

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

DOMINICAN REPUBLIC

FORMALIZATION AND PRODUCTIVITY IMPROVEMENT PROGRAM IN THE DOMINICAN REPUBLIC II

(DR-L1121)

LOAN PROPOSAL

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ABBREVIATIONS

| | |
|---------|---|
| BANDEX | Banco Dominicano de Desarrollo de las Exportaciones [Dominican Export Development Bank] |
| CATIs | Centros de Apoyo a la Tecnología e Innovación [Technology and Innovation Support Centers] |
| CODOCA | Consejo Dominicano para la Calidad [Dominican Quality Board] |
| CONFIE | Fondo de Contrapartida Financiera para el Desarrollo del Emprendimiento [Financial Counterpart Fund for Entrepreneurship Development] |
| DGCP | Dirección General de Crédito Público [Government Credit Directorate] |
| DGII | Dirección General de Impuestos Internos [Internal Revenue Office] |
| FDI | Foreign direct investment |
| GCR | Global Competitiveness Report |
| GDP | Gross domestic product |
| IMF | International Monetary Fund |
| INDOCAL | Instituto Dominicano de Calidad [Dominican Quality Institute] |
| LIBOR | London Interbank Offered Rate |
| MSMEs | Micro, small, and medium-sized enterprises |
| NFPS | Nonfinancial public sector |
| ODAC | Oficina de Acreditación [Accreditation Office] |
| OVE | Office of Evaluation and Oversight |
| PBP | Programmatic policy-based loan |
| PERSS | Plan Estratégico para la Reforma de la Seguridad Social [Strategic Plan for Social Security Reform] |
| PPP | Public-private partnership |
| R&D&I | Research, development, and innovation |
| ROA | Return on assets |
| ROE | Return on equity |
| SMEs | Small and medium-sized enterprises |
| TFP | Total factor productivity |
| TSS | Tesorería de la Seguridad Social [Social Security Treasury] |

PROJECT SUMMARY

DOMINICAN REPUBLIC FORMALIZATION AND PRODUCTIVITY IMPROVEMENT PROGRAM IN THE DOMINICAN REPUBLIC II (DR-L1121)

| Financial Terms and Conditions | | | | |
|---|---------------|--------------------------|--|-------------------------------------|
| Borrower: Dominican Republic | | | Flexible Financing Facility ^(a) | |
| | | | Amortization period: | 20 years |
| Executing agency: Ministry of Finance | | | Disbursement period: | 1 year |
| | | | Grace period: | 5 years ^(b) |
| Source | Amount (US\$) | % | Interest rate: | LIBOR-based |
| IDB (Ordinary Capital): | 300 million | 100 | Credit fee: | ^(c) |
| | | | Inspection and supervision fee: | ^(c) |
| Total: | 300 million | 100 | Original weighted average life: | 12.73 years ^(d) |
| | | | Approval currency: | U.S. dollar |
| Program at a Glance | | | | |
| Program objective/description: The objective of the program and this second operation is to boost productivity in the Dominican Republic by: (i) extending the scope of financial intermediation; (ii) improving the business climate and productive development and innovation policies; and (iii) improving social security policies and incentives for work in the formal sector. This is the second of two consecutive loan operations that are technically linked but financed independently under the programmatic policy-based loan modality. | | | | |
| Special contractual conditions precedent to the single disbursement of the loan: The single disbursement of the loan is contingent on fulfillment, to the Bank's satisfaction, of the policy reform conditions set forth in the Policy Matrix (Annex II), the Policy Letter , and all other conditions provided in the relevant loan contract (paragraph 3.2). | | | | |
| Exceptions to Bank policies: None. | | | | |
| Strategic Alignment | | | | |
| Challenges: ^(e) | SI | <input type="checkbox"/> | PI | <input checked="" type="checkbox"/> |
| Crosscutting themes: ^(f) | GD | <input type="checkbox"/> | CC | <input type="checkbox"/> |
| | | | IC | <input checked="" type="checkbox"/> |

^(a) Under the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule as well as currency and interest rate conversions. When considering such requests, the Bank will take operational and risk management considerations into account.

^(b) Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

^(c) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors during its review of the Bank's lending charges, in accordance with the corresponding policies.

^(d) The weighted average life could be less, depending on the actual signature date of the loan contract.

^(e) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

^(f) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem to be addressed, and rationale

- 1.1 **Macroeconomic context.**¹ With gross domestic product of 5.3%, the Dominican Republic was one of the region's fastest growing economies between 1990 and 2016.² While real GDP growth fell slightly to 4.7% in 2013, it regained momentum in the period 2014-2016, averaging more than 7%. This figure far exceeded the growth forecast for that period in the first operation of this programmatic series (around 5%) and surpassed even the country's long-term potential growth rate, estimated at 5% to 6%.³ Despite this, inflation has remained under control and the country's external position has improved. In fact, the current account deficit in the balance of payments declined significantly in recent years, from 4% of GDP in 2013 to 1.5% of GDP in 2016. Starting in 2017, growth is expected to converge toward the potential rate of 5% to 6%, provided that significant structural and policy reforms such as those envisaged in this operation continue apace.⁴
- 1.2 The country's high growth rate has enabled the Dominican government to implement a progressive fiscal consolidation process in the wake of the significant deterioration in 2012. This consolidation process has included an increase in tax revenue from 14.0% of GDP in 2012 to 14.6% of GDP in 2016, along with a reduction in nonfinancial public sector (NFPS) expenditure from 20.4% of GDP in 2012 to 17.1% of GDP in 2016.⁵ As a result, the NFPS deficit went from 6.6% of GDP in 2012 to 2.7% of GDP in 2016.
- 1.3 **Economic structure and productivity.** The country's main economic sectors are manufacturing (24% of GDP in 2016), transportation and communications (10%), trade (9%), and hotels and restaurants (8%). The economic structure is characterized by high levels of informality⁶ and the significant role of micro, small

¹ Data based on [International Monetary Fund \(IMF\), Article IV Consultation with the Dominican Republic, 2017](#), and World Economic Outlook, various years.

² Only behind Panama and Chile.

³ See Johnson, C. 2013. [Potential Output and Output Gap in Central America, Panama and Dominican Republic](#), IMF Working Paper 13/145, and [IMF, Article IV consultation with the Dominican Republic, 2017](#).

⁴ See [IMF, Article IV Consultation with the Dominican Republic, 2017](#).

⁵ By 2017, tax revenue is expected to increase by 0.3% of GDP for a total of 14.3% of GDP, and NFPS expenditure is expected to decline by 0.1% of GDP. Thus, the NFPS primary surplus would rise to 0.8% of GDP and the overall deficit would drop to 2.3% of GDP. Source: [IMF, Article IV Consultation with the Dominican Republic, 2017](#); and the Dominican Ministry of Finance, Public Finance Results 2016-2017, Santo Domingo, 2017.

⁶ Sixty-five percent of wage earners in the Dominican Republic do not pay social security contributions (legal informality). In turn, self-employment is 38% (2017), while so-called "productive informality" (which includes employees of firms with fewer than five employees, self-employment, and employment in very low productivity categories of work) rose from 53% in 2000 to 59% in 2017. [National Ongoing Workforce Survey](#), 2017.

and medium-sized enterprises (MSMEs)⁷ in job creation and the business structure.⁸ In the last two decades, the country's economy has not encouraged a positive structural change, with job creation concentrated in microenterprises marked by low productivity and high informality levels, especially in the service sector and most particularly in wholesale and retail trade.⁹ Between 1993 and 2013, the share of microenterprises in total employment increased from 29% to 41%, and the number of microenterprises per 1,000 inhabitants rose from 41 to 75. In addition, 76% of these businesses employ one or two persons at most, and 80% either have not expanded or have reduced their workforce since their inception.¹⁰ This trend limits any increase in the aggregate productivity of the economy. Thus, the economic growth of the last decades is primarily due to the accumulation of factors of production in medium-sized and large businesses, principally physical capital and, to a lesser extent, labor.¹¹ Lower relative productivity affects businesses in all sectors, but especially microenterprises, where average labor productivity is a mere 31% of the labor productivity of SMEs and barely 20% of the labor productivity of large businesses.¹²

- 1.4 **Policy challenges.** One of the country's main growth challenges is to implement a program of reforms to reduce the distortions that hold back growth in the most productive businesses. The main distortions include:¹³ (i) infrastructure, particularly in terms of coverage and efficiency of energy infrastructure; (ii) the level and quality of human capital; (iii) the quality of public administration and the investment climate;

⁷ At present, under Law 187-17, Dominican businesses with 1 to 10 employees and gross sales of up to RD\$8 million (US\$168,000) are considered microenterprises; businesses with 11 to 50 employees and gross sales of up to RD\$54 million (US\$1.132 million) are considered small enterprises; businesses with 51 to 150 employees and gross sales of up to RD\$202 million (US\$4.234 million) are considered medium-sized enterprises; and businesses with more than 150 employees and gross sales of over RD\$202 million are considered large enterprises.

⁸ MSMEs account for 98% of businesses (2.4% are small and medium-sized enterprises (SMEs)) and generate 39% of GDP (51% of this segment, or 20% of GDP, is generated by SMEs) and 54% of total employment in the country. According to the National Statistics Office (ONE) (2017), 58% of MSMEs with fixed retail space are led by women. In addition, women own 51.3% of the country's microenterprises. Fifteen percent of MSMEs are in the manufacturing sector; 47% in the trade sector; and 38% in the services sector. See: [Ortiz, Marina; Cabal, Miguel; and Mena, Rita. Micro, Pequeñas y Medianas Empresas en la República Dominicana, FondoMicro, Santo Domingo, 2014.](#)

⁹ See Abdullaev, U. and Estevao, M. [Growth and Employment in the Dominican Republic. Options for a Job-rich Growth](#). IMF Working Paper, 2013.

¹⁰ See: [Ortiz, Marina; Cabal, Miguel; and Mena, Rita. Micro, Pequeñas y Medianas Empresas en la República Dominicana, FondoMicro, Santo Domingo, 2014.](#)

¹¹ On the other hand, total factor productivity (TFP) made a negative contribution in the period 1991-2015 (somewhere between -0.63% and -1.04% per year, depending on the methodology used). See: [Michel, José Manuel; Díaz, Fidias; and Pérez Medrano, Paola. Crecimiento Económico y Productividad en la República Dominicana. Banco Central de la República Dominicana. Documento de Trabajo 2016-03, Santo Domingo, 2016.](#)

¹² Ministry of Industry, Commerce, and MSMEs. Políticas de Apoyo al Emprendimiento y Consolidación de la Oferta de Desarrollo Empresarial, Santo Domingo, 2015.

¹³ See, for example, [IMF, Article IV Consultation with the Dominican Republic, 2017](#); and World Bank, [Enterprise Surveys](#), 2016.

(iv) access to the global markets, foreign direct investment (FDI),¹⁴ and finance; and (v) informality. In the interest of proper targeting, this program will address the latter three aspects, which are highly complementary to one another.

- 1.5 **Institutions, informality, and productivity.** The institutions regulating access to finance, the business and investment environment, and social security affect the relative costs of operating in the formal or informal sector. In business environments where the cost of finance and/or red tape is onerous, the cost of operating in the formal sector is higher, reducing the growth capacity of formal businesses. Businesses operating in the informal sector (or formal businesses that hire informal workers) find their capacity for growth and productivity improvements limited. This is due to: (i) more limited access to finance (for example, to introduce new production technologies); (ii) higher transaction costs (for example, to guarantee contract enforcement); (iii) incentives to remain small so as to avoid detection by the authorities; (iv) or greater restrictions on accessing particular markets (for example, public procurement). These facts are consistent with the lower productivity observed in the informal sector relative to the formal sector.¹⁵ The institutional environment in which businesses operate plays a decisive role in the size distribution of businesses, which has profound consequences for the economy's productivity. However, as will be explained below, financial regulation and the business climate also have a direct impact on productivity that includes a structural transformation of the economy, adding more weight to the formal sector. Therefore, to improve productivity, it is crucial to adopt an integrated approach to addressing improvements in institutions and regulations affecting access to finance, the business climate, exports, FDI attraction, innovation, and business formalization.
- 1.6 **Development of the financial system in the Dominican Republic.** Financial development is a key factor in productivity growth. The literature provides empirical evidence of a causal relationship between the level of development of the financial system and economic growth¹⁶ and showing that this occurs primarily through its effect on productivity.¹⁷ In addition, the empirical evidence reveals that more developed financial systems help to raise productivity by: (i) enabling a better allocation of factors to projects with greater returns; (ii) providing incentives for innovation and for research and development, facilitating access to higher value-

¹⁴ For an exhaustive analysis of export performance and FDI attraction in the Dominican Republic, see Labraga, Juan; Schecker, Elka; and Isa Contreras, Pavel: [República Dominicana: Promover las exportaciones para mejorar la calidad de vida: Análisis de los mecanismos, instituciones y mejores prácticas para fomentar las exportaciones y atraer inversión extranjera.](#) (IDB, 2017).

¹⁵ For a characterization of the lower productivity levels of informal businesses, see: La Porta, R. and Shleifer, A. [Informality and Development. NBER Working Paper 20205](#), 2014. In Latin America and the Caribbean, see Perry et al.: Informality in LAC - A Barrier to Growth and Social Welfare World Bank, 2007.

¹⁶ For an analysis of the causal relationship between productivity and financial development, see Rajan, R. G. and Zingales, L. Financial Dependence and Growth, *The American Economic Review* 88, pages 559-586, 1998; and Beck, T.; Levine, R.; and Loayza, N. Finance and the Sources of Growth, *Journal of Financial Economics* 58, pages 261-300, 2000.

¹⁷ For a study on the evidence of these effects, see IDB. *The Age of Productivity: Transforming Economies from the Bottom Up*. Carmen Pagés (Ed.), Washington D.C.: IDB, 2010; and Arizala, F.; Cavallo, E. A.; and Galindo, A. J. (2013). Financial Development and TFP Growth: Cross-country and Industry-level Evidence, *Applied Financial Economics* 23(6), pages 443-448, 2013.

added markets and segments; and (iii) blunting the impact of volatility and macroeconomic shocks.¹⁸

- 1.7 **Key indicators of the financial system.** The Dominican financial system's indicators have improved significantly since the financial crisis of 2003-2004. Information from the Superintendency of Banks confirms that the banking system is sound and profitable: at year-end 2016, equity over risk-weighted assets was 15.8%, showing an adequate capitalization level, while aggregate average return on equity (ROE) and return on assets (ROA) were 22.1% and 2.1%, respectively, exceeding the average values in Central American countries.¹⁹ In addition, portfolio quality levels have improved; thus, the past-due portfolio as a proportion of the total portfolio is 1.6% and it is covered by provisions for bad debt for up to 181.3%. The country's financial structure is dominated by the banking system, which accounts for 87% of total financial system assets and is highly concentrated (with the three largest banks).²⁰ The remainder of the system is comprised of savings and loan associations, financial corporations, and public-sector financial intermediation institutions.²¹ The insurance industry and capital markets are relatively undeveloped. As of year-end 2016, the Dominican insurance sector had a premium-to-GDP ratio (penetration rate) of 1.2%, the lowest in the entire region. As of the same date, the country's premium per capita (density) ratio was a mere US\$83, lower than in countries such as El Salvador (US\$98), Costa Rica (US\$161), and Panama (US\$350).²² The securities market, which is based on fixed-income and sovereign debt transactions, lacks sophistication. Of the US\$6.443 billion traded in the primary and secondary markets in 2016, US\$5.633 billion (87.4%) was traded in fixed-income instruments, 98% of which were Central Bank and Ministry of Finance issues.²³
- 1.8 **Pending challenges.** Despite the fact that credit to the private sector as a percentage of GDP averaged 26.6% per year from 2014 to 2016 and reached 27.1% in 2016, it remains low in comparison with the average for the countries in the region (49.4%). Intermediation is also inefficient in comparative terms (the net interest spread in the Dominican Republic was over 10% between 2000 and 2016, almost twice the average for the countries of the region), which is related to the high level of concentration mentioned above. Moreover, protection of borrowers' and lenders'

¹⁸ For a comprehensive review of the relationship between financial development and productivity, see [Support to SMEs and Financial Access/Supervision Sector Framework Document](#) (document GN-2768-5), IDB, August 2017.

¹⁹ According to data from the [Executive Secretariat of the Central American Monetary Council](#), in 2016, the equity ratio for this group of countries was 15.7%, while ROE and ROA at year-end were 14.7% and 1.6%, respectively.

²⁰ The financial system's three largest institutions are BanReservas (30%), Banco Popular (22%), and BHD León (16%).

²¹ The assets of savings and loan associations and unregulated microfinance institutions account for less than 1% of the system's total.

²² MAPFRE Studies Service. [El Mercado Asegurador Latinoamericano en 2016](#). Madrid, 2017.

²³ Bolsa de Valores de República Dominicana [Dominican Republic Securities Exchange]. [2016 Annual Report](#). Santo Domingo, 2017.

rights is weak and bankruptcy expensive, with very low levels of recovery.²⁴ This is reflected in the high levels of collateral required from businesses and the difficulty in accessing the banking system, particularly for MSMEs.²⁵ While the Dominican financial system has improved in terms of access to banking services (in 2016, 1,838,104 individuals had loans in the financial system, an increase of 169,214 with respect to 2015), there is the continuing task of regulating and supervising entities such as savings and loan associations, which have a fragmented client base. Thus, in line with various diagnostic assessments,²⁶ in order for the financial sector to contribute to a more efficient allocation of productive resources in the Dominican Republic, improvements are needed in the following areas: (i) strengthening prudential regulation to consolidate financial sector stability based on an assessment of compliance with the Basel principles²⁷ and international best practices;²⁸ (ii) developing new institutions and instruments for long-term financing of productive development to complement the role of commercial banks in this area; and (iii) strengthening legal infrastructure, particularly transaction security and creditors' and investors' rights.

- 1.9 **Business climate, foreign trade, and productive development policies in the Dominican Republic.** Business climate, understood as the institutional web that influences the current and expected return on the investment decisions of companies, is an essential variable for productivity improvement.²⁹ Key considerations in promoting a favorable business climate include: (i) institutions dedicated to reducing the transaction costs of companies in their dealings with government (measured in terms of time or financial cost); (ii) regulations promoting effective competition in the markets for products and services; and (iii) policies and institutions designed to encourage productive development and innovation. The program addresses each of these considerations.
- 1.10 **Business climate and competition in the Dominican Republic.** The Doing Business 2017 report ranks the country 103rd of 190 for ease of doing business, 14 positions higher than in 2013 and above the regional average (107th). This improvement is in large measure due to simplified administrative procedures both

²⁴ The bad debt recovery rate is low (8.8 cents on the dollar), while the cost of the process is high (38% of the value of the assets). These figures are significantly worse than the Latin American average (30 cents and 16%, respectively) and the Organization for Economic Cooperation and Development (OECD) average (60 cents and 9%, respectively). World Bank, [Doing Business](#), 2017.

²⁵ The collateral requirement in the Dominican Republic is 234% of the loan value, compared with a regional average of 197%. Only 35% of SMEs use bank loans to finance their investments, compared with 60% of large companies. Only half of SMEs report having a bank loan or credit line, compared with 76% of large companies. [Enterprise Surveys](#), World Bank.

²⁶ World Economic Forum, Global Competitiveness Index 2016-2017; World Bank, [Doing Business](#), 2017.

²⁷ References for improving the quality of financial regulation and supervision systems, identifying measures to strengthen financial systems, and achieving the implementation of best banking practices. Of the documents endorsed by the Committee, it is worth highlighting the Basel III Capital Agreement of 2010, which contains provisions to ensure that bank capitalization levels are in line with each institution's credit, operating, and interest rate risk exposure. While implementation of these measures is compulsory only for G-20 countries, many financial regulators and supervisors in other countries adapt them to their local framework to prevent systemic risks.

²⁸ Explicitly recognized in the Article IV Consultation, published in August 2017 by the IMF.

²⁹ The assessments of structural reforms in this area show significant effects on productivity and growth. See: Dabla-Norris, E., Ho, G. and Kyobe A. Reforms and Distance to Frontier. FMI, 2013.

for registering and operating businesses and for foreign trade-related activities. The main obstacles to doing business in the country are: (i) the minimum capital requirement for creating a business;³⁰ (ii) the lack of transparency and efficiency in the public administration; (iii) contractual enforcement; (iv) the poor quality of electric power service; and (v) unfair competition from the informal sector.³¹ The 2017-2018 Global Competitiveness Report³² points to problems with the quality of institutions (129th of 137) and training in companies (110th of 137), lack of research, development, and innovation (R&D&I) capacity and activities (120th of 137), high level of industrial concentration (131st of 137), and low effectiveness of antitrust policies (133rd of 137). The dominant position of companies in markets inclined towards anticompetitive behavior tends to create barriers to entry or to remaining in markets for potentially innovative companies, thus leading to conditions that reduce consumer welfare.

- 1.11 **Pending challenges.** In order to improve its business climate, it is particularly important that the Dominican Republic: (i) reduce the costs of creating new companies; (ii) enhance legal certainty in businesses' dealings with government; (iii) improve the programs aimed at fostering innovation and training in companies; and (iv) initiate actions to encourage competition.
- 1.12 **Foreign trade.** The economic growth in the Dominican Republic was partly due to a successful increase in exports over the last decades.³³ Starting in the 1960s, the country implemented programs designed to add new goods and services to an export basket originally based on static comparative advantages. These programs and incentives helped to increase export values and diversify the export basket by adding new agricultural products, manufacturing, tourism, audiovisual services, and services associated with the information technology and communications sector. The creation of special economic zones or export processing zones played an important role in consolidating the manufacturing sector.
- 1.13 **Pending challenges.** Since 2005, the buoyant export sector has waned and solid economic growth is no longer driven by foreign trade. This loss of export momentum is the result of both external and domestic phenomena.³⁴ Accordingly, it has become necessary to make the current investment and export promotion system more coherent and develop better incentives to attract FDI, so that exports and foreign investment can contribute to economic development and enable the country to scale up its participation in global value chains.
- 1.14 **Productive development and innovation policies.** Despite the progress made in the Dominican Republic in terms of the institutional and regulatory framework to

³⁰ Equivalent to 36.5% of per-capita income, and thus the highest in the region.

³¹ World Bank. [Doing Business 2017](#) and [Enterprise Surveys](#), 2016.

³² World Economic Forum. Global Competitiveness Report 2017-2018, Geneva, 2016.

³³ See World Bank, [Cómo mantener el dinamismo exportador en República Dominicana](#), 2014.

³⁴ The external sources notably include the gradual elimination of the Multi-Fibre Arrangement, which was agreed upon at the Uruguay Round of the General Agreement on Tariffs and Trade, and the emergence and consolidation of China, Hong Kong, Vietnam, and Bangladesh as the great textile, garment, and footwear producers of our time, with the concomitant increase in their share of sales to the United States. This change in the global competitive environment was compounded by the global financial and economic crisis of 2008.

support productive development,³⁵ public policy weaknesses and institutional fragmentation persist and investment in innovation is low. These are key factors in the Dominican economy's productivity shortfall. The Dominican Republic's current low levels of research, development, and innovation (R&D&I) highlight the persistence of these weaknesses: resources channeled into these activities barely reach 0.25% of GDP (less than half the Latin American average), while the Global Competitiveness Report ranks the country 120th of 137 for innovation.

- 1.15 **Pending challenges.** The essential conditions for improvements in businesses' productivity include the existence of institutions and policies to: (i) identify market failures preventing an efficient allocation of resources to the most productive firms and projects; and (ii) design, implement, and evaluate effective short-, medium-, and long-term public policies to overcome these failures, in particular those that affect innovation and productive development.
- 1.16 **Social security policies and incentives for formal labor in the Dominican Republic.** The regulatory design of the social security system—as applied to labor relations—is one of the critical factors in determining the incentives for formality that employers and employees encounter in the labor market. In addition, to avoid being caught not paying social security contributions and other obligations in relation to their employees, firms have an incentive to stay small, with impacts for key variables affecting their levels of productivity.³⁶ Specifically, the context of high levels of informal labor in the Dominican Republic and the partial implementation of Social Security Law 87-01 of 2001 mean that pending challenges for social security need to be faced in order to raise levels of formality in the labor force in a way that supports the efficiency and sustainability of the social security system.³⁷
- 1.17 **Social security system and its relationship to informal labor in the Dominican Republic.** Although the creation of the Dominican social security system in 2001 by Social Security Law 87-01 was a big step forward in workers' social protection, the share of the labor force with a formal job (defined in terms of workers and employers paying social security contributions) is one of the lowest in the region (35%).³⁸ The country also has one of the region's highest rates of self-employment (41%)³⁹ and, in the last five years, 35% of wage earners who ought to be paying contributions into

³⁵ Bank support for productive development policy efforts in the country has included loan operations [2126/OC-DR](#) and [2432/OC-DR](#).

³⁶ As argued by Busso, Fazio, and Levy in [\(In\) Formal and \(Un\) Productive. The Productivity Costs of Excessive Informality in Mexico](#) - IDB-WP-341, 2012, providing a detailed explanation of the relationship between informality and productivity. See also Schmidt-Hebbel, K., [Does Pension Reform Really Spur Productivity, Saving, and Growth?](#), Working Paper 33, Central Bank of Chile.

³⁷ The principle of efficiency in this case means a system that does not raise taxes on formal work, which would make financing the system even more difficult as a result of evasion, while pursuing the efficient administration of its resources.

³⁸ In Chile, 83% of the population contributes; in Uruguay, it is 70% and in Costa Rica, 69%. See: World Bank. Pension Coverage in Latin America: Trends and Determinants. Social Protection & Labor Discussion Paper No. 1217, Washington DC, 2011; and IDB, [Better Pensions Better Jobs. Towards Universal Coverage in Latin America and the Caribbean](#), Washington, D.C., 2013.

³⁹ As Abdullaev, U. and Estevao, M. 2013 (op. cit.) point out, job creation has been concentrated in firms in low-productivity sectors with high levels of informality.

the contributory scheme are not doing so.⁴⁰ This highlights the need to monitor employers for evasion and avoidance of social security contributions more rigorously.

- 1.18 **Pending challenges.** Despite recent efforts in the context of social security reform, challenges remain. They include creating incentives for businesses to formally join the current contributory scheme and facilitate social security enrollment for businesses, particularly those located far from the country's capital. Another ongoing challenge is to improve the records of individuals and businesses, whether or not they are enrolled in the social security system, and develop mechanisms that can provide permanent monitoring of workers' movement between formal and informal labor and of businesses' strategies for evasion and avoidance.
- 1.19 Before the introduction of the one-stop-window business formalization portal "Formalizate," the process of setting up a limited-liability sole proprietorship or a limited-liability company was relatively burdensome, took approximately 20 business days, required eight visits, and cost over US\$1,000. However, the introduction of Formalizate has made it possible to streamline this process. As a result, a limited-liability sole proprietorship or limited-liability company can now be formed in seven business days and two visits, and at a cost of US\$150.⁴¹ In addition, since early 2017, the portal includes a registry of individuals. This is an important resource for microenterprises and independent professionals who previously did business in the informal sector and can now register in 24 hours at a cost of approximately US\$10.⁴² The use of the formalization portal has been supplemented by the growth of MSME centers, where business owners have access to advisory services on the use of the electronic platform. However, despite the improvements in the registration of businesses through Formalizate, the portal will need to have greater geographic coverage and be more widely used. In 2016, merely 20% of new business registrations were processed through the portal.⁴³
- 1.20 **Linkage between the two phases of the programmatic series.** The second operation expands on and completes a series of reforms initiated in the preceding programmatic operation (3326/OC-DR).⁴⁴ In the component related to strengthening financial regulation, regulation for financial stability was reinforced through the approval of new asset evaluation regulations, new corporate governance regulations, and the drafting of a new law on the Dominican credit union system. In addition, the development of new institutions and instruments for financing productive development was started through the approval of a law to create the Banco Dominicano de Desarrollo de las Exportaciones [Dominican Export Development Bank] (BANDEX), presented to Congress under the first operation, and approval of the implementing regulations that activated this institution specializing in foreign trade finance. In addition, a securities market bill was

⁴⁰ Based on data from the Ongoing Workforce Survey from 2012 to 2017 and data on contributors from the Superintendency of Pensions.

⁴¹ Report on One-Stop Formalization Window, Ministry of Industry, Commerce, and MSMEs, 2017, page 1.

⁴² Ibid., page 2.

⁴³ Based on business registration data from the Santo Domingo Chamber of Commerce and Production.

⁴⁴ The Policy Matrix identifies the new or reinforced commitments for this second operation with respect to those included in the first operation of the programmatic series, and are also classified as regulatory reforms (15) or reforms associated with the implementation of actions (13).

presented to the Congress with broad consensus among the relevant actors, and insurance legislation was drafted with a view to expanding the development of these two markets still in their early stages in the Dominican Republic. Furthermore, a legislative bill on public-private partnerships (PPPs) was presented to Congress to boost private-sector participation in financing, building, and operating basic and social infrastructure. New commitments were also included to improve private-sector access to financing, particularly for MSMEs, by drafting a new factoring law and launching an entrepreneurship development fund [Financial Counterpart Fund for Entrepreneurship Development] (CONFIE)). With regard to the objective of improving the reliability and security of contracts and financial transactions, a new anti-money laundering and counterterrorism financing law was passed and enacted. This law updates Dominican legislation to conform with global standards and, specifically, seeks to align local provisions with the 40 new recommendations of the Financial Action Task Force in terms of money laundering and terrorism financing, as well as strengthen the mechanisms for preventing and combatting these illicit activities. The bankruptcy bill presented to Congress under the first operation was approved and entered into force, and a new legislative bill on personal-property collateral that would facilitate the use of movable assets to secure loans, particularly by MSMEs, was presented to Congress.

- 1.21 In the component related to productive development, with regard to improving and simplifying administrative procedures, the process initiated under the first operation with the approval of the Law on Administrative Procedures was continued. In the second operation, a series of significant improvements and process simplifications will be implemented for obtaining construction permits, paying taxes, facilitation foreign trade, and setting up and registering businesses. In addition, the minimum capital requirement to set up a new business will be eliminated in line with international best practices. New commitments were also included in relation to foreign trade, such as ratification by the Congress of the World Trade Organization's Trade Facilitation Agreement and presentation of a new customs law to Congress. With regard to strengthening competition, the drafting of competition promotion and defense regulations was carried over from the first operation, and legal, regulatory, and/or market barriers affecting competition in key sectors of the Dominican economy (such as beer, pharmaceuticals, insurance, bread commercialization, and passenger and freight transportation) were identified. New commitments included the presentation to Congress of a legislative bill against illicit trade with a view to reducing unfair competition and market distortions caused by the introduction and sale of counterfeit products and contraband, as well as new regulations to strengthen competition and protect users of financial products and services. With regard to improvements in policies and institutions for productive development and innovation, the legislative bill on Business Classification presented to the Congress of the Republic under the first operation was approved. The institutional mechanisms to promote public-private dialogue for competitiveness were reinforced. The new Dominican Quality System (SIDOCAL) was launched as envisaged in the first operation, and the Technology and Innovation Support Centers (CATIs) created under the first operation were implemented and became operational. In addition, by way of new actions not envisaged in the first operation, a strategic sector plan to develop priority sectors was approved; 12 new support centers for MSME development were launched; and ProDominicana was created to provide professional support services to exporters and foreign investors.

- 1.22 Lastly, in the component of improving social security policies and incentives for work in the formal sector, the second operation will expand Formalízate into most of the country's provinces as a one-stop digital window for registering businesses, with a view to significantly reducing the cost of registering MSMEs and facilitating business formalization. In addition, the second operation designed an ongoing monitoring strategy by the Social Security Treasury (TSS) to reduce evasion and avoidance of social security contributions, following up on the first operation's implementation of the agreement between the Internal Revenue Office (DGII) and the TSS, which enabled these agencies to share tax and social security records.
- 1.23 To ensure continued progress in these areas going forward, support will be required for modernizing and consolidating the oversight activities of the financial system and further developing the regulatory framework for digital financial services, such as crowdfunding platforms and payment mediums that promote the use of technology to improve financial inclusion and reduce operating costs. In addition, efforts will also be needed to strengthen the strategies and institutional framework for productive development, innovation, and entrepreneurship, so as to support the diversification of production and increase the value added generated in the country; to continue actions to promote the formalization of labor and businesses; and to strengthen the functional and institutional structure of ProDominicana as an agency specializing in support for export development, which provides information, and investor attraction and support services.
- 1.24 **Value added, lessons learned, and Bank support to the sector.** Throughout the last decade, the Bank's technical teams have been closely supporting the reforms of this programmatic series, which target the financial, productive development, trade and investment, social security, and formalization areas in the Dominican Republic through policy-based loan operations, investment loans, technical support, and nonreimbursable technical-cooperation operations. The programmatic series is part of the Bank's ongoing support to the sector, driving a set of reforms in the areas of productivity and competitiveness. It also complements and is linked to other Bank operations involving productive development, social security, human capital development, and labor force employability, such as: (i) the Program to Support Policies to Enhance Productivity and Competitiveness (loan 2126/OC-DR);⁴⁵ (ii) the programmatic series Support for Health Sector and Social Security Consolidation (loans 3382/OC-DR and 3585/OC-DR); and (iii) the Program to Support the National Employment System (loan 2546/OC-DR) to improve the country's human capital. The Bank is also providing support to the Dominican Republic on productive development issues through investment operations, such as the Productive Development and Competitiveness of the Province of Juan (loan 3107/OC-DR), which aims to improve credit access for MSMEs and the quality of their business management. In addition, the present program embodies the lessons learned and highlighted in the evaluations of the Bank's Office of Evaluation and Oversight

⁴⁵ This programmatic series complements the previous one by: (i) introducing new key aspects for productivity, such as those related to prudential regulation, development of new financial instruments and institutions, strengthening of institutions for innovation, and regulation of social security; and (ii) completing the reforms carried out under the preceding operation in terms of the legal framework governing access to financing by drafting laws on business bankruptcy and restructuring, reciprocal guarantees, and personal-property collateral.

(OVE),⁴⁶ which include the importance of: (i) proper sequencing of policies and reforms; and (ii) technical support aimed at building capacity and consensus around the reforms.

- 1.25 The Bank has also added value in this operation through its support for related technical-assistance operations. The technical cooperation program Support to the National Initiative for Productivity and Competitiveness (ATN/OC-15814-DR) supported the institutionalization of public-private dialogue and partnerships. Furthermore, DR-CC2070, financed with resources from the Compete Caribbean Program, supported the institutional strengthening of ProCompetencia, as well as legal and economic diagnostic studies of the legal, regulatory, and/or market barriers impacting competition in strategic sectors of the Dominican economy. Another technical cooperation project financed by Compete Caribbean (DR-CC2064) supported business climate reforms, which also form a part of the present program. Through ATN/OC-15030-DR, Information and Communication Technologies and Broadband as a Tool for Financial Inclusion (2015-2018), the Bank supported Fundación Reservas in testing innovative tools to make the provision of financial services more efficient and build financial and business management capacity among microentrepreneurs using information and communication technologies. Also, the regional technical-cooperation operation ATN/KR-14171-RG, Support Program for the Development and Implementation of Comprehensive Strategies for Financial Inclusion, supported the Central Bank in preparing a draft law on the Dominican credit union system, is one of the agreements under the present program.
- 1.26 The process of social security reform was supported through technical-cooperation operation ATN/OC-14616-DR, particularly with regard to the design of policies to improve coverage and incentives to contribute to social security. An analysis of mechanisms, institutions, and best practices to promote exports and attract foreign direct investment in the Dominican Republic, published by the Bank's Integration and Trade Sector (2016), put forth a series of recommendations that helped strengthen the foreign trade reform agenda and led to the creation of ProDominicana, part of this programmatic operation, to provide professional support services to exporters and foreign investors. The regional technical-cooperation operation ATN/FI-14479-RG, Program to Support Strengthening the Joint Binational Commission, helped to reinforce and deepen economic, trade, and political cooperation between Haiti and the Dominican Republic, putting forth recommendations for improving integration and the balance of trade. In addition, the regional technical-cooperation operation ATN/MR-15348-RG, Program to Support the Public Sector in Dominican-Haitian Border Economic Development and the Use of Legal Instruments for Investment, seeks to help coordinate border economic development by attracting investment and trade in order to create jobs and wealth. DR-P1104, Identification of Priority Productive Sectors, served as input for improvements in productive development policies and institutions, enabling the policy agreement related to the approval of a strategic plan for priority sector development. Operation DR-P1105, Recommendations for Strengthening Links between Local Chains and Export Sectors, supported the identification of

⁴⁶ Country Program Evaluation: Dominican Republic 2009-2013 (document RE-453-3); and Country Program Evaluation: Dominican Republic 2013-2016 (document RE-505-1).

administrative, technological, and regulatory barriers to the development of linkages in three priority sectors.

- 1.27 **Coordination with other donors.** This operation is coordinated with and is complementary to the International Monetary Fund (IMF) technical cooperation actions on prudential regulation⁴⁷ and joint IDB and World Bank actions on business climate, more specifically regarding the simplification of procedures for setting up a business and regulations on personal-property collateral, restructuring and bankruptcy, and corporate governance. In addition, the International Finance Corporation has been providing support, together with the Bank, in drafting the new law on PPPs, which is another agreement under this operation.
- 1.28 **Strategic alignment.** The program is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008) and is strategically aligned with the development challenges of increasing productivity and innovation and promoting economic integration in the region. Specifically, it will contribute to the strategic objectives of establishing smart institutional frameworks to promote a healthy business climate, provide adequate knowledge and innovation ecosystems, and insert firms into value chains. Regarding the challenge of increasing productivity and innovation, the alignment is reflected in the program's following outcome indicators: (i) increase credit to the private sector as a percentage of GDP; (ii) facilitate the creation of companies by eliminating the minimum capital requirement; and (iii) improve the capacity of businesses to innovate. Regarding the challenge of promoting economic integration, the alignment is reflected in the outcome indicator of reducing the number of hours needed to comply with export formalities. In addition, the operation is consistent with the crosscutting theme of strengthening institutional capacity and the rule of law by introducing reforms to improve the reliability and security of financial transactions⁴⁸ and supporting the strengthening of institutions that foster productive development and innovation. By including commitments to provide incentives for businesses to join the formal sector, particularly MSMEs, the operation will contribute to the Corporate Results Framework 2016-2019 (document GN-2727-6) indicator that measures the percentage of formal jobs held by women.⁴⁹ The operation is aligned with the strategic objective of raising the productivity of MSMEs with growth potential and improving their market access, and with the social security reform dialogue area, established in the IDB Country Strategy with the Dominican Republic 2013-2016 (document GN-2748). The program is also aligned with the Innovation, Science, and Technology Sector Framework Document (document GN-2791-5) regarding appropriate financing of business innovation and improving the business and innovation climate. Moreover, the program is consistent with the Sector Strategy to Support Competitive Global and Regional Integration (document GN-2565-4) and with the Integration and Trade Sector Framework Document (document

⁴⁷ Specifically, the new Asset Evaluation Regulations, which form part of the agreements under this program, were created with IMF technical assistance.

⁴⁸ Particularly, enactment of the new Law on Money Laundering and Terrorism Financing.

⁴⁹ The program includes specific measures to foster formal employment by reducing avoidance and evasion in social security contributions, while fostering formal job creation by promoting business formalization (through measures to improve the business climate, the new CONFIE Fund, and strengthening of the Formalizate window). The percentage of formal employment of women is expected to increase as a result of this, since most MSMEs are women-led or -owned (see footnote 8).

GN-2715-6), particularly regarding trade facilitation and foreign investment promotion. The program is also aligned with the Labor Sector Framework Document (document GN-2741-7) with regard to improvements in social security policies. The program is included in the 2017 Operational Program Report (document GN-2884).

B. Objectives, components, and cost

- 1.29 **Objectives.** The objective of the program and the second operation is to boost productivity in the Dominican Republic by: (i) extending the scope of financial intermediation; (ii) improving the business climate and productive development and innovation policies; and (iii) improving social security policies and incentives for work in the formal sector. The program is comprised of a programmatic series consisting of two operations.
- 1.30 **Beneficiaries.** The program's reforms are crosscutting and are aimed at overcoming financial and regulatory restrictions that are hindering the proper functioning of input and output markets. Given this objective, and the broad nature of the reforms, the program is expected to benefit the country's businesses in general, and its most productive MSMEs in particular.⁵⁰ The Policy Matrix sets out the planned policy actions for executing the disbursement of resources of the second operation. The program includes the following components:
- 1.31 **Component I. Macroeconomic stability.** This component covers the policy objective of supporting and facilitating program implementation, through a stable macroeconomic environment that is consistent with program objectives.
- 1.32 **Component II. Strengthening financial regulation to boost productivity.** This component introduces reforms along three dimensions:
- a. **Regulatory strengthening for financial stability.** In the first operation, in order to guarantee financial stability, reduce uncertainty, and build the confidence needed to stimulate lending to businesses, measures were envisaged to further compliance with the Basel principles through the publication of regulations on integrated risk management, corporate governance, and liquidity risk for public consultation, as well as measures to broaden the regulatory perimeter through approval by the Monetary Board of the microlending policy regulations. The second operation will support: (i) the development of asset evaluation, market risk, interest rate risk, and capital adequacy regulations, which are to be an essential component of prudential regulation of the Dominican financial system; (ii) approval by the Monetary Board of new corporate governance regulations to make governance at financial institutions more solid and transparent; and (iii) presentation to the Monetary Board of a legislative bill on the Dominican credit union system, providing a new framework for the development of various types of credit unions in the country, including in the financial sector. The agreements planned

⁵⁰ Since MSMEs are those most affected by the financial constraints deriving from the lack of collateral or the use of dominant position in a particular sector, it may be expected that the effect is greater on this business segment, which bears the brunt of the constraints that the program aims to ease. Within this segment, MSMEs with growth plans restricted by regulatory constraints are particularly noteworthy.

for the second operation were fulfilled and reinforced, and a new commitment was included in relation to the new corporate governance regulations.⁵¹

- b. **Development of new institutions and instruments for financing productive development.** In the first operation, new mechanisms were introduced to promote long-term financing and financing alternatives to commercial banks. These included presentation of a law to convert the National Bank to Promote Housing and Production (BNV) into BANDEX, with a mandate to promote the country's productive development, following best practices on corporate governance and risk management; approval by the Monetary Board of banking subagent regulations as a mechanism for extending access to finance in regions with high intermediation costs; and presentation of a law to regulate PPPs in infrastructure financing, following international best practices. The second operation envisages: (i) the regulatory implementation of the BANDEX law, following best practices in terms of its corporate governance and risk management, so as to launch this new bank specializing in foreign trade finance and enable greater financing of the country's export activities; (ii) presentation to Congress of a draft securities market law as an instrument to promote the corporate debt market and expand the financing options for productive activities; (iii) development of a legislative draft bill on insurance to foster greater development of an insurance market still in its early stages; (iv) presentation to Congress of a legislative bill on PPPs in order to have a new, broader, and more complete framework allowing the private sector to participate along with the public sector in financing, operating, and maintaining infrastructure and public services deemed a priority for the country's development; (v) sending to the Executive Branch a legislative bill on factoring and negotiable invoices (Factoring Law) to promote the development of new instruments for productive development financing; and (vi) approval by the Ministry of Industry, Commerce, and MSMEs of the CONFIE Fund regulations to expand the financing of new productive enterprises in the country. The commitments envisaged for this operation were fulfilled and reinforced, and new commitments were included relating to the new PPP Law, the Factoring Law, and the regulations implementing the CONFIE Fund.
- c. **Improvements in the reliability and security of contracts and financial transactions.** In order to make financial transactions more secure and reduce the actual and expected costs of financial intermediation, the first operation included presentation to Congress of a draft Check Law; a legislative bill on bankruptcy that, in line with international best practices, establishes specific jurisdiction on the subject, introduces an integrated bankruptcy and restructuring process, and provides out-of-court dispute resolution mechanisms; and a reciprocal guarantees law facilitating the posting of pooled collateral for small and medium-sized enterprises (SMEs). The second operation envisages: (i) entry into force of the Law on Restructuring and Liquidation of Companies and Sole Proprietorships (Bankruptcy Law) and its implementing regulations, to provide greater legal certainty to both creditors and debtors in the context of business liquidation and restructuring processes;

⁵¹ For more details on the differences with respect to the commitments originally envisaged in the first operation for the second phase of the program, see the [Differences Matrix](#).

(ii) presentation to Congress of a legislative bill on personal-property collateral, to facilitate MSME access to financing; and (iii) enactment of the Law on Money Laundering and Terrorism Financing by the Executive Branch, to bring the legislation in line with international standards and strengthen the mechanisms for preventing and combatting these illicit activities. The policy goals envisaged for the second operation were reinforced and, as of early October 2017, the commitments had been substantially fulfilled.

1.33 **Component III. Improving the business and innovation climate for productive development.** This component introduces reforms along three fundamental dimensions:

- a. **Improving and simplifying administrative processes.** In order to simplify and modernize the operation of the public administration and so reduce the red tape businesses face, the first operation included approval of a law regulating administrative procedures, launching a formalization plan envisaging a pilot training program for formalization in coordination with chamber of commerce trade associations, and setting up a formalization portal to operate as a one-stop window for the services of the DGII, the National Industrial Property Office, and the TSS for registration purposes. The second operation envisages: (i) the simplification of processes in relation to obtaining construction permits, payment of taxes, cross-border trade, and the creation and registration of businesses, following up on the approval of the Law on Administrative Procedures, with a view to improving the business climate in the country; (ii) amending the Law on Corporations and Individual Limited Liability Corporations to eliminate or significantly reduce the minimum capital requirement for setting up a new business and promote the formalization of more enterprises; (iii) Congressional ratification of the World Trade Organization's Trade Facilitation Agreement to simplify, modernize, and harmonize export and import procedures and reduce the unnecessary bureaucratic delays and cumbersome red tape that burden Dominican businesses and exporters engaging in cross-border trade; and (iv) presentation to Congress of a draft Customs Law that enables full compliance with the ratified trade facilitation agreement, improving foreign trade procedures and making them more efficient. The agreements originally envisaged for the second operation were substantially fulfilled and, in addition, this policy goal was reinforced so as to include the latter two commitments as new agreements.
- b. **Strengthening competition.** In order to strengthen compliance with the Competition Defense Law, the first operation included the drafting of the law's implementing regulations and the preparation of operational guidelines for submitting complaints and investigating cases. The second operation envisages: (i) development of rules for competition promotion and defense in the country's main economic sectors;⁵² (ii) development of four studies on competition in strategic sectors, focusing on legal, regulatory, and/or market barriers that affect competition in key industries of the Dominican economy, so as to determine the state of competition and potential anticompetitive practices

⁵² Including the rules specifying the general, technical, and economic criteria for evaluating market competition and the implementing regulations of the Competition Defense Law (Law 42-08).

in significant sectors;⁵³ (iii) presentation to Congress of a legislative bill against illicit trade with a view to reducing unfair competition and market distortions caused by the introduction and sale of counterfeit products and contraband; and (iv) approval of regulatory provisions to strengthen competition, provide greater market transparency, and protect financial product and service users.⁵⁴ All agreements envisaged for the second operation were fulfilled, and the latter two were included as new agreements that reinforce the policy goal of strengthening competition in the Dominican Republic.

- c. **Improving policies and institutions for productive development and innovation.** The first operation included preparation and presentation to Congress of a legislative bill on business classification, standardizing the classification of SMEs used by the country's various institutions; strengthening the institutional framework of support to the SIDOCAL through the launch of the Dominican Quality Institute (INDOCAL), the entry into force and into operation of the Dominican Quality Board (CODOCA) as a public-private system to improve the quality of the country's businesses' and institutions' output, and the entry into force and into operation of the Accreditation Office (ODAC); and measures to promote technology transfer, through the plan to establish automated processes for the registration of intellectual property, and the creation of CATIs to build skills in the marketing of intangible assets and the management of intellectual property. The second operation envisages: (i) strengthening institutional mechanisms to promote public-private dialogue for productive development and competitiveness; (ii) evaluation of the implementation of SIDOCAL to determine the outcomes of the reforms carried out as part of the first operation's commitments⁵⁵ and identify the areas that require further work so as to continue to strengthen the Dominican quality system; (iii) implementation or operation of at least eight CATIs in the country and evaluation of the training provided by those centers, in order to determine the efficiency and effectiveness of the model employed to promote the use and marketing of innovations resulting from the research conducted in the universities and research centers; (iv) approval of a sector strategy for development of priority sectors, in order to strategically focus the policies and instruments supporting productive development on the sectors with greater potential for medium- and long-term growth; (v) implementation of at least 12 MSME support centers in the country to reinforce the supply of business

⁵³ The beer, pharmaceutical, insurance, bread commercialization, and passenger and freight transportation sectors.

⁵⁴ The regulations to protect financial product and service users were amended to establish the principles and criteria for effective protection of the rights of financial product and service users and update the current regulations in line with international principles and best practices, including: (i) better guidance on the functioning of the financial products and services offered by financial brokerage firms; (ii) the user's freedom of choice in purchasing a supplementary product or service provided by a third party that is essential for risk hedging by the financial or foreign-exchange brokerage firm, entailing the financial institution's obligation to present several options to the user in terms of providers; and (iii) greater public disclosure of information by the financial brokerage firms to ensure that the information is more accurate, complete, and timely.

⁵⁵ Notably including: the launching of INDOCAL; the entry into force and operation of CODOCA as a public-private system to improve the quality of the output of the country's businesses and institutions; and the entry into force and operation of ODAC.

training and development services for MSMEs; and (vi) creation of ProDominicana to offer professional support services to exporters and foreign investors. The commitments envisaged for the second phase were substantially fulfilled and/or reinforced as of early October 2017. In addition, the latter two were added as new commitments.

1.34 Component IV. Improving social security policies and incentives for formal work. This component introduces reforms along two fundamental dimensions:

a. Improvements in the incentives for formal employment and businesses.

In order to prepare a design for the social security system that improves the incentives for both employees and employers to participate in the formal system, the first operation supported the development of the Strategic Plan for Social Security Reform (PERSS) 2014-2018. The PERSS made it possible to develop a detailed framework of action plans for the various areas of social security reform and provided goals and indicators for developing the required rules, implementing the measures, and gauging the scope of the plan's measures. While the next step, i.e. regulatory development of the plan's measures in general, was planned for the second operation, that objective was fulfilled prior to this phase. It was accomplished through specific measures under the two programmatic loans of Support for Health Sector and Social Security Consolidation (loans 3382/OC-DR and 3585/OC-DR), approved in both cases after the first operation of the current programmatic series.⁵⁶ The above-mentioned programmatic series included not only regulations but specific actions in various key areas of social security reform. The PERSS, supported in the first phase, was essential for creating a roadmap for the reforms, and the steps of the reform continue to be monitored through that instrument. Since the specific measures related to the PERSS were fulfilled through the other programmatic series, that commitment was eliminated to avoid duplication. The second operation envisages the launching of Formalízate as a one-stop digital window for registering businesses in most of the country's provinces,⁵⁷ with a view to making it easier to set up new formal businesses and fostering a more favorable climate for new firms to emerge.

b. Improving the consolidation of administrative rules for workers to join the social security system. With a view to facilitating social security enrollment and making it easier to detect evasion and avoidance in the contributory system, the first operation implemented an agreement to consolidate the DGII and TSS tax and social security information systems. The second operation envisages the design of an ongoing monitoring strategy to reduce evasion and avoidance of social security contributions based on coordination between the tax and social security record information systems. This strategy includes creating a new Tax Intelligence Department at the TSS.

⁵⁶ The Policy Matrix for programmatic loans 3382/OC-DR and 3585/OC-DR supported measures such as an amendment to the draft Social Security Law (Law 87-01), an implementation protocol for the subsidized pension system, a development plan for the social security monitoring system, expansion of the information dissemination campaigns for beneficiaries, and a financial education plan.

⁵⁷ In 2014, the Formalízate window was present in only 11 of the country's 32 provinces, including the National District. In the framework of this operation, coverage is expected to be expanded to at least 19 provinces by year-end 2017.

C. Key results indicators

- 1.35 The key indicator for measuring achievement of the program's objective will be the contribution of total factor productivity (TFP) to GDP and GDP growth. TFP's contribution to GDP is expected to increase and GDP growth is expected to be faster than in scenarios without reform. The program's specific objectives will be measured using the following indicators: (i) bank credit to the private sector as a percentage of GDP; (ii) financial market development; (iii) legal rights; (iv) ease of cross-border trade; (v) ease of setting up a business; (vi) effectiveness of antitrust laws; (vii) capacity of businesses to innovate; (viii) percentage of new businesses that use the one-stop formalization window (Formalízate) to register; and (ix) the ratio of companies registered and paying contributions to the TSS to companies registered with the DGII (see [Results Matrix](#)).
- 1.36 **Economic analysis.** The economic analysis is based on the medium-term impact of the program's reforms on GDP growth based on a simulation of the projected effects of the reforms in the financial and business climate, productive development, and innovation areas. The simulation is based on the econometric work of Seistán, A. and Barro, L. (2011) and Dabla-Norris E. et al. (2013). A sensitivity analysis of the effects of the reforms has been conducted on various efficiency levels. Following Bank standards, the effects of the reforms are discounted at a rate of 12%, yielding a net present value for the program of US\$1.352 billion, well in excess of the loan amount. The result was robust to the sensitivity analysis (see [Economic Analysis](#)).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

- 2.1 This operation is structured as a programmatic loan based on the guidelines and directives of the New Lending Framework (document GN-2200-13). This operation is the second of two technically linked but independently financed consecutive loans, in line with Policy-based Loans: Guidelines for Preparation and Implementation. (document CS-3633-1). A programmatic series was selected in order to provide medium-term support to the productivity reforms program that the Dominican government has been advancing.
- 2.2 In accordance with paragraph 3.27(b) of the aforementioned guidelines (document CS-3633-1), since the country's gross financing needs in 2017 are expected to be equivalent to 4.6% of GDP (approximately US\$3.563 billion), this programmatic policy-based loan will provide US\$300 million in budgetary support to finance the fiscal deficit, also enabling the Dominican government to comply with its public debt strategy. The amount of this operation represents 17% of the estimated fiscal deficit, 52.7% of the budgetary support provided by multilateral agencies, and close to 8.4% of the public sector's gross financing needs for 2017.

B. Environmental and social risks

- 2.3 In accordance with Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (document GN-2208-20/Operational Policy OP-703), the operation does not require classification as it is a programmatic loan. Additionally, the policy changes in the framework of this operation will not have direct or significant effects on the environment or the country's natural resources.

C. Fiduciary risks

- 2.4 This operation does not pose any risk in terms of financial execution, since the technical conditions for disbursement will have been substantially fulfilled before it is presented to the Bank's Board of Executive Directors. The proposed financial instrument provides fungible resources that are not tied to specific expenditures. Therefore, there is considered to be no fiduciary risk, as the borrower (and recipient of the resources) has solid financial management country systems.

D. Other risks

- 2.5 The only risk considered medium is sustainability in implementing the reforms, due to a lack of resources and technical capacities or to legislative and political support. However, this risk is extensively mitigated by the fact that the reforms proposed under the program have been identified by country authorities within their reform priorities and government plan. Furthermore, during the process of preparing the operation, extensive consultations were conducted with interested private sector and civil society entities. In turn, the Bank's technical support has also been key for reform implementation and for mitigating this risk. In this regard, the following are worth noting: (i) support to regulatory strengthening reforms for financial stability; (ii) Support to Business Climate Reforms (ATN/CF-12160-RG and ATN/CJ-12159-RG); (iii) Institutional Strengthening of ProCompetencia (ATN/CF-12160-RG, ATN/CJ-12159-RG); (iv) Support for the Competitiveness and Productivity Initiative (ATN/OC-15814-DR); (v) Support for Trade and Integration Reforms (ATN/FI-14479-RG, ATN/MR-15348-RG); and (vi) technical assistance as part of the preparation of the two-loan programmatic series Support for Health Sector and Social Security Consolidation (3382/OC-DR and 3585/OC-DR).⁵⁸ Technical assistance will be used to make the technical and financial resources available to the institutions involved, and the project team will continue to provide support by closely monitoring the implementation of reforms under the program, helping to mitigate the risk of a lack of resources and capacities affecting the sustainability of the program's planned reforms.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

- 3.1 The executing agency will be the Ministry of Finance. Its Government Credit Directorate (DGCP) will coordinate the entities involved in execution and present the work plans and semiannual progress reports on fulfillment of the Policy Matrix. The DGCP will conduct periodic monitoring to assess the progress made by the entities responsible for fulfillment of the actions set forth in the program. The DGCP has mechanisms and staff with the capacities and experience to coordinate monitoring of the program's activities. The DGCP's planned collaboration with Bank specialists, and that of the various Bank specialists with the entities responsible through the technical cooperation activities mentioned above, ensure excellent coordination and monitoring of fulfillment of the matrix conditions.
- 3.2 **Special contractual conditions precedent to the single disbursement of the loan: The single disbursement of the loan is contingent on fulfillment, to the**

⁵⁸ For more details on the Bank's value added and support for the sector, see paragraphs 1.24 to 1.26.

Bank's satisfaction, of the policy reform conditions set forth in the Policy Matrix (Annex II), the [Policy Letter](#), and all other conditions provided in the relevant loan contract.

B. Summary of results monitoring arrangements

- 3.3 Program implementation and outcomes will be monitored by the DGCP. The borrower and the Bank will hold quarterly meetings to review fulfillment of the conditions required for the second programmatic policy-based loan. At program end, the Bank will prepare a project completion report and an ex post evaluation (see [Monitoring and Evaluation Plan](#)).

IV. POLICY LETTER

- 4.1 The proposed program Policy Matrix is aligned with the [Policy Letter](#) issued by the Dominican Republic, reaffirming the government's commitment to implementing the activities agreed upon with the Bank.

| Development Effectiveness Matrix | | |
|---|---|---|
| Summary | | |
| I. Corporate and Country Priorities | | |
| 1. IDB Development Objectives | Yes | |
| Development Challenges & Cross-cutting Themes | -Productivity and Innovation -Economic Integration -Institutional Capacity and the Rule of Law | |
| Country Development Results Indicators | -Formal employment of women (%) -Percent of GDP collected in taxes (%) -Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Beneficiaries of improved access to formal financial services (#)* -Public registries strengthened (#)* -Business environment reforms enacted (#)* | |
| 2. Country Development Objectives | Yes | |
| Country Strategy Results Matrix | GN-2748 | Boosting the productivity of MSMEs with growth potential and increasing their market access. |
| Country Program Results Matrix | GN-2884 | The intervention is included in the 2017 Operational Program. |
| Relevance of this project to country development challenges (If not aligned to country strategy or country program) | | |
| II. Development Outcomes - Evaluability | Evaluable | |
| 3. Evidence-based Assessment & Solution | 9.6 | |
| 3.1 Program Diagnosis | 3.0 | |
| 3.2 Proposed Interventions or Solutions | 3.6 | |
| 3.3 Results Matrix Quality | 3.0 | |
| 4. Ex ante Economic Analysis | 10.0 | |
| 4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis | 2.5 | |
| 4.2 Identified and Quantified Benefits | 2.0 | |
| 4.3 Identified and Quantified Costs | 2.0 | |
| 4.4 Reasonable Assumptions | 2.0 | |
| 4.5 Sensitivity Analysis | 1.5 | |
| 5. Monitoring and Evaluation | 5.5 | |
| 5.1 Monitoring Mechanisms | 1.5 | |
| 5.2 Evaluation Plan | 4.0 | |
| III. Risks & Mitigation Monitoring Matrix | | |
| Overall risks rate = magnitude of risks*likelihood | Low | |
| Identified risks have been rated for magnitude and likelihood | Yes | |
| Mitigation measures have been identified for major risks | Yes | |
| Mitigation measures have indicators for tracking their implementation | Yes | |
| Environmental & social risk classification | B.13 | |
| IV. IDB's Role - Additionality | | |
| The project relies on the use of country systems | | |
| Fiduciary (VPC/FMP Criteria) | Yes | Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit. |
| Non-Fiduciary | Yes | Strategic Planning National System, Monitoring and Evaluation National System. |
| The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions: | | |
| Gender Equality | | |
| Labor | Yes | The program aims at social security policy reform and providing incentives toward formalization (in a context in which 65% of salaried workers do not subscribe to social security and self-employment and informality are high). |
| Environment | | |
| Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project | Yes | The Bank has provided technical assistance through several operations for: (i) Supporting reforms for regulatory strengthening toward financial stability; (ii) Supporting reforms on the investment climate; (iii) Institutional strengthening of Pro-Competitiveness; (iv) Supporting the Competitiveness and Productivity Initiative; (v) Supporting reforms on commerce and integration; and (vi) Supporting and consolidating of the Health Sector and Social Security . |
| The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan | | |

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The Dominican economy is characterized by high informality and 98% of its companies are MSMEs which contribute 39% of the economy's GDP and 54% of its employment. Despite a positive trend in the country's economic growth, it is mainly rooted in the accumulation of capital and labor and not in productivity gains. This \$300 million project is the second (of two) operations of a multisector PBP aimed at increasing productivity in the Dominican Republic via: (i) improving the reach of financial intermediation; (ii) improving the investment climate and policies aimed at productive development and innovation; and (iii) improving social security policies and incentives toward formalization. The project documents detail evidence of the current situation and the gaps vis-à-vis other countries in all three of these spaces and allow for an understanding of the intervention's logic and its proposals.

The cost benefit analysis is adequate and provides estimates of the reform's benefits compared to its implementation costs. The benefit estimates stem from projections of the increase in value added at the country level generated because of the financial reforms (using elasticities product/financial reform estimated in recent IMF studies in the region) and innovation reforms (using estimates of the impact of such reforms on the investment climate and productive development conditional to distance from the frontier – approximated given GDP/capita). Costs estimation related to implementing the reforms is done from projections of an increase in budget for public expenditures of the agencies involved in these reforms. Both in the base case scenario and in the scenarios brought forth by the sensitivity analysis the program appears to be beneficial.

The proposed evaluation rests on a general equilibrium model developed for Brazil which will be adapted for the case of the Dominican Republic. This approach is adequate for this type of policy based project, although it will not allow for conclusions on attribution at closure.

POLICY MATRIX

| Policy objectives | Agreements Program I | Agreements Program II |
|--|--|---|
| Component I: Macroeconomic stability | | |
| a. Support and facilitate program implementation | Maintain a macroeconomic environment consistent with the program objectives and guidelines established in the sector policy letter | Maintain a macroeconomic environment consistent with the program objectives and guidelines established in the sector policy letter |
| Component II: Strengthening financial regulation to boost productivity | | |
| a. Regulatory strengthening for financial stability | <p>Stronger regulation and risk-based supervision through publication of the following regulations for public consultation:</p> <ul style="list-style-type: none"> • Comprehensive risk management • Corporate governance • Liquidity risk <p>Monetary Board approval of microlending policy regulations with the aim of improving microlending entities' credit risk assessments and governance</p> | <p>Development of risk-based supervision regulations for evaluating assets, market risk, interest rate risk, and capital adequacy ^(RR)</p> <p>Monetary Board approval of new corporate governance regulations ^(*) ^(RR)</p> <p>Presentation to the Monetary Board of the draft law on the Dominican credit union system ^(**) ^(RR)</p> |
| b. Development of new institutions and instruments for financing productive development | <p>Presentation to Congress of a law to convert the National Bank to Promote Housing and Production (BNV) into BANDEX, with a mandate to promote the country's productive development, following best practices on corporate governance and risk management;</p> <p>Approval by the Monetary Board of banking subagent regulations as a mechanism for extending access to finance in regions with high intermediation costs; and presentation of a law to regulate PPPs in infrastructure financing, following international best practices</p> <p>Presentation to Congress of a bill to regulate public-private collaboration in infrastructure financing, following international best practices</p> | <p>Development of regulations implementing BANDEX, following best practices ^(IR)</p> <p>Presentation to Congress of a legislative bill on the securities market ^(**) ^(RR)</p> <p>Development of a legislative draft bill on insurance ^(RR)</p> <p>Presentation to Congress of a legislative bill on PPPs ^(**) ^(RR)</p> <p>Sending of a legislative bill on factoring and negotiable invoices to the Executive Branch ^(*) ^(RR)</p> <p>Ministry of Industry, Commerce, and MSMEs approval of the regulations for the Financial Counterpart Fund for Entrepreneurship Development (CONFIE Fund) ^(*) ^(IR)</p> |

| Policy objectives | Agreements Program I | Agreements Program II |
|--|---|---|
| c. Improvements in the reliability and security of contracts and financial transactions | <p>Presentation to Congress of a legislative bill on the use of checks as a means of improving the transparency, reliability, and speed of financial transactions by improving the trustworthiness of checks as a means of payment</p> <p>Presentation to Congress of a legislative bill on bankruptcy reached in consultation with private agents, introducing business reorganization as an alternative in bankruptcy proceedings and judicial specialization on the subject</p> <p>Presentation to Congress of a legislative bill on reciprocal guarantees as a way to facilitate SMEs' access to finance</p> | <p>Enactment by the Executive Branch of the Law on Money Laundering and Terrorism Financing ^(**) (RR)</p> <p>Entry into force and regulatory implementation of the Law on Restructuring and Liquidation of Companies and Sole Proprietorships (Bankruptcy Law) ^(RR)</p> <p>Presentation to the Congress of a legislative bill on personal-property collateral ^(**) (RR)</p> |
| Component III: Improving the business and innovation climate for productive development | | |
| a. Improving and simplifying administrative processes | <p>Approval of the Law on Administrative Procedures, regulating the procedures of all government agencies in the country and that, following international best practices, incorporates:</p> <ul style="list-style-type: none"> • The principle of lightening the bureaucratic burden and limiting the time the authorities take to reply and complete procedures. • Objectivity, certainty, and simplicity in the actions of the public administration. <p>Launch of a formalization plan including:</p> <ul style="list-style-type: none"> • A pilot formalization program in coordination with chamber of commerce trade associations to promote training for formalization • Implementation of a formalization portal that acts as a one-stop window for the services of the Internal Revenue Office (DGII), the National Industrial Property Office (ONAPI), and the Social Security Treasury (TSS) for registration purposes. | <p>Following approval of the Law on Administrative Procedures, simplification of processes in the areas of:</p> <ul style="list-style-type: none"> • Obtaining construction permits • Paying taxes • Cross-border trade • Setting up and registering businesses ^(**) (IR) <p>Presentation to Congress of a draft amendment to the General Limited Companies Law to significantly reduce the minimum capital requirements to set up a new business ^(**) (RR)</p> <p>Ratification by Congress of the World Trade Organization's Trade Facilitation Agreement ^(*) (RR)</p> <p>Presentation to the Congress of a legislative bill on customs ^(*) (RR)</p> |
| b. Strengthening competition | <p>Strengthen compliance and development of the Competition Defense Law through its regulations, in line with best practices, including:</p> <ul style="list-style-type: none"> • Drafting the law's implementing regulations • Development of operational guidelines for filing complaints and investigating cases | <p>Development of competition promotion and defense rules in the country's main economic sectors ^(RR)</p> <p>Conducting of four legal and economic diagnostic studies on the legal, regulatory, and/or market barriers impacting the state of competition in the country's strategic sectors (IR)</p> |

| Policy objectives | Agreements Program I | Agreements Program II |
|--|---|---|
| | | <p>Presentation to Congress of a legislative bill against illicit trade (*) (RR)</p> <p>Approval of regulatory provisions to strengthen competition, provide greater market transparency, and protect financial product and service users (*) (IR)</p> |
| <p>c. Improvements in policies and institutions for productive development and innovation</p> | <p>Improvements in the organization of productive development policies through:</p> <ul style="list-style-type: none"> The preparation and presentation to the Congress of a legislative bill on business classification, in line with international standards, to harmonize the classification of SMEs used by the country's various institutions <p>Strengthening the institutional framework supporting the Dominican Quality System (SIDOCAL) by:</p> <ul style="list-style-type: none"> Launching the Dominican Quality Institute (INDOCAL) Bringing the Dominican Quality Board (CODOCA) into force and operation as a public-private system to improve the quality of the output of the country's businesses and institutions Bringing the Accreditation Office (ODAC) into force and operation <p>Measures to promote technology transfer through the commercialization of intangible assets and management of intellectual property:</p> <ul style="list-style-type: none"> Plan for the establishment of automated processes for the registration of intellectual property, and the proper evaluation of applications for intellectual property rights Creation of Technology and Innovation Support Centers (CATIs) for capacity-building in the commercialization of intangible assets and intellectual property management | <p>Strengthening of institutional mechanisms to promote public-private dialogue for productive development and competitiveness (**) (IR)</p> <p>Evaluation of SIDOCAL implementation completed (IR)</p> <p>Implementation or operation of at least eight CATIs in the country and evaluation of the training conducted through the CATIs (IR)</p> <p>Approval of a sector strategy for development of priority sectors (*) (IR)</p> <p>Implementation of at least 12 MSME support centers in the country (*) (IR)</p> <p>Creation of ProDominicana to provide professional support services to exporters and foreign investors (*) (IR)</p> |

| Policy objectives | Agreements Program I | Agreements Program II |
|--|---|---|
| Component IV. Improving social security policies and incentives for formal work | | |
| a. Improvements in the incentives for formal employment and businesses | <p>Formulation of the Strategic Plan for Social Security Reform by the National Social Security Council (CNSS), including:</p> <ul style="list-style-type: none"> • Alternatives for implementation of social security schemes that are financially sustainable and enable more workers to be included in the system • Timetable for implementation of the reforms, including the associated regulations • Delegation of responsibilities social security agencies are to fulfill • Plan for public input on the diagnostic assessment of the situation and reform options for the social security system | <p>Launching of Formalizate as a one-stop digital window for registering businesses in most of the country's provinces ^(***) (IR)</p> |
| b. Improvements in the consolidation of administrative rules for workers to join the social security system | <p>Implementation of the agreement for the consolidation by DGII and TSS of information systems holding tax and social security records so as to detect evasion of the contributory scheme</p> | <p>Design of a permanent monitoring strategy to reduce evasion and avoidance of social security contributions, based on coordination between the tax and social security record information systems ^(IR)</p> |

(*) New commitment (see [Differences Matrix](#)).

(**) Reinforced commitment (see [Differences Matrix](#)).

(***) New commitment to replace an originally envisaged commitment that was fulfilled through the programmatic series Support for Health Sector and Social Security Consolidation (loans 3382/OC-DR and 3585/OC-DR).

(RR) Regulatory reform.

(IR) Implementation reform.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-____/17

Dominican Republic. Loan ____/OC-DR to the Dominican Republic
Formalization and Productivity Improvement Program
in the Dominican Republic II

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Dominican Republic, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the Formalization and Productivity Improvement Program in the Dominican Republic II. Such financing will be for the amount of up to US\$300,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ____ 2017)