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James E. Mahon Jr.

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James E. Mahon Jr. presented this research before the Economic and Social Council (CES) of the Dominican Republic in June 2014.

This book is the result of the author's participation in GFDD/Funglode's Fellows Program from the summer of 2013 to the summer of 2014.

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The 2012 Dominican Tax Reform in Historical and Regional Context

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Foreword

The Global Foundation for Democracy and Development (GFDD) in the United States of America and the Fundación Global Democracia and Desarrollo (Funglode), headquartered in Santo Domingo, Dominican Republic, are dedicated to promoting research and awareness in areas crucial to the democratic, social and economic sustainable development of the Dominican Republic and the world. GFDD and Funglode organize meetings, educational programs and research as well as generate studies and publications that contribute to the development of new perspectives, enriching public policy debate and proposals, promoting the search for innovative solutions and transformative initiatives on a national and international level.

GFDD and Funglode are honored to present the publication series Research and Ideas, which offers the results of research projects, academic articles and intellectual speeches that address critical issues of the contemporary world from local, regional and global points of view.

On this occasion the series showcases the work titled *The Dominican Tax Reform of 2012 in Historical and Regional Context*, which presents an analysis of the challenges and scope of the 2012 tax reforms, placing them in an historical and geographical context while proposing options and developing opportunities for their future development.

These selected works present scrupulous analysis, introduce innovative ideas, and transmit inspiration. We hope they will contribute to a better understanding of the world, empowering readers to act in more informed, efficient, and harmonious ways.

Natasha Despotovic
Executive Director
GFDD

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Preface

Promoting economic, social and democratic development in the Dominican Republic is a critical part of the mission of GFDD and Funglode and the production and dissemination of research to influence public policy on both economic and social development continue to play an essential role in the implementation of this mission. This study, conducted by Dr. James Mahon, professor of political science and economics from Williams College in Williamstown, Massachusetts and GFDD Fellow, focuses on identifying the conditions and strategies that lead to an economically efficient and socially distributive tax policy in the Dominican Republic. In this report, Dr. Mahon discusses the tax reform that took place in the Caribbean nation in November 2012, highlighting the participation of Dominican civil society in its creation, as well as reflecting on the future role of civil society in the formation of a new fiscal pact.

Dr. Mahon began his research in Santo Domingo, Dominican Republic, in the summer of 2013, during which time he made many trips and met with important government officials, the press, members of civil society and the private sector until he finally presented his work to the *Consejo Nacional de la Empresa Privada* (National Council of Private Companies, CONEP) and the *Consejo Económico y Social* (Economic and Social Council, CES) in June 2014. In his report, Mahon states that tax reform, as was the case with Latin American tax reforms between 1975 and 1995 (and the Dominican Republic in 1983 and 2005), can be seen as part of a transition to a neoliberal model and that fiscal efforts in later years could be considered a revision of that model. In the Dominican Republic, Law No. 253-12 attempted to increase taxes with the goal of stabilizing the public debt and increasing spending on education and infrastructure. In its goals as well as its political circumstances, the Law resembled previous reforms in other places.

One of the main points in this research can be viewed in these terms: should reformers pay more attention to tax progressivity or should they continue attempting to maximize total revenue? Should they try to overcome the neoliberal model or, instead, should they try to perfect it? In detailing both sides of the debate, Mahon underscores how fiscal performance in the Dominican Republic illustrates the most important points of it.

Fellows such as James Mahon contribute to GFDD's growing body of research on issues of international interest that directly affect the Dominican Republic, the region and the world. . The Fellows Program provides opportunities to Masters and Doctoral candidates to undertake high-level research in the Dominican Republic on issues related to democracy and development. During their studies, researchers work in close coordination with GFDD and Funglode teams as well as with national academic advisors.

We hope that this report on tax reform will encourage debate on economic, democratic and social development, not only in the Dominican Republic but also in other Latin America countries.

Mandy Sciacchitano
Programs Manager
InteRDom, Fellows and GDAE

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James E. Mahon Jr.
GFDD/Funglode Fellow

The 2012 Dominican Tax Reform in Historical and Regional Context

James E. Mahon, Jr.

Introduction

In November 2012, publicly worried about a large fiscal deficit, the new government of President Danilo Medina passed a tax reform. The move was preceded by technical discussions with the International Monetary Fund (IMF), consultations with various social and economic interests, and the convocation, for just over two weeks, of the new Economic and Social Council. Many factors pointed to the success of a major reform. The President's party, the Dominican Liberation Party (Partido de la Liberación Dominicana, PLD), enjoyed an overwhelming majority in the Senate, and (along with its allies) a clear majority in the House of Representatives. The 2030 National Development Strategy, publicly discussed at length during the period 2010-11 and signed into law on the first day of 2012 by the previous government, also of the PLD, had set fiscal revenue levels above those recorded in 2011-12. However, despite the obvious need, the international support, the fresh mandate of the President, and the undisputed control of almost all the formal seats of power in the country, the reform was rightly called "half of a reform," or even "a missed opportunity." Why? Is another large reform possible in the coming years?

This paper attempts to answer these questions through an analysis of the political economy of the tax reforms, with reference to Dominican history as well as to the regional context. Finally, the paper focuses on the relationship between the executive and the interests of the private sector, and its possible mediation through the political parties and, as was done too hastily in October 2012, civil society forums such as the CES.

The first part outlines the major tax reforms that took place in the Dominican Republic between its democratic opening in 1978 and the 2012 efforts, along with the political and economic conditions in each case, with a special focus on the 1992 reform. Next, the document describes the rigidities that accumulated during that period, which were the legacy of crisis, international commitments, and the goals of the ambitious tax revenue goals of the National Development Strategy.

The second and longest section describes the regional debate on tax policy and redistribution, while showing how the DR is situated in this scenario, with statistics on the fiscal performance of the DR and other Caribbean and Central American countries. From there, with the ground prepared, the paper narrates the process of the 2012 reform and investigates the question posed above by comparing different episodes of fiscal reform. Finally, the paper discusses the challenges and possibilities for future reforms, from narrow technical ones to those that would involve a broad and reciprocal process, with a focus on the role that could be played by fiscal pacts.

The Models, the Crises, and the Reforms

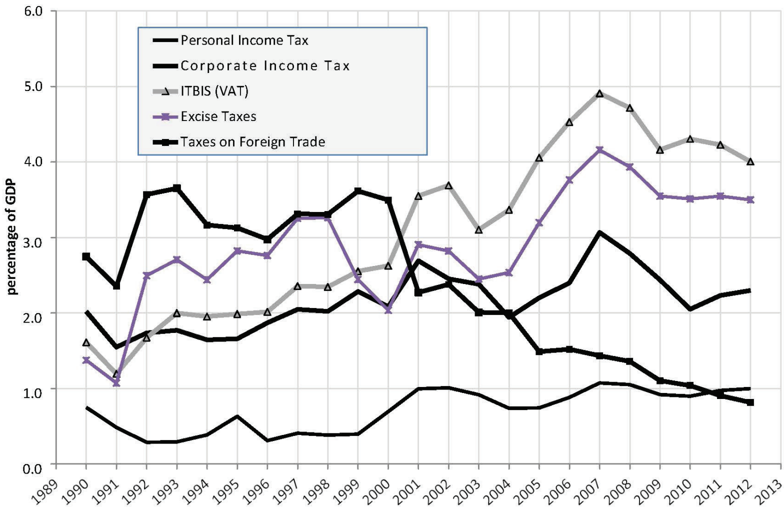
States are consolidated on the basis of regular sources of income, and they can be classified according to which sources are most important to them. The modern Dominican state was built gradually with taxes from international trade. Revenues from this source, increased along with the expansion of the sugar industry, which began in the final decades of the 19th century and made further progress after the American occupation (1916-1924). The Trujillo regime built on this foundation a system of non-tariff trade protection for manufactured goods, using special concessions and contracts to create a captive market in which the favored companies could thrive (Moya Pons 1992: 8; Andújar 2005: 13-19; Hartlyn 1998: 43, 49-50). At the fall of the dictatorship, the Trujillo family properties reverted to the State, and in the climate of political instability, both the protection policy and the ownership of industrial and commercial properties were put into question, which in turn encouraged the early organizing efforts of the private sector. During the first Balaguer administration, these interests were favored as the protection regime was formalized in 1969-70 (Andújar 2005: 20-21).

However, similar to other countries in the region, this model was exhausted within two decades. This was caused not only by its own limitations due to the small size of the country and the poor performance of the export sector, but also because of the international debt crisis that erupted dramatically in 1982. In the Dominican Republic, the resolution of this crisis was managed by adapting and mostly undoing the model of industrialization through import substitution.

From a historical and comparative perspective, these economic reforms mark a slow transition from the old model to a Dominican variant of neoliberalism. While some countries in the region abruptly changed their model amid deep crises, often under authoritarian or emergency regimes (Chile, Peru, Argentina), the DR went through a similar change but on an installment plan. This is not to deny the roles played, in the DR as well as in the other cases, by fiscal and currency crises, or by international actors. By the same token, with regard to tax policy, all the cases are similar insofar as they involved the same decline in the importance of taxes on international trade and a corresponding increase in indirect taxes, particularly the value added tax (VAT).

Table 1 lists the major tax reforms in the Dominican Republic since 1983. Within the multitude of minor changes and "band-aid reforms" during the period, these were selected either because they impacted the keystone of the new system the VAT (known in the DR as the Tax on the Transfer of Industrialized Goods and Services, Impuesto a la Transferencia de Bienes Industrializados y Servicios, ITBIS), or because they had significant effects on some other source of tax revenue, as can be seen in the graph depicted in Figure 1.

Figure 1
Dominican Republic: Taxes by Type and Revenue, Central Government



Sources: CIAT-IDB until 2011; 2012 -OECD/ECLAC

Table 1 yields interesting data. First, all reforms except one (1992) occurred during the first year or even the first months of a newly elected government. And in the case of Law 11 of 1992, other emergency fiscal measures had already been taken at the beginning (1990-91) of the constitutional term. Second, not all Presidents enjoyed a majority in both houses of Congress to pass their measures. Balaguer did not have the House of Representatives in 1992 and

Table 1.
Major Tax Reforms in the Dominican Republic, 1983-2012

Year and law	Major changes and taxes	Tariffs and other details	President and government ruling party	Senate	House of Representatives	External commitments	Comments
1983 74	Creation of the ITBI, 6 %	Tariffs are still high	Blanco, PRD	PRD 17 PLD 0 PR 10	PRD 62 PLD 7 PR 50	IMF Extended Funds Facility	Acute B of P and fiscal crisis; proposed a 50%
1992 11-92	ITBIS, up from 6 to 8%; differential on oil; simplification; elimination of incentives in three years	Drop in tariffs by decree 1991; agreement to rationalize 1993 had no real effect	Balaguer, PRSC	PRD 2 PLD 12 PRSC 16	PRD 33 PLD 44 PRSC 41	*Stand-by*, IMF	Acute crisis in B of P, fisc, inflation, and politics; Solidarity Pact in August 1990
2000 112-00 147-00	Excises on hydrocarbons, others; ITBIS from 8 to 12%; CIT (Income tax) advance payment 1.5% of gross income	Tariff reductions in Law 146-00	Mejía, PRD	PRD 24 PLD 4 PRSC 2	PRD 83 PLD 49 PRSC 17		"Social debt"; first step toward decreasing the importance of tariffs
2004 288-04	ITBIS from 12 to 16%	Emergency 1-04 and 2-04; bank bailout	Fernández, PLD en pacto con Mejía	PRD 29 PLD 2 PRSC 1	PRD 73 PLD 41 PRSC 36	*Stand-by*, IMF	Fiscal deficit because of bank crisis
2005 557-05	Hike in excises, capital income withholding	Compensates losses for DR-CAFTA	Fernández, PLD				Needed because of DR-CAFTA
2012 258-12	ITBIS from 16 to 18%, now includes additional products	Anticipates other DR-CAFTA losses	Medina, PLD	PRD 0 PLD 31 PRSC 1	PRD 75 PLD 105 PRSC 3		Fiscal deficit, electoral expenditure, future expenditure commitments

Leonel Fernández lacked both in the 2004-2005 period.[1] But in these cases there was another factor to convince the public and to push the lawmakers--a commitment to the IMF, agreed in conditions of scarce international credit.[2] In two instances (2000 and 2012), the President enjoyed full majorities in both Houses but without having signed an agreement with the IMF (although in the former, WTO rules were cited).[3] In addition, in these two cases, the incoming President spoke of the spending commitments he had made during his campaign, either to pay the "social debt" (Mejía) or to allocate to education what the Constitution promised (Medina).

In this context, the reform of May 1992 (Law 11-92) takes on great importance for having achieved the changes that many would consider most difficult politically. The measure raised the ITBIS rate from 6 to 8 percent. It removed a lot of specific-value excise taxes on consumption, replacing them with two ad valorem duties. It reduced the number of brackets in the personal income tax and lowered the top rate, while raising the basic exemption. And, it achieved what was perhaps the most difficult thing: it rationalized the corporation income tax by eliminating all exemptions over the next three years.

Through these changes and the new tax code, the reform created the basis for strengthening tax administration and marked a step toward state institutionalization. In the words of the World Bank, it was "an important achievement" (1992: 12-14).

What were the sources of this political success? The drama began in an atmosphere of crisis when the President summoned

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1 Santana attributes the impossibility of deepening the 1992 reform, following Leonel Fernández' during his first mandate (1996-2000), to the lack of congressional majority of his party during this period (2013: 130).

2 Consultations on the tax reform took place with the IMF during 2012, and representatives of that organization said that they preferred to visit the country after the reform was enacted. All this, however, was part of the regular meetings on Article IV and not a condition for the loan. The previous Stand-By Agreement had expired in March 2012 (*Listín Diario*, Oct. 4th, Nov. 2nd, 2012; IMF 2012).

3 Therefore, these reforms follow the majority of the list of the most important factors that predict this kind of tax reform, as suggested by this author (Mahon 2004): high inflation, a new government, an agreement with the IMF, and a majority in the legislature; in addition to a few lesser ones.

employers, unions, and other sectors of civil society to what was called the Economic Solidarity Pact. The President issued short-term stabilization measures, while the government continued negotiating with the IMF. With the Stand-By Agreement and loan in hand, the government submitted the structural reforms to Congress (Andújar 2005: 27-29; Tejera 1993: 57-60; Ceara 1996: 50-52; Hartlyn 1998: 2002-06). For some observers, the most important factor was the existence of divisions both within the business community (UNE in favor, CNHE against) and the unions. This allowed the government to impose its vision (Andújar 2005: 29). For others (Tejera, 1993: 61; Hartlyn 1998: 200-02), it was a Congress divided between the two opposition parties (PLD and PRD).

Of course, at the margin, division between the interests opposing change surely facilitated change. It is also true that the goodwill of social groups, and their conciliatory disposition (Núñez Collado 1997: 401), has to be acknowledged. It is also worth noting that the Economic Solidarity Pact demanded more (and much more specifically) from the government than from the other sectors.[4] But from a historical and comparative perspective, it appears that the depth of the crisis and the international environment should be given greatest importance. The crisis prompted a search for a solution, while inflation and recession contributed to the depreciation of the value of investments by domestic-market-oriented firms. This gave the initiative to an important group of businessmen who had long clamored for a fundamental change in the tax and tariff system (Dauhajre 1990: 53-54).

And, perhaps most importantly, a neoliberal solution was visible on the horizon: in early 1990, the government of Mexico completed its loan restructuring through the Brady Plan; Costa Rica and Uruguay were already in the middle of this process, and Venezuela was on the verge of joining them. The Dominican Republic would follow in 1993-94.

4 Of its 18 items, 12 required something concrete from the government -starting with a balanced budget and its financing without recurring to inorganic emissions of the central bank- along with five items for the business sector to comply with and one for the labor sector. Note that in the third item of the tax reform, the pact proposes to "minimize indirect taxes" (Núñez Collado 1997: 402).

After 2000, other factors raised the need for tax revenue. On one side, there was the debt incurred by the bailout of the banking sector and the large deficits of the electricity companies, which added up to an important quasi-fiscal deficit. On the other side, the DR-CAFTA treaty implied the loss of the option to tax many imports in emergencies, especially those from the United States. Together, these factors created more fiscal rigidity, which would constrain the evolution of the budget and the fiscal responses to the crisis of 2004. More recently, the 2030 National Development Strategy (Estrategia Nacional de Desarrollo, END) was approved, which called for raising the tax burden (then at 13.5%) up to 16 percent by 2015 and 19 percent in 2020, until it reaches 24 percent in 2030 (Montás 2013: 2; RD Congress 2012: 45), all to pay for the ambitious spending plan included in the document. In short, these factors introduced a fundamental bias towards the constant search for a higher level of tax revenue.

The Fiscal Performance of the DR in Comparative Perspective

Just as the Latin American tax reforms of the period from 1975 to 1995 (and the DR's for 1983-2005) could be portrayed as part of a transition to a neoliberal model, fiscal efforts in subsequent years should also be considered revisions of that model. In the DR, Law 253-12 tried to increase tax revenue in order to stabilize public debt and to increase spending on education and infrastructure. Both in its goals and in its political circumstances, the law looked like earlier reforms elsewhere. And as with the END itself, the law was influenced by technical and programmatic discussions among tax experts in the region.

The most important debate can be outlined in these terms: should reformers pay more attention to progressive tax policy or should they keep trying to maximize total revenue? In other words, should they try to overcome the neoliberal tax model, or instead, perfect it? In detailing the two sides of the debate, we can see how the fiscal performance of the DR illustrates its main points. We can also see how the tension between tax progressiveness and revenue maximization has moderated in recent years. The November 2012 reform also serves as an example of this new confluence of ideas.

More progressive taxation or more revenue? Background

Any discussion on taxes and recent experience with tax reform in Latin America has to acknowledge two facts. First, public commentary about neoliberalism and the "Washington Consensus" often do not reflect reality. Although supposedly committed to shrinking the government by virtue of adoption of market-friendly policies, Latin American countries, on average, increased their tax burden (as a percentage of the GDP) more than any other region of the world between 1990-1996 and 2004-2010 (Corbacho, Freites and Lora, 2013: 7). This was not a product of the new left-wing governments in the region after 1997. Colombia, which was never governed by the left in this period, has nearly doubled its tax collection over the last two decades (Salazar 2013a). Guatemala, under a President who was a former right-wing General, was finally able to increase its revenue in 2012 through a tax reform (Cabrera and Schneider 2013). In fact, the most clearly populist left-wing governments in the region -Venezuela, Ecuador, and Bolivia- have relied more on the expansion of revenues from natural resource than on taxing the consumption or income of their citizens.

The Dominican Republic is not an exception to this rule. Although government revenues fell sharply between 2007 and 2010, this was not due to an embrace of the minimal-government philosophy, which, for many, distinguishes the neoliberal model. In ideological terms, we observe the opposite. As already mentioned, the National Development Strategy includes ambitious targets for increasing tax revenue in terms of GDP, which emerged, it should be noted, from an agreement that included the most important representatives of the private sector.

The second regional pattern complicates the first. This is because the expansion of tax revenues has not been accompanied by a significant increase in progressivity of tax systems, despite the high levels of inequality in Latin America and the spread of democracy there (Mahon 2011). The main reforms of the last generation (from the late sixties to the mid-nineties) mainly attempted to make up for revenue lost due to the liberalization of trade and, in some cases, because of inflation, through the value added tax. By cutting the highest rates of income tax on individuals and rates on corporations, and in some cases reducing the number of tax exemptions, the reformers paid more attention to efficiency and "horizontal equity" than to "vertical equity." According to this approach, redistribution should be achieved on the expenditure side, by focusing social spending more intelligently on the poor (IDB 1998, 7). This view remained dominant for decades.

From a theoretical and comparative perspective, this result is difficult to understand. The most influential theory (among economists, at least) of tax politics, the median-voter model, says that democratic governments in very unequal societies tend to enact redistributive fiscal policies (Meltzer and Richard 1981; Profeta and Scabrosetti 2008).[5]

Latin America has, according to several sources, the most unequal distribution of income in the world. If the model is correct, the region

5 Although one could say that redistribution is now most important in Uruguay, in 2011 the PIT accounted for only 13 percent of total revenue there (Uruguay MEF 2012).

should not be lagging in the world with respect to redistributive efforts.

Perhaps because of this, in recent years there has been an important division in the practical assessments of Latin American fiscal policy. Should reforms continue emphasizing tax collection, or should they emphasize progressiveness on the tax side? Let us first consider the arguments for the latter.

The argument for progressivity

The argument in favor of a more progressive tax system is based primarily on the extraordinarily low contribution of personal income tax (PIT) to the Latin American public revenue. This contributes greatly to the weak redistributive performance of tax systems in the region. Compared to other regions, Latin American governments collected less than any other region in the world or group through the PIT. In addition, based on a sample of countries with more reliable data, between the 1970s and the period from 1995 to 2000, governments in Latin America decreased their revenue from this kind of tax, further distancing themselves from the rest of the world (Mahon 2011).[6] We can say that in terms of revenue or in absolute terms, Latin America's aversion to taxing personal income is dramatic, regionally consistent, and getting worse.

A second front in the battle for progressiveness begins from this observation: Latin American countries collect, on average, much less in property taxes than others. According to the IDB, income from urban and rural property averaged only 0.37 percent of the GDP in the 2000s, about half of the revenue collected by other developing countries, and only a sixth of the average of the OECD (Corbacho, Freites and Lora 2013: 89; also see Sepúlveda and Martínez Vázquez 2012).

With respect to consumption, income, and property taxes, recent Dominican Republic data show that before the 2012 reform, the DR

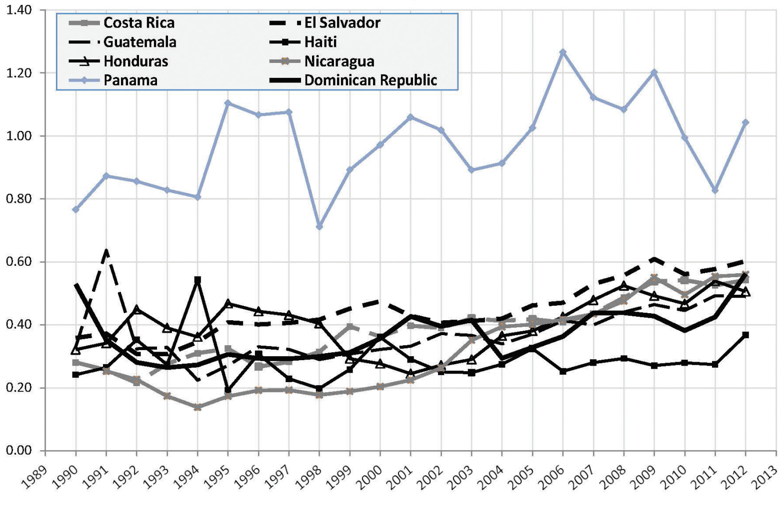
6 The comparison over time includes Colombia, Costa Rica, Dominican Republic, Peru, Uruguay, and Venezuela. It excludes Argentina and Brazil, for which the percentage of revenue from the PIT rose perhaps a bit over the years, but which also lacked data. Incidentally, relative regional proportions are similar when calculated on the basis of central or general government (Mahon 2011).

had a relationship with the region similar to the one the region had with the world. In other words, even in comparison with the other Latin American countries, the Dominican government has been quite dependent on taxes from consumption. Figure 2 shows the ratio of revenue from direct taxes and revenue from indirect taxes in eight countries, including the Dominican Republic. As we can observe, during the years 2009-2011, only Haiti had a ratio lower than the DR. (The rapid rise in the ratio in 2012 is due to extraordinary revenue from the sale of the national brewery plant; DR Ministry of Finance 2013: 8-9).[7] Meanwhile, in terms of property tax, we see that the Dominican Republic clearly lagged behind some 16 countries of Latin America, with only 0.03 percent of the GDP of revenue from this item during the 2000s. (Figure 3, a copy of Figure 2.1 De Cesare 2012: 9-11).

Figure 2

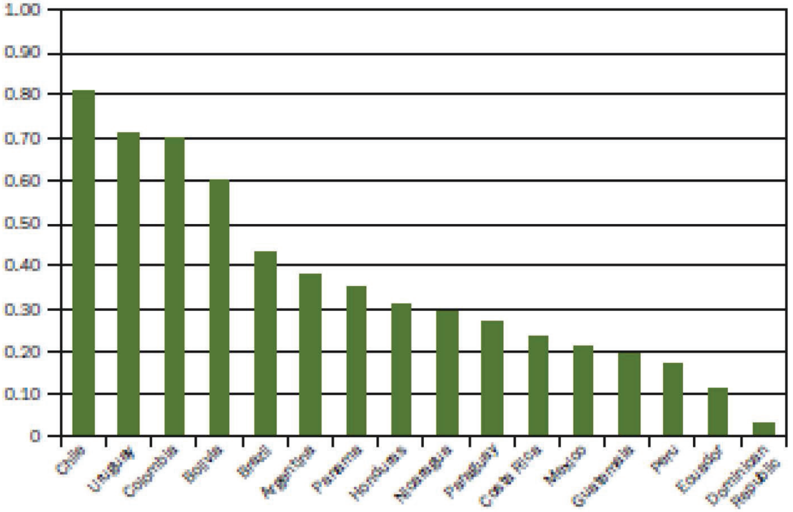
Direct/Indirect Tax Revenues, Central Government

(*Data calculated by CEPALSTAT*)



7 The ratio will be relatively high in 2013 due to revenue from Barrick Gold, and in 2014 thanks to the selling of other major companies. It is expected to go down again in 2015 (Montás 2014a).

Figure 3
Property Tax Revenue, as a Percentage of GDP



Why is all this important? Mainly because property taxes and individual income taxes are more likely to have progressive incidence than are consumption taxes. Table 2 summarizes recent empirical studies on the statutory incidence and the distribution effects of taxation in Latin America. Net effects are provided by Reynolds-Smolensky (RS) indexes, which calculate the differences between the Gini coefficients for household income before and after tax.[8] The results appear in alphabetical order by country, and for each country, with polls in sequence according to their date. If the calculations are based on tax laws following the survey, it is so noted. Taxes on individual income are abbreviated as "PIT" and the value-added tax as "VAT." If the surveys did not distinguish between payment for income taxes and contributions to social security, these are represented together by "IY." Where all consumption taxes (e.g., excise taxes, sales taxes, and VAT) have been clustered in a similar manner, the sum bears the initials "CT." For each country, estimates based on older surveys appear first, to give an approximate idea of their evolution over time.

8 By convention, this index has a positive value for progressive changes, in which the Gini coefficient drops, and a negative value for regressive changes. To use an example from the middle part of the Table: a 0.002 reduction in the (0-1) Gini for the VAT in Ecuador in 2003 appears as an increase in the RS index.

Table 2
Distributive Effects of Various Taxes, Latin America, Recent Studies

	Types of Taxes (VAT; CT = other consumption tax; IY = ISLR on income tax plus social contribution; PIT = personal income tax)			Studies by author and date (abbreviations explained below)
	Year	Consump-tion Taxes	Income Taxes	
ARG	1997	-.006	PIT +.004	Gomez Sabaini et al. 2002
	2001	CT .00	IY +.01	GLS
BOL	2003	IY +.01	-.011	Cossio Muñoz 2006 en BRV
BRA	1998	CT .00	IY .00	GLS; Dedecca 2010
	1999	VAT -.012	PIT .008	Immervoll et al. in CGSM
	2003	CT -.018	PIT +.013	Resende and Afonso 2010
CHI	1994	CT -.01	IY +.01	Engel, Galetovic and Raddatz 1999
	2003	VAT -.0177	PIT +.0207	Jorratt 2008
COL	2003	VAT -.004	PIT +.008	Zapata y Ariza 2006 en BRV
	2003	CT: -.01	IY +.01	GLS
CRA	2000	VAT -.002	PIT +.003	Bolaños 2002 en CVH
	2004	VAT -.0032	PIT +.0079	IICE 2011 in CGSM
ECU	2003	VAT +.002		Arteta 2005 en BRV
SAL	2000	VAT -.013	PIT +.001	Acevedo y González O. 2005 en CVH
	2006	VAT -.033	PIT +.0087	BBR
GUA	2000	VAT -.0077	PIT +.0011	BBR
	2004	VAT -.006	PIT +.002	Schenone and de la Torre 2005 in CVH
	2006		75% of PIT redistribution	WC
HON	2004	VAT -.012	PIT +.007	Gillingham, Newhouse and Yakovlev 2008 in CVH
MEX	2000	CT .00	IY +.01	GLS
NIC	1998	VAT -.029	PIT +.004	Gómez Sabaini 2005b en CVH
	2001	VAT -.0036	+.0058	BBR
PAN	2003	VAT -.001	PIT +.004	Rodríguez A. 2007 en CVH
PAR	2001	VAT -.005 (2004 law)	No PIT	Alarcón 2010
PER	2000	VAT -.012	+.0013	Haughton 2005 in BRV, CGSM
	2004	CT -.02	IY +.01	GLS

RDM	1989	VAT "progres-sive"		Jenkins Jenkins and Kuo 2006
	2004	VAT -.005	PIT +.0347	BBR
URU	2006	VAT -.010 (2007 law)	PIT +.012	Roca 2010
	2008	VAT -.002 (2007 law)	PIT +.014	Amarante et al. 2008 in CGSM
VEN	2003	VAT -.004		Garcia and Salvato 2006 in BRV

Abbreviations for multi-country studies

BBR Barreix, Bes and Roca 2009
BRV Barreix, Roca and Villela 2007
CVH Cubero and Vladkova Hollar 2010
CGSM Cornia, Gómez-Sabaini, Martorano 2011
GLS Goñi, López and Servén 2011
WC Wang and Caminada 2011

Table 2 shows that the estimated incidence of taxes on individual income (PIT) is more progressive than the incidence of consumption taxes. Income tax payments combined with social security payments, together, have no regressive effect, while general consumption taxes do. (Excise taxes on products of popular consumption, which are not noted here, are particularly bad in this regard, while excise taxes on cars or luxury items are usually progressive.) The VAT is slightly regressive in most cases, but in some cases (e.g., Guatemala and Panama) it comes closer to distributive neutrality. For the Dominican Republic (2004), the calculation yields a slight regressiveness when taxes on consumption and the PIT are combined, despite the progressiveness of the latter (Barreix, Bes, and Roca 2009).

The arguments for more (and more efficiently collected) revenue

The argument for giving priority to collection, rather than to redistribution, is based on four pillars: first, that in current fiscal systems, spending is much more important than revenue for this purpose; second, that this approach would be more politically feasible; third, the probability that alternatives to tax revenue (debt or inflation) are worse from the distributive point of view than any feasible taxation; and, lastly, the fact that current tax codes everywhere offer relatively easy targets for additional revenue collection.

Judging from a large sample of countries, the incidence of spending is much more important for redistribution and social welfare that is the incidence of taxation. This is seen, albeit at low levels, in most of Latin America. Table 3 summarizes recent empirical studies on the primary incidence and the resulting distributive effects of social spending and taxation in Latin America. As in the taxation table, the net effects are provided by the Reynolds-Smolensky (RS) indices, with differences between the Gini coefficients for household income pre-and post-expenditure (in one column) and pre-and post-tax (in the next column), with a positive value for progressive changes and a negative value for regressive changes. With few exceptions (Argentina in 2001, Guatemala in 2006), the RS indices for expenditures outweigh those for taxes, and for most, they do so in a very significant way.[9]

In this area, it seems that the Dominican Republic has a long way to go. Although there are no good recent estimates (cf. Santana and Rathe 1993) of the distributive impact of spending, Cubero and Hollar Vladkova (2010) conclude that spending on education is almost neutral (elementary education spending is progressive), spending on health is regressive (27-28), and the net effect of spending is almost negligible or slightly regressive.

In fact, countries outside the region are the ones that strongly show us the redistributive potential of well-targeted spending. According to OECD figures from the early 2000s, Sweden, Denmark and Finland had regressive tax systems, but once spending was

9 Several authors have discussed the poor targeting of public spending in Latin America (Zolt and Bird 2005:12, 48; Lora 2007:205; Heady 2004, 140-41; Goñi, López and Servén 2011). However, the table suggests an uneven but welcome trend. Five of the seven countries with multiple surveys on expenditure, are becoming more progressive. For the 13 countries with multiple surveys on the effects of taxes, 10 became more progressive. The latter agrees with Cornia, et al. (2011: Table 11 and pp 28-29.).

Table 3.
Distributive Effects of Spending and Taxation, Latin America, Recent Studies

	Data year = Survey year, or year of tax law, if different			Studies by author and date (abbreviations explained *below*)
	Year	Spending	Taxation	
ARG	2001	.00	+.01	GLS
	2004		-.009	Cont et al.2009 en CGSM
	2006	+.091	+.019	Gómez Sabaini y Rossignolo 2008 en CGSM
BOL	2003	+.046	-.011	Cossio Muñoz 2006 en BRV
BRA	1998	+.03	.00	GLS
	2003	+.015	-.005	Resende y Afonso 2010
	2006	+.070	+.014	WC
CHI	1994	+.01	.00	Engel, Galetovic y Raddatz 1999
	2003	+.045	+.0027	Jorratt 2008
COL	2003	+.050	.000	Zapata y Ariza 2006 en BRV
	2003	.00	.00	GLS
	2004	+.006	-.001	CGSM, WC
CRA	2000	+.060	.000	Bolaños 2002 en CVH
	2004	+.068	+.012	CGSM
ECU	2003		+.007	Arteta 2005 en BRV
SAL	2000	+.036	-.014	Acevedo y González O. 2005 en CVH
	2006		-.0075	BBR
GUA	2000		-.0077	BBR
	2004	+.031	.000	Schenone y de la Torre 2005 en CVH; Auguste y Artana 2005
	2006	+.002	+.012	CGSM, WC
HON	2000		-.028	Gomez Sabaini 2005a
	2004	+.032	-.011	Gillingham, Newhouse, y Yakovlev 2008 en CVH
MEX	2000	+.01	+.01	GLS
	2004	+.018	.000	WC
	2006	+.037	+.003	Álvarez 2009
NIC	1998	+.055	-.052	Gómez Sabaini 2005b en CVH
	2001		+.0017	BBR
PAN	2003	+.074	+.002	Rodríguez A. 2007 en CVH
PER	2000	+.035	-.008	Haughton 2005 en BRV
	2002	.00	-.01	GLS
	2004	+.005	.000	WC

RDM	1989		"progressive""	Santana y Rathe 1993 en CVH
	2004		-.002	BBR
URU	2004	+.114	+.010 (2006 law)	CGSM
	2006	+.079	+.002 (2007 law)	Roca 2010
	2006		+.012 (2007 law)	Amarante et al. 2007 en CGSM
VEN	1997		+.0076	Sejas et al. 2003 en CGSM

Abbreviations for multi-country studies

BBR Barreix, Bes and Roca 2009
BRV Barreix, Roca and Villela 2007
CVH Cubero and Vladkova Hollar 2010
CGSM Cornia, Gómez-Sabaini, Martorano 2011
GLS Goñi, López and Servén 2011
WC Wang and Caminada 2011

considered, the three were highly redistributive (Table 4), like the rest of Europe (cited in Barreix, Roca and Villela 2007, 55-60 and Tables 32 and 34; also see López and Perry 2008, 18).[10] For many, this means that even when redistributive objectives prevail, it would be advisable to strengthen and improve the current tax systems based on the VAT, in order to pursue more equitable public spending.

This, after all, is what some of the most successful welfare states have been doing for a long time.

The second, related argument for emphasizing efficient tax collection is that it would be more politically sustainable. Kato (2003) links the growth of welfare states to regressive taxes (see also Steinmo 1993). The idea here is that in countries such as Sweden and Denmark, conservative elites had enough power to block large increases in direct taxes on capital, leaving the Social Democratic governments the only option to expand funding for social assistance by means of taxes on consumption. In its political logic, this is what Timmons

10 Data from Wang and Caminada for these countries, from the Luxembourg Income Study, are less dramatic but similar (2011).

Table 4

Household Gini Coefficients by Country: Before Fiscal Policy; Post-Taxes; and Post-Taxes and Spending

A	B	C	D	E	F
Country (2001 surveys)	Gini before fiscal policy	Gini post-taxes	Percentage-point variation for taxes only [(B-C) x 100]]	Gini post-taxes and spending	Percentage-point variation, total [(B–E) x 100]
Germany	.3868	.3467	4.01	.3055	8.1
United Kingdom	.4705	.4610	0.95	.3434	12.7
Portugal	.4442	.4056	3.86	.3835	6.1
France	.3776	.3568	2.08	.3016	7.6
Denmark	.4373	.4580	-2.07	.3063	13.1
Finland	.4437	.4446	-0.09	.3233	12.0
Sweden	.4066	.4276	-2.1	.2940	11.3

Source: Barreix, Roca and Villela 2007, calculated from OECD data

calls a "fiscal contract," whereby governments provide policies and institutions in exchange for revenue, and therefore their spending mainly benefits those who provided the taxes (2005: 534-36 cf. Levi 1988).[11] To paraphrase his argument, while the median-voter models describe a world in which person A's taxes will benefit person B, the "fiscal contract" describes what the State has to give person A to get resources reliably from this same person A (2005). This implies that to fund welfare programs, regressive taxation is politically necessary.

This point of view also suggests that there are limits to levying taxes on the rich in Latin America. According to Breceda et al.:

11 A similar argument informs new work on tax compliance (Torgler et al. 2010: 145-53, 160-67).

> On the one hand, tax revenues in Latin America are substantially lower than in OECD countries or in the eu; on the other hand, the richest income quintile already contributes a much larger share of taxation than in the OECD and EU. The roots of this apparent incongruity lie largely in the high levels of income inequality throughout Latin America. Because Latin American countries have much higher income inequality than OECD and EU countries, to support similar levels of spending the richest income quintile must be taxed more heavily, at least in absolute terms... because the rich in Latin America contribute a substantial share of government revenue, raising their contribution even further may impose a strain on the social contract. The rich may resent contributing excessively to a welfare state that gives little back to them (2009: 734-35).

Because the rich already pay more under the current system, the authors predict that they would resent an increase in VAT rates, but even more would they resist progressive reforms that affected property and capital income.

The third pillar of the pro-revenue-maximization argument is that the common alternatives to additional revenue in Latin America, inflation and debt, would be worse than almost any tax in distributive terms. With regard to inflation, several studies have concluded that, especially in the developing countries, inflation hurts the poor more than the rich (see López and Perry 2008, 6-8). Easterly and Fischer (2001) find that the personal concerns of the poor that were surveyed regarding inflation correspond well with the econometric results, which show a negative relationship between inflation and various measures of income of the poor.[12] As for loans, if we consider the implication of the net distribution of the future interest payments financed by the tax burden of the future, the likely result is regressive. As for liabilities acquired at an international level, the distributional problem has historically been less polemical than the relationship between debtors and creditors, hit by boom and bust cycles. But lately more of the total of government debt in Latin America has become denominated in local currency and stays within the countries of origin (Cowan et al 2006). Therefore, the impact of the transfers from taxes to interest could begin to affect income distribution by this route.[13]

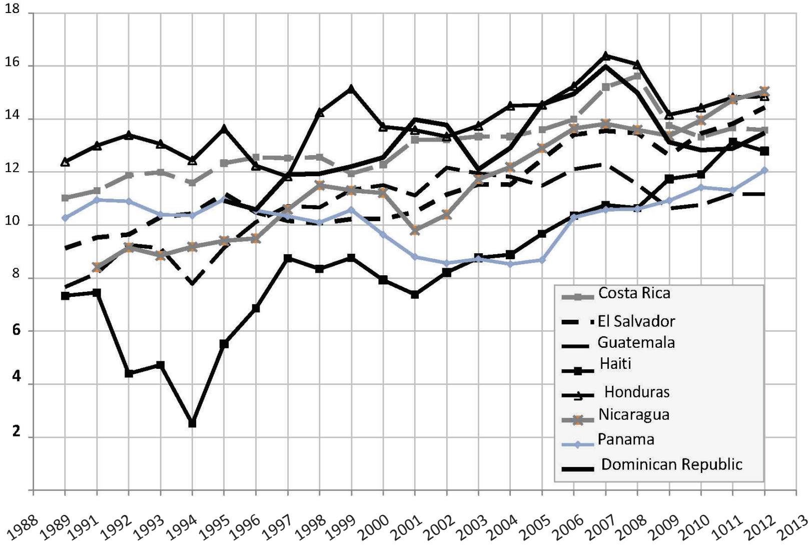
12 See Bulir (2001), who concludes that most of the benefits of disinflation come from reducing hyperinflation, with fewer benefits due to further reductions in the inflation rate.

13 See Lerner 1948 and Mankiw 2000: 123.

Finally, it is clear that in many countries there are still obvious ways to raise more revenue. For one thing, not all countries have shared the increases in tax revenues over the last 15 years. The Dominican Republic is an example of recently weak performance, as may be seen in Figure 4. The 2012 fiscal reform sought to increase revenues that had fallen after 2007, remaining at the low level of 13 percent until 2011. In 2011, according to this measure, the DR had fallen to a level below Haiti, and well below the Latin American average of 20.4 percent of GDP (Garcimartín and Díaz de Sarralde 2012). Based on these data, one cannot lay all the blame on trade liberalization. This lowered the gross receipts from trade sharply between 2000 and 2001 (figures also affected by the aftermath of the September 11 attacks) and then again in 2004-2005, on the eve of the DR-CAFTA treaty (Figure 1, above). But the sharp drops between 2007 and 2009 had several sources: non-recurring gross receipts in 2007; the non-indexation of the excise tax on hydrocarbons and the drop in their prices; some tax incentives that affected corporate income tax; and the international economic crisis (DR DGII 2011). For these reasons the primary balance fell into deficit in 2008 and remained there, despite a large cut in spending in 2009 and more cuts in 2010 and 2011 (CEPALSTAT 2013). The fiscal problems worsened in 2012. Gross receipts remained weak despite an extraordinary flow from the CIT, already mentioned (DR Ministry of Finance 2013: 8-9). On the spending side of the ledger, this was the year of a close election, and spending increased by 40 percent. Combined with weak tax collection, this led to an estimated deficit of 7 to 8 percent of the GDP.

Second, for reforms aiming at efficiency and "horizontal equity," there is no shortage of big targets. It is a universal law of politics that tax expenditures tend to multiply over time. Unfortunately, the Dominican Republic is at the forefront in this regard. By 2011, the Dominican tax code had become full of tax expenditures, especially in the ITBIS (VAT). While the regional average was just above 4 percent of the GDP, in 2010 these incentives amounted to an estimated 5.8 percent of GDP in the Dominican Republic. Even if we deduct what was being taxed through the excise on hydrocarbons, which represents a gap for the ITBIS of an estimated 0.51 percent of GDP, the figure is impressive (Garcimartín and Díaz de Sarralde 2012: 2, 40; Dominican Republic Ministry of Finance 2011). And, of course, since revenue is scarce, these shortcomings are compensated with increases in the rates on those still paying.

Figure 4
Tax Revenue, Central Government, % of GDP



Source: *CEPALSTAT*

A point of rebuttal from the progressives

Before turning to more contemporary issues, it is important to note a final argument made by advocates for progressive reforms, as a rebuttal to their counterparts: spending to benefit the poor has been difficult politically. For years it has been observed that despite the significant expansion of social spending in Latin America since 1990, this spending has been directed mainly to the non-poor (Goñi, López, and Servén 2008, 18-21). A detailed study of five countries concludes that "what prevents Argentina, Bolivia, and Brazil from achieving a similar reduction in poverty [when compared to European countries] is not a lack of revenue but the fact that they spend less on cash transfers -especially on those transfers that are progressive in absolute terms- as a proportion of GDP" (Lustig et al 2012: 1). And this leaves aside the large, unexpected financial bailouts that benefit the rich at the expense of the treasury, as in the case of BanInter and other banks in the Dominican Republic during the 2003-04 period, or the distribution of public funds to the families and friends of the political class. In short, spending effectively on the poor is almost as difficult, in practice, as taxing the rich.

Reconciliation between revenue-raising and progressivism

By 2012, the academic debate between these two goals had abated. True, the increase in tax revenues in the region during the period 2004-2010 originated mainly from the VAT, the CIT, and rents from natural resources, and much less from a new effort towards progressive taxation. But the 2006 reform in Uruguay showed that income taxes and progressivity could be part of the agenda. Meanwhile, despite the new conditional cash transfer programs and the non-contributory pensions, which represented great progress in orienting spending toward the poor, much of this spending was still poorly targeted or regressive. Reformers have now acknowledged the political obstacles to progressive spending. As a result, they no longer ignore the distributive issues on the tax side of the ledger, nor can they assume that well-directed spending will be implemented.

This confluence of opinions can be seen in the tax advice coming from international agencies (for example, see Pita 2008) and multilateral banks, such as we find in a major publication of the Inter-American Development Bank (Corbacho, Freites and Lora, 2013). For the IDB, the essential ingredients of the reform are a dual PIT system with low, proportional rates on capital income and with the highest rate on wages equal to the CIT rate;[14] the elimination of exemptions on capital income (of people) and special corporate rates; the elimination of exemptions and zero rates on the VAT, with a "personalized VAT" or other form of reimbursement system for consumption by poor households; a change in the financing of social security, from payroll taxes to VAT; the elimination of unconventional taxes such as those on financial transactions; and increased sub-national funding of sub-national governments, especially through property tax (*ibid.*).

As we can see, much of the agenda favors "clean" reforms of one tax or another, condemning the proliferation of special regimes in

14 See Bird and Zolt (2011) on this subject.

the tax code. This is to be expected from multilateral banks. Nor is it surprising to see the concern over informality and its effects on the fiscal sustainability of social security (also see Levy 2008), not to mention the tone of disapproval toward taxes on financial transactions. But this program also has a concern for equity, noticeable in its approach to taxing capital income and real estate. With the dual income tax, the proportionality of the tax on capital allows withholding at the source, while the fact that the rate is low helps avoid evasion. Equity is also the goal of compensating within the tax system for elimination of VAT exemptions on popular consumption items. This package, therefore, incorporates new progressive ideas with the typical priorities of the previous generation's reforms.

The 2012 Dominican reform was clearly a revenue-raising reform -this was its main public justification[15] - but, as we shall see, it also included some progressive elements from the IDB list. This is consistent with the National Development Strategy, which proposes moving the tax burden toward direct taxes, for the sake of greater redistribution and social justice.

15 With regard to redistribution, as in the reforms of the previous generation in Latin America, in the case of Law 253-12, its contribution to equity was justified in terms of the spending it would make possible in education, health, social security, public safety, agriculture, and assistance to small and medium businesses (Fernández, Speech 2012).

The November 2012 Reform

During the 2012 presidential campaign, which culminated in the election of May 16th, little was mentioned about a tax reform. Nor was it specifically mentioned by the President-elect in his swearing-in speech on August 16th. The issue entered the national discourse in connection with the emerging fiscal deficit of that year and the public spending commitments made by the President during the campaign. By August, it evident that there would not be enough time to arrive at a consensus on tax changes with civil society at a formal forum such as the Economic and Social Council (CES) (Rolando Reyes in Listín Diario, August 23rd, 2012). Besides, the government repeatedly postponed calling the CES from August 30th to September 17th and again to October 4th, claiming on one occasion the need first to reach an agreement with the IMF (*Listín Diario*, August 27th, August 29th, October 4th, 2012). Thus, the CES met to discuss the reform only between October 4th and October 21st. During these sessions, the prevailing opinion of the business related to shrinking the fiscal deficit and investigating its causes (*Listín Diario* October 9th, October 18th, 2012). The government did not want to discuss these issues. It emphasized its proposal to reduce public investment by the same amount it had been increased in the months prior to the election, without going into further negotiations on spending or its implementation (*ibid*. October 8th, 2012). It soon cut off discussions with the CES and submitted the draft bill to Congress, where it found wide acceptance among a majority comprising members of the ruling party and its allies, while negotiating several items one by one with selected business groups and unions. The bill became law 18 days later.

The reform included a package of measures, none of which was very broad, and some of which had been proposed earlier but had not been included in any previous reform. The main source of new projected revenue was the increase in the general VAT rate from 16 to 18 percent for two years (2013-2014), only to fall back again to 16 percent in 2015. During this period, several categories of popular consumer goods would lose their exemption or special treatment. Most food, for example, would have to carry a rate of 8 percent in 2013, and this would increase gradually to the general rate of 16 percent in 2016. Regarding corporate income tax, the law abolished and reduced a few special exemptions, while it scheduled a drop in the general rate starting in 2014 from 29 to 27 percent. As for the PIT, the law took some important steps towards a dual structure, with 10 percent retained from many types of capital income (Deloitte 2013; 2012 DR Senate). And, regarding real estate taxes (Tax on Real Estate Assets, IPI, Arts 13-14), a switch to valuation based on the individual owner, rather than property by property, was accompanied by an increase in the basic exemption (to RD$ 6,500,000; Garcimartín and Diaz de Sarralde 2012: 45-46; DR DCII 2013). The law, however, left much unchanged.

Judging by the results of its first year in terms of revenue, the law was not too far from being just another "fiscal band-aid." As projected, though by a smaller percentage, revenues from VAT went up, but the revenue from excise taxes fell with respect to the previous year. In addition, after a short time in force, the license plate tax (car registration tax) was suddenly postponed in response to a minor protest (c.p.). Had it not been for a tax amnesty provision and the revenue from expanded operations at Barrick Gold's mine,[16] 2013 could have ended with a tax revenue level of 13.44 percent of the GDP, very similar to the one in 2012 of 13.42 percent (Consultores para el Desarrollo 2014: 3). Projections for 2015 and thereafter place taxation at an equal or lesser level (Montás 2013: 12).

If with these estimates we extend the total tax curve as a percentage of the GDP that appears in Figure 4, the reform does not record any visible change. Perhaps it raised slightly the proportion of revenue withheld from the income tax of individuals, which appears in Figure 1. If only because of the changes in the ITBIS, the reform could be described as fairly significant, which is the reason why it appears along with the rest in Table 1. But perhaps the problem is deeper, affecting the relationship between the two parts of the ratio of tax pressure and GDP. That is, due to exemptions and informality, it may be possible for the Dominican economy to grow faster in the parts that are not taxed than in the parts that are. This could reduce the elasticity (or more precisely, the buoyancy) of the tax system to the point where economic growth itself would bring a fall in the tax revenue/ GDP ratio.

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16 Through a contract with Barrick, the government delayed the bulk of the company's initial loss-related tax deductions until 2016, thereby increasing tax collections now and leaving the bill for the next President.

Why These Changes?

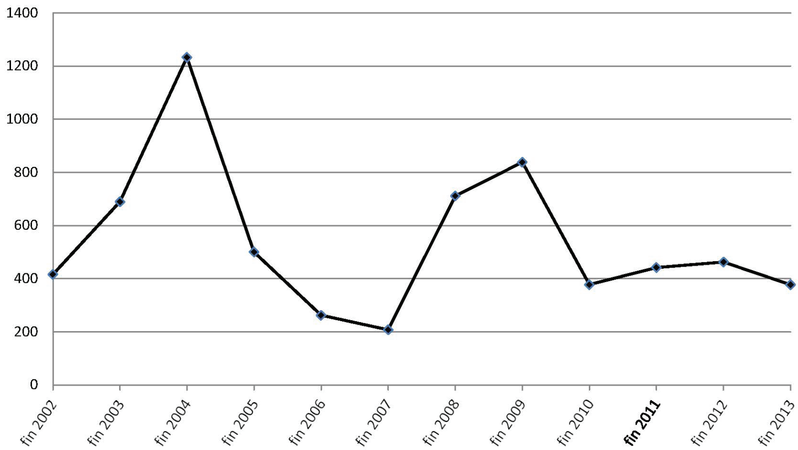
A comparative approach provides grounds for another question. In the regional context, we can say that the political conditions for reform in the Dominican Republic were extraordinarily favorable. We can see this by comparison to the nearly contemporary conditions in Guatemala. In both countries, governments proposed and approved reforms shortly after taking office, amid an ongoing security crisis (Guatemala) and a lasting revenue deficit (both). Neither was a left-wing government. But unlike Guatemala, the executive power in the Dominican Republic did not have to improvise a legislative coalition against weak parties. Unlike other past tax reforms in the Dominican Republic, there was no need for haggling with a Congress dominated by the opposition. The PLD already enjoyed a clear majority in the House of Representatives and all but one seat in the Senate.

It is worth going back to the original question: Why was the reform relatively timid? It is true that both the inclusion of many items of mass consumption in the VAT and the new tax on capital income had a political cost. But on the CIT side, the reform did relatively little. Several changes were also accepted in the implementation of the reform, which ended up diluting it.

To explain this relative weakness, we might point to four sets of factors. The first comprises more **circumstantial** reasons. Some of these were implied above: in 2012 there was no real fiscal crisis (the government could still sell bonds easily in domestic and international markets) and it had signed no reform commitments with the IMF or in a trade agreement. This set of factors is not about possible barriers to a more thorough reform, but rather about the missing sources of political will (although we could also think of crises as moments that weaken the interests opposed to change). Next, economic factors would include the **economic** interests favored by the current tax system, and opposed to the reform, which also have an influence over congress members through the funding of their campaigns. The third type of factor includes those of a **political** and **institutional** nature, such as the lack of confidence of many taxpayers in the government's spending capacity, the lack of time between the ascension of the new government and the deadline to finalize the budget for the coming year. The balance of power in Congress should also be noted here. With respect to the balance between the parties, in 2012 this presented no obstacles to reform, but here we might instead look at factions within the PLD. This becomes more important to the extent that one faction or another is linked to different economic interests. The fourth answer blames the timidity of the reform on the **personal** characteristics of the President, citing what some would describe as an excessive concern for social discontent and his approval rating, although this could also be linked to a relatively weak position within the ruling party.

Now, from this point of view the circumstantial explanations seem more persuasive. We cannot explain an infrequent outcome−deep tax reform−with a nearly constant condition--the lack of unity within a Dominican political party. The same goes for Presidents preoccupied with their approval ratings. But what is different between the cases of the deeper 1992 reform and the most recent one, is the presence in the first of a financial spur, visible in the government's inability to borrow, along with the economic crisis that weakened existing interests.

Figure 5
Differential with U.S. Treasury Bonds, Dominican Republic (basis points)



Source: World Bank

To verify the relative lack of financial crisis in 2012, Figure 5 shows the "spread" or differential between Dominican government bonds and their U.S. counterparts. Note that the conditions became difficult in 2003-04 with the Dominican banking crisis, and again in 2008-09 with the financial crisis in the rich countries, but that they had become quite normal by the end of 2011. The differential barely rose during 2012, despite the supposed severity of the fiscal deficit of that year, and it went on to drop significantly in 2013. Its level of 377 by the end of 2013 placed it well below Argentina (1067), Venezuela (927), Ecuador (637) and Jamaica (653), but above lower-risk countries such as Brazil (209), Mexico (189), and Peru (159) (World Bank 2014). Interest rates on debt in Dominican pesos (RD$) showed equal signs of normalcy (DR Min of Finance 2014). In other words, in late 2012 the credit market was not sending signals to the government that it was time to tax more and spend less.

Is It Time for a Fiscal Pact? The Role of the Economic and Social Council

There is much talk these days about fiscal pacts. For about two decades, ECLAC economists have described their advantages, and others have joined them recently (a good summary is the ECLAC 2006, also see Lerda 2008 and Lora 2008). However, we should understand that the term can be used in two senses. The first is the implicit fiscal pact, the constant level of taxation that can be observed in any country. Tax experts have long recognized a phenomenon called "fiscal inertia" (Bird 2012: 8). This is seen in the large differences in the levels of tax revenue (as a percentage of the GDP) between countries of the same region and similar development levels, such as Mexico and Brazil (Ondetti 2013). It also includes the possibility that a country could have a suboptimal level of both income and expenditures. It is reasonable to ascribe these differences to politics, but observed inertia suggests that there is no simple explanation for why there is a given tax burden that a given society can endure.

The second sense of "fiscal pact" refers to an explicit process of entering into agreements, by important social and economic actors in a country, to raise the tax burden. That is, it is an attempt to break fiscal inertia in order to arrive at a higher income-expenditure equilibrium. Thus, its main purpose is to legitimize the increase in tax revenue. Social forces coordinate on the task of guiding and monitoring public spending, and in return, consensus is reached regarding the obligation and convenience of collecting tax revenues to pay for it. In several cases the idea has been put into practice. In Guatemala, for example, a fiscal pact planned in the framework of the Peace Accords was negotiated in the year 2000, but it then failed because of the opposition from big businesses and interests in Congress (Fuentes and Cabrera 2006).

There is much talk about fiscal pacts in the Dominican Republic. In fact, a fiscal pact is one of three pacts that have to be negotiated in accordance with the National Development Strategy (Estrategia Nacional de Desarrollo, END). But at the same time, the END itself is a fiscal pact in the explicit sense. And as in the second sense of the word "pact" mentioned above, the END argues for a constant rise in the tax burden, until it reaches 24 percent of the GDP in 2030, along with dismantling tax exemptions and improving the quality of public spending. Yet the November 2012 reform was not agreed on at the CES—which government representatives fled--but in a friendly Congress.[17]

Nevertheless, and mainly because of the bad reputation of Dominican public administration with regard to spending (Table 5), these calls to agree to a pact have not ceased. However, they differ in tone and goals from the proposals of the END. For example, in late January 2014, the National Council of the Private Enterprise (Consejo Nacional de la Empresa Privada, CONEP) repeated its call for the government to subscribe a fiscal pact within the CES, to raise the quality of public spending- and to not fall into the temptation of raising taxes through Congress.[18]

Several things can be observed about the decision to establish a pact in this manner. First, in the theoretical terms mentioned earlier, fiscal pacts imply that taxation is better done in a spirit of reciprocity, as the "fiscal contract" model describes. In other words, you show me that you are spending well, so as to benefit me, and then I will pay you more. Second, these pacts are generally described in ways that suggest that the legislature is not the best place to negotiate them. It is not sufficiently "representative" of the key stakeholders. Thus, in several countries, councils made of representatives from civil society are taking an active role. In the Dominican Republic this forum is the CES.

Hence the question: if Congress is not the appropriate forum to legitimize taxes and to create mechanisms to supervise spending, why not? What is going on? The second point above suggests an answer: perhaps because the key players in this pact are not there, because they are not members of Congress. In the event of an increase in income taxes, it is the employees of the formal sector, whose taxes are withheld, as well as large individual and corporate taxpayers. In the

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17 To immediately respond to fiscal deficit, the executive branch closed the spending tap, suddenly and drastically lowering public investment.

18 "CONEP insists on the importance of addressing the Fiscal Pact for Development" *Diario Libre*, January 29th, 2014, p. 7.

Table 5
The bad reputation of Dominican public administration with regard to spending

World Economic Forum, 2012

Dominican Republic

The Global Competitiveness Index in detail

	INDICATOR	VALUE	RANK/144
	1st pillar: Institutions		
1.01	Property rights	3.9	89
1.02	Intellectual property protection	2.7	119
1.03	Diversion of public funds	1.8	142
1.04	Public trust in politicians	1.6	138
1.05	Irregular payments and bribes	3.3	106
1.06	Judicial independence	2.6	120
1.07	Favoritism in decisions of government officials	1.8	144
1.08	Wastefulness of government spending	1.8	144
1.09	Burden of government regulation	3.2	83
1.10	Efficiency of legal framework in settling disputes	3.3	95
1.11	Efficiency of legal framework in challenging regs.	2.9	119
1.12	Transparency of government policymaking	4.3	69
1.13	Gov't services for improved business performance	3.2	99
1.14	Business costs of terrorism	5.5	73
1.15	Business costs of crime and violence	3.4	127
1.16	Organized crime	4.3	110
1.17	Reliability of police services	2.0	143
1.18	Ethical behavior of firms	3.5	111
1.19	Strength of auditing and reporting standards	4.5	73
1.20	Efficacy of corporate boards	4.2	98
1.21	Protection of minority shareholders' interests	4.3	63
1.22	Strength of investor protection, 0–10 (best)*	5.7	52
	2nd pillar: Infrastructure		
2.01	Quality of overall infrastructure	3.7	96
2.02	Quality of roads	4.2	62
2.03	Quality of railroad infrastructure	2.7	62
2.04	Quality of port infrastructure	4.7	51
2.05	Quality of air transport infrastructure	5.4	**41**
2.06	Available airline seat kms/week, millions*	332.1	**50**
2.07	Quality of electricity supply	2.1	130
2.08	Mobile telephone subscriptions/100 pop.*	87.2	99

	INDICATOR	VALUE	RANK/144
	6th pillar: Goods market efficiency		
6.01	Intensity of local competition	5.0	56
6.02	Extent of market dominance	2.7	139
6.03	Effectiveness of anti-monopoly policy	3.4	123
6.04	Extent and effect of taxation	2.7	131
6.05	Total tax rate, % profits*	41.7	83
6.06	No. procedures to start a business*	7	74
6.07	No. days to start a business*	19	80
6.08	Agricultural policy costs	3.6	93
6.09	Prevalence of trade barriers	3.7	119
6.10	Trade tariffs, % duty*	7.3	88
6.11	Prevalence of foreign ownership	5.0	54
6.12	Business impact of rules on FDI	4.8	59
6.13	Burden of customs procedures	4.3	61
6.14	Imports as a percentage of GDP*	34.8	100
6.15	Degree of customer orientation	4.4	95
6.16	Buyer sophistication	3.1	98
	7th pillar: Labor market efficiency		
7.01	Cooperation in labor-employer relations	4.7	**43**
7.02	Flexibility of wage determination	5.3	53
7.03	Hiring and firing practices	4.0	68
7.04	Redundancy costs, weeks of salary*	26	113
7.05	Pay and productivity	3.3	117
7.06	Reliance on professional management	3.4	129
7.07	Brain drain	3.6	59
7.08	Women in labor force, ratio to men*	0.66	103
	8th pillar: Financial market development		
8.01	Availability of financial services	5.0	**48**
8.02	Affordability of financial services	4.2	65
8.03	Financing through local equity market	2.7	113
8.04	Ease of access to loans	2.5	90

event of a hike in taxes on consumption, it is the representatives of the great consuming public. It is to them, after all, that the taxation needs to be legitimized. It is they, therefore, who now have a greater direct interest in monitoring public spending.

And this illustrates well the constitutional mismatch. Although Congress retains the constitutional power to raise taxes, today in the Dominican Republic, as in many countries, the legislature represents both the beneficiaries of spending and the contributors of revenue. Many would argue that it represents the former group better.

For the government, the main questions about a fiscal pact will be why it should agree to one, and what it should agree to. With regard to the first, the government could rightly take a steady rise in the tax burden, set by the END, as a starting point for negotiation. After all, this is what society, including the representatives of the businessmen, agreed to. But CONEP has a different position. Does it want to leave the END, or is this its initial negotiating position? If so, in the absence of financial difficulties the government would have no incentive to come to the table to negotiate a pact that would tie its hands and leave it without resources for patronage. Therefore the "why" depends on the "about what" to negotiate, with different forms of bargaining according to the degree of agreement among the parties with the fiscal and monitoring targets of the END.

Hence the question: what would be appropriate fiscal measures for the government to seek to negotiate? For starters, there are several administrative measures that would not require turning to the CES or Congress. Opportunities for tax evasion would be reduced by unifying the computer and monitoring systems between the General Directorate of Internal Taxes (Directorio General de Impuestos Internos, DGII) and the Customs.

Required advance payments on the VAT could be eliminated for Small and Medium Enterprises (SMEs). Changing the rule for calculating the interest rate for late payments would allow them to be adjusted to current market conditions. It would also be possible to create cheaper alternatives, for SMEs, to the controversial tax printers, such as paper pads with invoice forms and carbon copies, coupled with auditing efforts among micro-businesses, as happens in Colombia (Arias, c.p.).

A second type of measure includes those that would require legislative action, but not a fiscal pact, because they are merely institutional adjustments. The most important here would be the merger of the DCII and the DGA (customs) in a single agency. This would make computer consolidation more effective, and it would be equivalent to the tax administration structure in other countries that have changed their most important revenue source from the customs to the value-added tax. In the DR, about half of VAT revenue arrives through customs; thus, it would be much better to have an administrative and managerial integration of these revenue authorities. A similar thing could be said about the effort, already underway, to finish the national real estate survey, which will adjust the valuation of real estate subject to IPI (real estate tax). Of course, it is very likely that these two measures would significantly add to the tax burden in statistical terms, by narrowing the opportunities for tax evasion. But they do not affect either the rates or the bases. It would be difficult to force the government to negotiate them. Is good law enforcement, supported by increased economic information, something that needs to be bargained for? Who would publicly defend poor oppressed tax evaders?

The third type of policies includes those that should be bargained in good faith, due to their innovative impact on the legal framework for taxpayers, even though they would not increase the tax burden. Several of these would be fair counterparts to more transparent and efficient public spending. For example, in exchange for government transparency and greater guarantees when companies are intervened, the government could ask for a similar transparency with regard to shareholding by eliminating bearer shares and requiring companies to disclose the names of their shareholders and the dividend earnings they have received. The same could apply to banks with regard to fiscal accounts. One could also argue that, in exchange for a more educational role from tax inspectors, firms could pay for training courses for personnel responsible for tax compliance. Finally, it could be advisable to provide tax authorities with sufficient powers to punish tax evasion through the seizure of property.

The fourth kind of changes involves tax expenditures. In this area the END already promises an in-depth reform, and the Economic and Social Council may be the right forum in which to achieve it. It has two aspects. One appeals to "horizontal equity," claiming that the benefits of some come at the expense of the rest.[19] The other calls for the elimination of distortions by which many companies and groups channel tax evasion, placing their profits where they will be less taxed, and even opening another branch of the company in a sector whose profits are exempt. If fiscal consolidation is put in place first, as a standard among large economic groups, this would reduce the incentive to protect the exemptions that facilitate these moves. Of course, this argument would be stronger if the tax authority were to undertake a cost-benefit analysis of each exemption, as already prescribed in the END, along with specific estimates of the unavoidable trade-offs between the overall level of rates and the amount of the exemptions. As this implies, this process does not have to lead to a rise in the tax burden.

So is it still worth it to follow the National Development Strategy? Yes, although its tax goals are too ambitious. The fiscal pact within the END can be conceived as a way to move the country to an income-expenditure equilibrium that better suits its needs. This does not only mean a higher level of taxes, but also a State that becomes more efficient and capable of effectively administering the resources entrusted to it. This reciprocity, the trade-off between taxes, on one side, and on the other, institutionalization and greater transparency, is the spirit of the fiscal pact.

Hence we should add a fifth kind of policies at this point: those that seek to preserve the circumstances that make pacts possible. One of these is most fundamental. All revenues from non-renewable natural resources should be allocated to a capital fund,

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19 If exemptions cannot be abolished, perhaps because of arguments based on legal security and "acquired rights," a possible useful fallback position would be to determine an overall limit of their value per taxpayer. This was proposed by the Blanco administration (at 50 percent of the value of the exemptions) in 1983. This later was decreed by President Balaguer in 1987 (after his party had opposed the measure four years earlier; Tejera 1993: 76). This was similar to the original proposal of the IMAN in Colombia in 2012, but in its final form that tax was not extended to capital income, the self-employed or to taxes on corporations (Salazar 2013a, 2013B). These limits reduce the value of all tax expenditures without directly confronting their advocates.

to invest countercyclically in good public projects. An expansion of the Barrick Gold mine, the Falconbridge operations, or other projects could subvert the trade-off that lies at the heart of the pact. Experience teaches us that revenue bonanzas from natural resources allow citizens to ignore their responsibility of vigilance while the State loses its coherence, leading to Venezuelan-style extravagance.

At the end of the day, reaching a fiscal pact in the spirit of the END is a matter of prudence. First, the DR's country risk in the markets is still higher than it should be, by about 150 basis points. Reducing this premium would be a desirable goal--and an effective one, given the short average maturity of government debt. Second, thinking about economic uncertainty, concluding a pact now would serve as insurance on the country's economy, and on democracy, from setbacks that might come suddenly from nature or the global economy. The recent downward trends in emerging markets, coupled with the ongoing threat of deflation in the rich countries, remind us that stability is often ephemeral. A fiscal pact that would make spending more transparent would not necessarily imply a rise in the tax burden at the same time, but would make it easier to contemplate a higher level of taxation if this were necessary in the future.

Finally, regarding the National Development Strategy, there are two related concerns. The first is that, as long as taxation levels remain stagnant, over time its ambitious goals in this regard may come to appear increasingly unattainable. The second is that the response to this increasing gap would be to discard the END rather than amending it.

Conclusion

The Dominican Republic has had several tax reforms and will surely have more. Regarding the political economy of these reforms, the country has a strong tradition of social conciliation on fiscal policy, but this goes along with a political class that does not dare to risk big changes outside times of crisis.

In a regional and global context, there are several notable aspects of the Dominican fiscal system and of the November 2012 reform. On the first, the most striking is that, just as Latin America stands out in the world for its high reliance on taxes on consumption and the underperformance of its personal income and property taxes, the Dominican Republic also stands out (pre- and post- reform) in the region for high regressive and low progressive taxation. To the extent that the reform sought to remedy a decline in public revenue, which had something to do with trade liberalization in 2004-06, it shared an important feature with the reforms of the past generation in the region. At the same time, the reform included something new in its design--namely, a dual structure for individual income tax. However, the stagnation of public revenues after 2007 also had another source. By 2012 the Dominican tax code lost more in tax expenditures than the regional average, which in turn was higher than the world average.

Finally, in comparison with other reforms in the region, Law 253-12 was enacted in extraordinarily favorable political circumstances at the national level. And despite the convenience and legal obligation to reach a fiscal pact, this did not happen, probably because the government did not find it necessary. The government was not in financial trouble, and it could bring the project to another more favorable forum -a Congress that it dominated- and the END did not set a deadline for the pact. But this does not negate a pact's future usefulness. Financial markets are fickle and the Dominican public debt level continues to rise. Given this, it might be appropriate for the CES to dedicate itself to "pre-cooking" a consensual fiscal reform, which would include both taxes and spending, pending the arrival to the negotiating table of a government prepared to contemplate an in-depth pact.

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