a means to secure political support in rural areas.

The budget process has improved recently, although weaknesses still remain

23. The Dominican Republic has a relatively well-developed system of budget formulation, including some more sophisticated features that are not always found in the public expenditure systems of middle-income countries. Under the IDB-supported *Programa de Administracion Financiera Integrada* (PAFI) and within the framework of the Integrated Financial Management System (SIGEF), the government has made significant progress over the past year and-a-half in moving forward with its financial management reform aimed at improving budget formulation and execution. These efforts, including the introduction of a medium-term expenditure framework and capital budgeting as well as planned reforms to budget execution, are sound policies that should be pursued.

24. However, the current public expenditure system lacks some of the substantive aspects of budget preparation and implementation that would help inform policy-makers, support better policy choices and increase the effectiveness of public spending. First, the process of formulating

[4] Agricultural spending refers to expenditure on crops, fisheries, livestock, irrigation and natural resource management.

and implementing the budget is led by the National Budget Office (*Oficína Nacional de Presupuestos*, ONAPRES) located in the Technical Secretariat of the Office of the President. This institutional arrangement lends itself to undue political influence in the preparation and implementation of the budget. The Budget Office sets the budget process in motion by sending out a budget circular and detailed budget request forms to all Ministries and spending agencies. Each request that is returned to the Budget Office must cover general fund expenses, special funds and external assistance. Second, the fund authorization process is slow. The budget execution process generally follows the sequential chain that, at the fundamental stage, involves the Budget Office and each Ministry or spending agency. Each Ministry or spending agency submits a quarterly spending plan (warrant) to the Budget Office for approval; the approved request is then returned to the Ministry or spending agency and copied to the *Contraloría*. The slow and cumbersome authorization process (although it is being replaced with an automated system in some Ministries) has been used as an excuse by some agencies to commit funds and borrow from domestic banks without the prior authorization of the Budget Office or the Treasury. It also generates surplus funds that are subsequently transferred to Presidential Account 1401. Third, public procurement does not always follow the rules of transparency and fair opportunity for all potential suppliers. In fact, by Article 2 of Act 105 promulgated in March 1997, the Office of the President is allowed to directly contract for any public work that, under certain circumstances, is deemed in the best interest of the public. The failure to clearly define those circumstances means that projects are contracted directly, often circumventing the scrutiny of the Legislature.

25. Going forward, responsibility for budget formulation and implementation needs to be shifted from the Office of the President to a separate Ministry, such as the Ministry of Finance, where systems for accurate reporting, expenditure programming, expenditure execution and personnel management should be developed. Also, the ability of the Office of the President to automatically spend the undisbursed funds of other spending agencies should be eliminated as this could constrain the authorities' ability to control the fiscal deficit. Public procurement has to be reformed. In particular, direct contracting should be abolished for procurement contracts exceeding certain amounts.

26. The *Cámara de Cuentas*, the *Contraloria* and Congress exert only weak control over public expenditures. The primary responsibility of the *Cámara de Cuentas* is to review and prepare the final accounts of the Executive, Legislature, Judiciary, decentralized agencies and municipalities. The *Contraloría* is responsible for financial control of government income and expenditures as well as centralized internal ex-ante and ex-post control. Neither the *Cámara de Cuentas* nor the *Contaloría* performs its control functions with maximum efficiency. Both institutions use an outdated cash flow accounting system, are understaffed and saddled with tedious ex-ante and ex-post review responsibilities. Congress reviews the financial accounts submitted by the *Cámara de Cuentas* but malpractices, especially when they concern a sitting government, are rarely made public knowledge, let alone prosecuted. The functions of the *Cámara de Cuentas* and *Contraloría* should be better delineated to reduce overlaps, enhance efficiency, detect deviations, correct shortcomings and prosecute malfeasance. Institutional leaders must be held professionally and personally accountable for the efficient management of resources under their watch; consequences for violations and deviations must be explicitly spelled out; and the independence of the *Cámara de Cuentas* should be strengthened and upheld.

A major effort needs to be undertaken to professionalize the civil service

27. The structure of the Dominican civil service is fuzzy and suffers from a weak management and control system. The Office of Personnel Management (*Oficina Nacional de*

Administración y Personal, ONAP) does not exercise full management control over the employment profile or records of the average civil servant and is therefore unable to ensure that appointments (numbers, types and distribution of positions) match verifiable national development needs. In addition, it is unable to distinguish unqualified public sector employees from those who may meet the minimum requisites and might even perform satisfactorily with the right incentives and leadership. Low salaries are a common trait of the patronage-based Dominican civil service. According to ONAP, compensation for patronage-style civil service jobs is 15 to 50 percent below the market rate.[5] Considering the limited number of available jobs in the private sector and given the loophole in the Civil Service Act that permits civil servants to hold parallel jobs in the private sector, many party faithful prefer the largesse of a low-paying public sector job that supplements their income. As a result, the public sector not only absorbs a great proportion of the highly educated workforce (compared with non-public sector employees) but also counts a high proportion of employees with two or more jobs than in the rest of the economy.

28. Rather than implement a system-wide reform at once, the authorities of the Dominican Republic might want to design a comprehensive civil service reform to be implemented in a sequential fashion, starting with agencies with direct responsibility for public financial resources management and those with significant responsibility in the management of social programs. The reform of the Central Bank may provide an example of successive agency-wide reform. The Central Bank model indicates that the will of the Chief Executive is crucial for reform to go ahead and that salaries and working conditions need to be improved substantially. However, its generalization is not financially feasible without a drastic reduction in the number of civil servants (the cost of salaries and benefits for the average Central Bank employee is five times that of other civil service employees). Moreover, the continuous weakness of banking supervision and the resultant large fiscal and economy-wide costs of the collapse of *Baninter* show that internal restructuring of public institutions is not sufficient to guarantee and sustain good institutional performance. Just as with the reform of the Central Bank, civil service reform will need to be matched with a political economy transformation that clearly dedicates public institutions to the pursuit of the common good. Human resource programs should be implemented in coordination with other changes because of the direct conflict between a career or other merit-based system and the culture of patronage and party control of public sector jobs. It is recommended that all political parties and their leaders formally issue communiqués expressing their commitment not to use public sector jobs as reward for political support. The fiscal aspects of reform should receive priority attention, as severance and benefit packages, transfers, job retraining and placement will involve significant budget costs. In the interim, in order to control the wage bill, Government should discontinue paying civil servants who receive a second or third paycheck from the private sector or from another public sector job. The authorities have taken initial steps which, if followed through, would contribute to reinforcing ONAP's role in establishing the career civil service. In compliance with a joint resolution issued by ONAP and the *Contraloría,* beginning in January 2003 the selection and hiring for various career track positions in the central government were opened to public competition. This resolution was further reinforced by Executive Decree 538-03, aimed at regulating appointments and promotions in the civil service.

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[5] Throughout Latin America and other developing regions, the general trend is for unskilled employees to earn more in the public than the private sector, and for public sector professionals to be paid under the market rate. This pattern has led to a frequent recommendation to raise salaries at the upper end in order to "decompress" wages.

The decentralization process should be accelerated in an orderly fashion

29. Since the mid-1990s, decentralization, an indispensable step toward the efficient delivery of public services and poverty alleviation, has involved the active participation of community-based organizations, non-governmental organizations and political institutions. However, the legal framework for the devolution of functions is non-existent and the institutional set-up for decentralization is weak, leaving the process of decentralization vulnerable to changes by successive presidents and legislators (the only existing legal instrument Law 17-97, focuses on the financial aspects of decentralization). With a yet to be defined legal framework for decentralization, Government has nonetheless made some progress by granting some autonomy to municipalities and is making an effort to increase resource transfer to the sub-national levels of government (though care must be taken to ensure that increased transfer is matched with capacity building for adequate financial management at the local government level).

30. However, beyond the current state, further decentralization in the Dominican Republic is impeded by the : (i) weak political support for the effective adoption and implementation of decentralization measures; (ii) constantly changing policy course in response to unstable political coalitions of stakeholders; (iii) prevalence of ideological principles over concrete decentralization decisions and implementation; (iv) relative neglect of fiscal considerations; and (v) lack of capacity for sound management of public funds at the decentralized levels. Moving forward will require developing CONARE into a technically competent and independent entity that can monitor and evaluate information on sub-national government practices.

31. The main recommendations of the report are summarized in Table E.2.