TC Document

I. Basic Information for TC

▪ Country/Region:	Regional
▪ TC Name:	Improving institutions for better public investment spending
▪ TC Number:	RG-T2985
▪ Team Leader/Members:	Edna Armendáriz (IFD/FMM), Team leader; Axel Radics (FMM/CUR), Alternate Team Leader; Huáscar Eguino (IFD/FMM), Andrés Muñoz (FMM/CBR), Emilio Pineda (FMM/CAR), Martín Ardanaz (FMM/CNI); Belinda Perez-Rincon (FMM/CDR); José Larios (FMM/CPE); Javier Jimenez (LEG/SGO); and Maria Lorena Kevish (IFD/FMM).
▪ Taxonomy:	Research and Development
▪ Date of TC Abstract authorization:	May 19, 2017
▪ Beneficiary:	Latin America Countries
▪ Executing Agency:	Inter-American Development Bank - (IDB) through the Fiscal and Municipal Management Division (IFD/FMM)
▪ Donors providing funding:	Ordinary Capital Strategic Development Program for Institutions (INS)
▪ IDB Funding Requested:	US$550,000
▪ Disbursement period (which includes Execution period):	36 months
▪ Required start date:	November, 2017
▪ Types of consultants:	Individual consultants and firms
▪ Prepared by Unit:	IFD/FMM
▪ Unit of Disbursement Responsibility:	Institutions for Development Sector (IFD)
▪ TC Included in Country Strategy (y/n):	No
▪ TC included in CPD (y/n):	No
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Productivity and Innovation, Institutions and Rule of Law

II. Objectives and Justification of the TC

2.1 The objective of this technical cooperation is: (i) to strengthen Public Investment Management Systems (PIMS) in selected Latin America (LA) countries; (ii) to assess international good practices in PIMS that could help LA countries to make their capital spending more efficient; and (iii) to promote dialogue through the dissemination of knowledge and policy recommendations in LA.

2.2 **Justification.** LA has faced low growth over the last years, with some heterogeneity across countries[1]. Debt and fiscal positions have deteriorated in many countries, emphasizing the importance of fiscal adjustment to ensure sustainability in the medium term. Given relatively low world growth, lower commodity prices, and higher global

[1] The growth rate of the LA region reached 1.4% during 2012-16 and is expected to be 1.6% in 2017, below growth rates foreseen in ASEAN-5 (4.9%) and Emerging and Developing Europe (3.1%).

interest rates, growth prospects over the next years will likely remain subdue. In this context, a vigorous policy debate is focusing on accelerating public investments to promote higher economic growth (BID, 2016), while the evidence shows that public investment is usually the first budgetary line to be cut in difficult times (Ardanaz and Izquierdo, 2017).

2.3 Public investment levels in the region are still low. Public investment spending increased from 3% of GDP in 2006 to 4.1% of GDP in 2014, but remain well below the current levels in the Association of Southeast Asian Nations (ASEAN) countries (6.2% of GDP) [2]. The region's infrastructure network has been upgraded over the past decade, but still compares relatively poorly with their export rivals, especially Asia (IMF, 2014). The resulting infrastructure gap in LA has been estimated between 4% of GDP (Reyes-Tagle and Leon, 2017) and 5-7,5% of GDP (Perrotti and Sanchez, 2011). Inadequate infrastructure in the region has been widely viewed as one of the principal barriers to growth (Calderon and Serven, 2004 y 2010).

2.4 The economic and social impact of investment spending depends on its efficiency[3]. At the same time, the efficiency of public investment depends crucially on how it is managed. Countries with stronger public investment management institutions have more predictable, credible, efficient, and productive investments. Strengthening these institutional arrangements is crucial to improve the quality of capital spending (for example, a medium-term investment portfolio linked to strategic priorities, a sound project cost management system, learning from completion review and ex-post evaluation of finished projects).

2.5 For all countries in the region, the efficiency of public investment needs to be improved[4]. An IMF study (2015) finds that 30 percent of the potential benefits of public investment in a selected group of countries worldwide are lost due to inefficiencies in processes[5]. The impact on GDP from a 1% increase in public investment is about 0.6% in countries with efficient PIMS, while the impact is reduced by half in countries with inefficient systems (0,3%). Recent work by the Bank (Armendariz and Contreras, 2016) estimate an index of public investment management efficiency for 16 countries in the region (0 low efficiency – 4 high efficiency)[6]. The results show that countries

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2 FMM database and World Economic Outlook.

3 Efficiency can be defined as the ratio between the actual increment of public capital and the amount spent (Pritchett 2000, Caselli 2005). This technical cooperation focuses on efficiency issues of the broad institutional framework underpinning the provision of investment; the public investment management process.

4 There are different approaches to measure public investment efficiency (See IMF, 2015), for example, the relationship between the accumulated public capital stock and various indicators of the quality of and access to infrastructure.

5 The efficiency gains related to the investment process shrink as income rises, with developing countries facing margin of 40 percent, emerging markets facing a margin of 27 percent, and advanced economies facing a margin of 13 percent on average.

6 This index was constructed based on the methodology developed by Dablas-Norris et. al. (2011), which considers dimensions and subdimensions of the investment cycle (strategic guidance and project appraisal, project selection and budgeting, project implementation, evaluation and audit).

have different levels of efficiency: Chile has the highest level of efficiency in the region (3.2), while Panama has the lowest level (1.6). At the regional level, the areas showing the weakest performance were strategic guidance and project appraisal; ex-post evaluation and audit; scrutiny and public access to information over the investment cycle; and use of digital tools to facilitate investment processes.

2.6 In addition, while an important share of public investment is executed by subnational governments (about 75% in Mexico or Brazil, and close to 60% in Argentina or Perú), in-depth knowledge about their management capacities is limited. In LA, most recent studies on this matter are either: (i) limited in their geographical coverage of subnational governments (IERAL, 2016), or (ii) based on an ad-hoc assessment methodology which provides limited scope for benchmarking and national/international comparisons (IFC, 2013). The need to have a better understanding of the challenges of PIM at the subnational level poses both methodological and operational challenges and is a priority for several LA countries with high degree of expenditure decentralization.

2.7 In many LA countries, there has been a renewed demand to revamp their public investment management systems. This interest covers the full cycle from pre-investment (a traditional area of support of public investment), to prioritization, project appraisal (and selection), execution and ex-post evaluation. In this regard, this TC builds on previous initiatives supported by the Bank mainly at central government level and meets the need for further work on PIMS at subnational level where weaknesses are notorious in most countries.

2.8 In particular, the TC RG-T2288, Innovations in Public Investment Systems, developed a detailed diagnosis of public investment systems in six LA countries (Chile, Colombia, Dominican Republic, Guatemala, Paraguay and Peru), using as a benchmark the case of Korea. The results of these diagnoses showed key problems along the PIMS, particularly for those countries that have more recently adopted formal public investment systems (Dominican Republic, Guatemala and Paraguay): (i) weaknesses in the planning process of public investment, and its integration with the project pipeline; (ii) insufficient development of guidelines to conduct pre-investment studies; (iii) poor monitoring and evaluation of investment projects after they are approved; (iv) weak capacities for the preparation and evaluation of projects; and (v) incomplete coverage of the system, particularly with respect to subnational governments and decentralized governmental agencies. As a result of this work, there has been an increasing demand to identify good practices of public investment management, both in LA and OECD countries.

2.9 In addition, the ESW RG-K1392, Public investment spending in Latin America: How much and how efficient, helped build a database of public investment in the region and estimated an index of public investment management efficiency in most countries as mentioned previously, identifying relative strengths and weaknesses along the PIMS.

2.10 The activities included in this TC are also informed by other initiatives supported by the Bank on this topic. Indeed, the Bank coordinates through IFD, with support of the Korean Fund, the regional network on national public investment systems. Moreover, with support of KNL the Bank has organized regional workshops on PIMS (with focus on project execution) in Colombia (2015) and Paraguay (2016), as well as a high-level international workshop on public investment and growth in Peru (2017), including the participation of Korean experts[7]. In addition, a Korean Knowledge Sharing Program (KSP) is under execution in El Salvador. The program includes: (i) an assessment of El Salvador's national public system, using the Korean system as a benchmark; (ii) an exchange workshop and the establishment of key recommendations to improve public investment management; and (iii) the implementation of activities identified as priority in the country assessment. These initiatives have allowed the Bank to have a better understanding of the challenges that countries are facing with regard to PIMS, knowledge that we take into account in the preparation of this TC.

2.11 Lastly, based on country demand, there is an active policy dialogue with several LA countries on PIMS, including Argentina, Bolivia, Brazil, Chile, Dominican Republic, El Salvador, Honduras, Nicaragua, Paraguay and Peru. In this regard, this TC follows up on the previous technical assistance (RG-T2288) and initiatives as well as demand for sharing country experiences, especially from Korea and other OECD countries. The value added of this TC is using the results and recommendations of previous work to support specific areas along the PIMS and to generate new research with a focus on improving the quality and efficiency of public investment in LA. In addition, the activities prioritized in this TC intend to support mainly the Bank ongoing policy dialogue, with the view of contributing to future larger interventions supporting public investment reforms.

2.12 This TC is consistent with the Update to the Institutional Strategy (UIS) 2010-2020-(AB-3008) and is strategically aligned with the development challenge of productivity and innovation by supporting stronger institutional frameworks for productive investment. The TC is also aligned with the cross-cutting theme of institutional capacity and rule of law. In addition, this TC will contribute to the following Corporate Results Framework (CRF) 2016-2019 (GN-2727-6) indicator: government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery. This TC is aligned with the Fiscal Policy Framework (GN-2831-3) that identifies strengthening of institutional capacity to design and implement fiscal policies to improve allocation of resources for investment expenditure in public infrastructure. It also complements TC on Fiscal Policy based on evidence and use of Smart data for strengthening equity and efficiency (RG-T3001), TCs on

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[7] Jongyearn Lee, Director of the Analysis and Evaluation Division (Korean Development Institute – KDI); Kangsoo Kim, Director of the Department of Land and Infrastructure Policy (KDI); and Inho Song, Director of the Policy and Research Division (Korean Public and Private Infrastructure Investment Management Center--PIMAC).

improving the quality and efficiency of public spending in Latin America (RG-T2508 and RG-T2509), TC on Modernization of Public Financial Management Systems (RG-T2635) and TC on Innovations in Public Investment Systems (RG-T2288). Lastly, the TC is aligned with the objectives of the Ordinary Capital Strategic Development Program for Institutions (INS) (GN-2819-1).

III. Description of activities/components and budget

3.1 **Component I. Implementation of improvements along public investment management systems (US$200.000).** This component will focus on implementing some of the key recommendations found in the TC RG-T2288 and RG-K1392, through technical assistance to conduct specific improvements in up to five selected countries. The country selection criteria include a recent PIM diagnostic and/or commitment of a reform program to strengthen its PIM framework and to improve the efficiency of capital expenditures[8]. Consistent with the findings of the TC RG-T2288 and RG-K1392, the prioritized activities will comprise: (i) development of instruments for better planning, budgeting and prioritization; (ii) design of project appraisal methodologies and guidelines as well as training; (iii) development of tools and training for better monitoring and improvement of project execution (including procurement) and expost evaluation; and (iv) expansion of institutional coverage of PIMS.

3.2 **Component II. Strengthening public investment management systems at subnational level (US$200.000).** This component will support in-depth analysis of PIMS at subnational level, building on the diagnoses conducted by the RG-T2288 and RG-K1392, and using a specific methodology to be developed by this TC[9]. Countries such as Colombia have made progress in this regard and Peru is preparing a diagnostic to measure PIMS efficiency at subnational level. Subsequently, an action plan will be developed targeting key areas identified in the diagnosis for improvement. It will also implement key activities stemming from the proposed action plan. The country selection criteria include high degree of decentralization of public investment, medium efficiency levels of their public investment systems (at central level) and lack of a diagnostic at subnational level. Two countries will be selected and potential beneficiaries are Argentina, Brazil and/or Mexico. This component will finance the following activities: (i) design of in-depth PIMS assessment methodology at subnational level[10]; (ii) application of the methodology; (iii) development of action plans; and (iv) technical assistance for the implementation of specific key activities.

[8] At the start of this project, the selected countries will be defined by the corresponding criteria and letters of non-objection. The potential benefiting countries of this component are: Argentina is seeking to improve its planning and pre-investment management capacity following the recent institutional reform that strengthened the National Cabinet Office’s role in PIM; Chile is considering options to improve the relevance of its national investment system, along with the incorporation of a multi-year investment plan; Honduras is updating its methodology guide for project formulation and appraisal, accompanied by full training; Paraguay is trying to incorporate a multi-year investment plan, along with procedures to track its compliance; and Dominican Republic is designing a plan to improve public investment capacities.

[9] For a more details about the methodological aspects, please refer to the corresponding terms of reference. The assessment methodology will be in principle an adaptation to subnational governments of IMF’s PIM-Index (PIMI) and PIM-Assessment (PIMA) tools.

[10] The methodology will consider several used toolkits developed by IMF, OECD, World Bank and IDB.

3.3 **Component III. Research and dissemination of international good practices (US$145.000).** This component will undertake research on public investment, focusing on the key areas for improvement that were identified by the TC RG-T2288 and RG-K1392, and ensuring complementarity of latest research efforts at the Bank and other international organizations. Specific areas of public investment systems in selected OECD countries will be analyzed and lessons for Latin America will be drawn from these experiences. This component will also provide opportunities to share experiences from the previous components to contribute to regional learning. It involves the following activities: (i) preparation of reviews identifying international good practices (up to 5 reviews)[11]; (ii) preparation of regional study on public investment, economic growth and equity; (iii) build up and launch of a (virtual) network of regional experts on public investment to bring the latest thinking, research, and frameworks to help address challenges and knowledge sharing[12]; and (iv) the organization of a dissemination workshop of the three components that will be held in one of the beneficiary countries[13], with the participation of policy-makers and scholars.

Table 1. Indicative Budget

Activity/Component	**IDB**	**Counterpart Funding**	**Total**
Component I. Implementation of improvements of public investment management systems	200,000	0	200,000
Component II. Strengthening public investment management systems at subnational level	200.000	0	200.000
Component III. Research and dissemination of international good practices	145.000	0	145.000
Evaluation	5,000		5,000
Total	**550.000**	**0**	**550.000**

3.4 The evaluation framework to track the progress of the TC against its expected outcomes and outputs, and indicators is included in Annex I. The expected outputs of the TC will strengthen public investment systems. Therefore, this TC will contribute to the results framework of the Strategy for Strengthening and Use Country Systems (GN-2538-14).

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11 Specific practices will be selected based on results of TC RG-T2288 and RG-K1392 among them: Planning (Australia on long-term and integrated infrastructure planning approach, New Zealand on long-term subnational investment plans; United Kingdom on structured state-regional planning); Project selection (Korea on multi-criteria decision making approach); Investment appraisal and expost evaluation (Chile on cost-benefit analysis and expost evaluation system); Execution (Korea on Total Project Cost Management System; United Kingdom on contract management framework); Coordination (Australia on central local coordination arrangements); Transparency and accountability (Colombia on mechanisms to align the central and local agenda and promote transparency-contratos plan, Mexico on an integrated geographic information system).

12 This network will consider the members of the current network of Public Investment National Systems (SNIPs) coordinated by CoPLAC-GpRD. including Directors of SNIPs. This network will add value to previous efforts by bringing together academics, (regional and international) experts and public officials. This activity will be closely linked to FMM agenda on public investment and other initiatives at the Bank.

13 The criteria to select the country where the dissemination workshop will take place include: (i) beneficiary country of component I and/or II; and (ii) larger public investment intervention supporting a reform in pipeline. After progress in the implementation of all components, the selected country for the dissemination workshop will be defined by the corresponding criteria and a letter of non-objection. This activity will be closely linked to FMM agenda on public investment and other initiatives at the Bank.

IV. Executing agency and execution structure

4.1 Given the regional dimension of this TC and the lack of a regional entity with capacity to execute it, the Bank will be the executing agency through the Fiscal and Municipal Management Division (IFD/FMM). The substantial experience of the Bank in this area will ensure the sustainability of TC implementation.

4.2 The Bank will coordinate activities through Public Investment Units and the responsible Units with subnational governments at the Ministries of Finance. For the contracting of individual consultants, the Bank project team will observe Human Resource selection procedures (AM-650); as well as in the case of non-consulting services contracts, the Corporate Procurement Policy and Procedures (GN-2303-20).

V. Major issues

5.1 The main risk associated to this TC is lack of interest of public investment agencies in LA countries. To mitigate this risk, the TC will target those countries with relatively highest needs, as identified in recent work (Armendariz and Contreras,2016); and countries with clear demand, as expressed in letters of interest. Data quality and coordination between central and subnational entities could be a major risk for the implementation of component II. To mitigate this risk, the TC will focus on countries with easy access to information and good quality of data at subnational level.

5.2 **Sustainability.** To contribute to the sustainability of the products financed by this TC among the beneficiary public institutions, all activities will be conducted hand in hand with career public servants (who have stability in their posts of duty) directly involved in PIMS. This includes joint elaboration and validation of terms of reference; and joint supervision and approval of deliverables by Public Investment Units and/or the responsible Units with subnational governments at the Ministries of Finance. It also includes the participation of public officials in the dissemination activities included in component 3. The involvement of career public officials in the execution of the activities and products financed by this TC will facilitate their appropriation and continuation beyond the duration of this project, hence contributing to the strengthening of the quality and efficiency of the PIM systems.

VI. Exceptions to Bank policy

6.1 This TC does not involve exceptions related to Bank´s policies.

VII. Environmental and Social Strategy

7.1 Due to their nature, the activities in this TC will not have negative social or environmental impacts. This TC is classified as "C".

Required Annexes:

- Annex I: Results Matrix
- Annex II: Terms of Reference
- Annex III. Procurement Plan.

IMPROVING INSTITUTIONS FOR BETTER PUBLIC INVESTMENT SPENDING

RG-T2985

CERTIFICATION

I hereby certify that this operation was approved for financing under the **Ordinary Capital Strategic Development Program for Institutions (INS)** through a communication dated June 7, 2017 and signed by Kai Hertz (ORP/GCM). Also, I certify that resources from said fund are available for up to **US$550,000** in order to finance the activities described and budgeted in this document. This certification reserves resource for the referenced project for a period of four (4) calendar months counted from the date of eligibility from the funding source. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, represent a risk that will not be absorbed by the Fund.

CERTIFIED BY:	Sonia M. Rivera	10/03/17
	Chief Grants and Co-Financing Management Unit ORP/GCM	Date
APPROVED BY:	Vicente Fretes Cibils	10/04/17
	Division Chief Fiscal and Municipal Management Division IFD/FMM	Date