**TERMS OF REFERENCE**

**Individual international consultant – Elaboration of the database of fiscal indicators and construction of the sub-components and the composite indicator of Fiscal Policy Quality in LAC**

1. Background
   1. There is a widespread knowledge about the multidimensional features of fiscal policy and the wide range of channels through which public finances can impact on economic growth and development[[1]](#footnote-1). Additionally, there are broad sources of information on fiscal data: quantitative indicators are available for relatively long time horizons and different levels of public sector coverage. Moreover, organizations like Multilateral Financial Institutions (MFIs), private institutions, think tanks, the academia and NGOs, among others, have developed qualitative indicators that intend to measure the perception of economic agents about a country’s economic and fiscal management and how it affects private behavior. This production of fiscal statistics has supported the growth of a literature on the influence of fiscal policies on social and macroeconomic aggregates, using statistical and econometric tools.
   2. However, most of the research on this topic has been done considering the isolated effects of different sides of fiscal policy (fiscal revenues and the structure of tax systems, public expenditure efficiency and management, debt sustainability, budgetary institutions, etc.). The analysis through separate indicators makes it difficult to build up an integrated assessment regarding the quality of the fiscal policy in a given country and period, its consequences on long term growth and development, and how it compares with its regional peers. Moreover, a one-dimensional perspective would overlook the contribution of the elements analyzed in isolation. To tackle this omissions and limitations, an integrated composite indicator of the quality of fiscal policy emerges as an interesting option since it would summarize the country’s underlying fiscal structure and capture the fact that fiscal policymaking is a complex process in which various elements are strongly related and where progress in some aspects could reinforce -or be made at the expense of- others.
   3. Interest on composite indicators is growing as well as the aspects of economic and social development it covers, including competitiveness, ease of doing business, central bank independence and technological progress, among others, and even specific areas of fiscal policy (fiscal rules, efficiency of public investment, budgetary institutions and processes, among others). A noticeable advantage of composite indicators is that it enables summarizing complex, multidimensional realities, easing its interpretation and the decision-making process as well as the communication to the public. At the same time, adequate composite indicators should also permit to go “back to the data”, which means that it must be possible to profile country performance at the indicator level so as to reveal what is driving the composite indicator results, to identify if those are overly dominated by few indicators and to explain the relative importance of specific sub-components. Additionally, it becomes possible to establish comparisons and rankings among countries based on the definition of benchmarks.
   4. In that sense, the Bank is involved in the construction of a composite indicator to measure the quality of fiscal policy in LAC, which will be one of the few efforts that apply this concept to fiscal data, and the first one that focuses entirely on LAC. This TC will seek to answer the following questions: What is the overall quality of the fiscal policy of the countries in the LAC region? Which are the factors that have driven the current state of the quality of fiscal policy in each of them and how do they compare across the region? Does the quality of fiscal policy have an impact on long-term economic growth? If so what is the direction, magnitude and significance of that effect? How do the different fiscal policy mixes affect the overall quality of fiscal policy and its impact on growth?
2. Objectives of the Consultancy
   1. Perform literature review on the use and methodology of composite indicators, with special focus on applications of composite indicators to fiscal data,
   2. Collect relevant fiscal variables and construct a database for a significant sample of LAC countries and period of time,
   3. Construct sub-indexes for each aspect of fiscal policy and the final composite indicator of fiscal policy quality,
   4. Conduct sensitivity analysis of the composite indicator to methodological changes, and,
   5. Complementary support to other components of the TC.
3. Work Plan

A. Literature review on the construction of composite indicators

* 1. The consultant must perform a review of the existing literature regarding the applications of the methodology of composite indicators to issues related to economic growth and development. Special focus should be put on the existing efforts to apply composite indicators to fiscal data.

B. Database of fiscal variables

* 1. The consultant must evaluate and select those fiscal variables that are indicative of the quality of fiscal policy. The data selection will consider four areas of public finances: (i) fiscal revenues and tax administration, (ii) public expenditure and financial management, (iii) budgetary policies and fiscal institutions, and (iv) macro-fiscal results, debt sustainability and liabilities management. The variables selected should be both quantitative and qualitative. Quantitative variables should be collected from official sources or MFIs that disseminates such information; also, a careful review to account for consistency and comparability must be carried on. Qualitative data must be collected from trustworthy sources.

C. Construction of sub-indexes and the Fiscal Policy Quality Index

* 1. Based on the literature review and the database assembled, the consultant will construct sub-indexes for each area of fiscal policy and the composite indicator of fiscal policy quality. This task should select the most appropriate methodology for dissemination and discussion purposes. A guideline in this step must be the Handbook on Constructing Composite Indicators published by the OECD and the EC. Finally, based on the values of the composite indicator, rankings of fiscal policy quality must be established for a year or a period of time and distinguishing between the complete sample of countries and sub-groups.

D. Sensitivity analysis of the composite indicator

* 1. To account for the robustness the composite indicator, the consultant, under the supervision of the team leader, must carry on sensitivity analysis of the indicator to methodological changes, reporting any significant difference as well as its causes and implications for the usefulness of the indicator.

The outputs of the mentioned activities will be a database and a Discussion Paper.

E. Complementary support to other components of the TC

3.5 Additionally, the consultant must give support to other components of the TC, including the organization of the BBL and the seminar as well as the elaboration, edition and publication of the final working paper.

1. Term and Place of Service
   1. The consultancy will be held in Washington, DC for a period of up to 18 months from the day following the date of signing the contract.
2. Coordination and Monitoring
   1. The coordination and monitoring of the Consultancy will be under the supervision of Gustavo Garcia, Principal Technical Leader Fiscal Economist and Coordinator of the Fiscal Cluster at the Fiscal and Municipal Management Division (FMM).

**TERMS OF REFERENCE**

**Individual international consultant – Effect of a composite indicator of Fiscal Policy Quality on long-term economic growth in LAC**

1. Background
   1. There is a widespread knowledge about the multidimensional features of fiscal policy and the wide range of channels through which public finances can impact on economic growth and development[[2]](#footnote-2). Additionally, there are broad sources of information on fiscal data: quantitative indicators are available for relatively long time horizons and different levels of public sector coverage. Moreover, organizations like Multilateral Financial Institutions (MFIs), private institutions, think tanks, the academia and NGOs, among others, have developed qualitative indicators that intend to measure the perception of economic agents about a country’s economic and fiscal management and how it affects private behavior. This production of fiscal statistics has supported the growth of a literature on the influence of fiscal policies on social and macroeconomic aggregates, using statistical and econometric tools.
   2. However, most of the research on this topic has been done considering the isolated effects of different sides of fiscal policy (fiscal revenues and the structure of tax systems, public expenditure efficiency and management, debt sustainability, budgetary institutions, etc.). The analysis through separate indicators makes it difficult to build up an integrated assessment regarding the quality of the fiscal policy in a given country and period, its consequences on long term growth and development, and how it compares with its regional peers. Moreover, a one-dimensional perspective would overlook the contribution of the elements analyzed in isolation. To tackle this omissions and limitations, an integrated composite indicator of the quality of fiscal policy emerges as an interesting option since it would summarize the country’s underlying fiscal structure and capture the fact that fiscal policymaking is a complex process in which various elements are strongly related and where progress in some aspects could reinforce -or be made at the expense of- others.
   3. Interest on composite indicators is growing as well as the aspects of economic and social development it covers, including competitiveness, ease of doing business, central bank independence and technological progress, among others, and even specific areas of fiscal policy (fiscal rules, efficiency of public investment, budgetary institutions and processes, among others). A noticeable advantage of composite indicators is that it enables summarizing complex, multidimensional realities, easing its interpretation and the decision-making process as well as the communication to the public. At the same time, adequate composite indicators should also permit to go “back to the data”, which means that it must be possible to profile country performance at the indicator level so as to reveal what is driving the composite indicator results, to identify if those are overly dominated by few indicators and to explain the relative importance of specific sub-components. Additionally, it becomes possible to establish comparisons and rankings among countries based on the definition of benchmarks.
   4. In that sense, the Bank is involved in the construction of a composite indicator to measure the quality of fiscal policy in LAC, which will be one of the few efforts that apply this concept to fiscal data, and the first one that focuses entirely on LAC. This TC will seek to answer the following questions: What is the overall quality of the fiscal policy of the countries in the LAC region? Which are the factors that have driven the current state of the quality of fiscal policy in each of them and how do they compare across the region? Does the quality of fiscal policy have an impact on long-term economic growth? If so what is the direction, magnitude and significance of that effect? How do the different fiscal policy mixes affect the overall quality of fiscal policy and its impact on growth?.
2. Objectives of the Consultancy
   1. Based on the construction of a composite indicator of Fiscal Policy Quality in LAC, conduct statistical and econometric exercises aimed at quantifying the effect of such an indicator on long-term economic growth in LAC.
3. Work Plan
   1. The consultant will execute the following activities:
4. Literature review and discussion of the contribution of fiscal policy to long-term economic growth.
5. Design of a theoretical model and derivation of the equation(s) to be estimated, which must include the indicator of Fiscal Policy Quality either as exogenous or interaction variable,
6. Description of the database to be used and perform statistical analysis and econometric regressions aimed at testing the impact of the Fiscal Policy Quality Index on long-term growth,
7. Sensitivity analysis and robustness of the coefficients estimated to changes in the sample or the specification of the model, and
8. Analysis of results
   1. The output of the mentioned activities will be a Discussion Paper.
9. Term and Place of Service
   1. The consultancy will be held in Washington, DC for a period of up to 6 months from the day following the date of signing the contract.
10. Coordination and Monitoring
    1. The coordination and monitoring of the Consultancy will be under the supervision of Gustavo Garcia, Principal Technical Leader Fiscal Economist and Coordinator of the Fiscal Cluster at the Fiscal and Municipal Management Division (FMM) of the Bank.

1. See Ter-Minassian (2013, forthcoming) for an overview of the theoretical and empirical contributions regarding fiscal policy and growth. Also see: Barrios, S. and Schaechter, A. The quality of public finances and economic growth. EC Economic Papers 337. September 2008. [↑](#footnote-ref-1)
2. See Ter-Minassian (2013, forthcoming) for an overview of the theoretical and empirical contributions regarding fiscal policy and growth. Also see: Barrios, S. and Schaechter, A. The quality of public finances and economic growth. EC Economic Papers 337. September 2008. [↑](#footnote-ref-2)