TC Document

I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ TC Name:	Program for Strengthening Fiscal Policy and Management of the Extractive Industries in the effects of the COVID-19 crisis
▪ TC Number:	RG-T3666
▪ Team Leader/Members:	Reyes-Tagle, Gerardo (IFD/FMM) Team Leader; Walter, Martin (INE/CCH) Alternate Team Leader; Astudillo, Karen (IFD/FMM); Delgado, C. Raul (CSD/CCS); Gomez Reino, Juan Luis (IFD/FMM); Gonzalez Alzualde, Yohana Beatriz (IFD/CTI); Munoz Miranda, Andres Felipe (IFD/FMM); Negret Garrido, Cesar Andres (LEG/SGO); Ospina Garnica,Laura Alejandra (IFD/FMM); Park Kwon, Yery (IFD/FMM); Perez Rincon, Belinda (IFD/FMM); Roman Sanchez, Susana (IFD/FMM); Valencia Arana, Oscar Mauricio (IFD/FMM)
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	.
▪ Date of TC Abstract authorization:	14 May 2020.
▪ Beneficiary:	Argentina, México, Trinidad and Tobago
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	OC Strategic Development Program for Institutions(INS)
▪ IDB Funding Requested:	US$150,000.00
▪ Local counterpart funding, if any:	US$0
▪ Disbursement period (which includes Execution period):	24 months (24 months of execution and 25 months of disbursement)
▪ Required start date:	August 15, 2020
▪ Types of consultants:	Individuals
▪ Prepared by Unit:	IFD/FMM-Fiscal Management Division
▪ Unit of Disbursement Responsibility:	IFD/FMM-Fiscal Management Division
▪ TC included in Country Strategy (y/n):	N/A
▪ TC included in CPD (y/n):	N/A
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Institutional capacity and rule of law

II. Objectives and Justification of the TC

2.1 The objective of technical cooperation (TC) is to support governments in the region strengthen fiscal policies to manage extractive industries (EI) during the pandemic caused by COVID-19 and the ensuing commodity price shock. Specifically, this TC will (i) develop diagnostics of the dual impact of COVID-19 crisis and commodity price shock in economies that heavily rely on hydrocarbon and mining industries and that are suffering due to measures imposed by the countries to manage the spread of the virus; (ii) assist in the formulation of fiscal policy responses for immediate actions and reduction of the fiscal stress in the medium and long-term, (iii) assist the governments

in developing fiscal recovery plans for the post-pandemic period mostly affected by the macro-fiscal shock[1], and (iv) disseminate diagnostics and plans to strengthen institutional capacity to promote the use of sound fiscal policies in the post pandemic period.

2.2 **Justification.** Due to the income they generate, EI[2] play a strategic role in the social, environmental, economic, and political development of the countries. In 2018, the extractive industries sector exports globally totaled US $ 2.1 trillion (15.7% of the total export) just behind the automotive industry, 50 percent of the countries in the world have activities related to production in the hydrocarbon sector, while 80 percent have it in mining. The Latin America and the Caribbean (LAC) region is the world's main source of metals and the fourth largest hydrocarbon in the world.[3]

2.3 EI have economic characteristics that distinguish them from other sectors of the economy. The limited and non-renewable nature of mineral resources, the social and environmental impacts they generate, the intensive use of capital and skilled labor[4], the large investments required at the beginning of the value chain[5], the long periods of financing[6], amortization and cost recovery, the low ratio of commercially successful projects[7], a high level of control and state ownership added to an oligopolistic structure and, the uncertainty surrounding the industry's returns due to the context in which they are developed are some characteristics that make extractive industries a complex sector with great challenges.[8]

2.4 Given the high economic rents, countries create fiscal regimes[9] that seek to capture rents from the exploitation of resources, which is known as government take (GT). The GT is made up of a range of both general and sector-specific taxes. There are around 25 different taxes in IE. The most common tax instruments used by countries to tax EIs include: royalties, corporate income tax, extraordinary income tax and resource income tax, withholding taxes, surface rental rates, customs duties and export taxes,

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1 Oil exporters are facing a triple macro-fiscal shock: a sharp revenue loss from the collapse in global oil prices, negative economic impact on domestic non-oil activity, and increased spending pressures arising from the policy response to the effects of COVID-19. Source: [Fiscal policy responses to the sharp decline in oil prices. Special series on COVID-19.]() International Monetary Fund 2020.

2 Extractive Industries (EI) is understood as the group that makes up the hydrocarbon (oil and gas) and mining sectors.

3 Source: Infrastructure and Energy Sector of the Inter-American Development Bank. U.S. Energy Information Administration (EIA), World´s Top Exports and World Mining Data information 2019.

4 The extractive industries tend to demand highly trained human capital (from both the private and public sectors), with knowledge and access to state-of-the-art technology and significant engineering capacity.

5 Investments are made up-front and are difficult to reverse or delay since they are very specific to the sector, have no alternative uses, and cost recovery periods are long. Global investments in exploration and exploitation in the oil and gas (P&G) sector between 2010 and 2019 averaged US $ 583.5 billion annually. A strong share of these investments is concentrated in onshore-offshore conventional oil wells that accounted for nearly 67% in 2018. Source: World Energy Investment 2019, IEA.

6 The extractive industries require access to financing and liquidity funds that sometimes, local banks cannot guarantee.

7 Between 2014 and 2019, the global commercial success rate of exploration in ocean wells was around 34%. Source: Westwood Global Energy Group.

8 The institutional frameworks adopted by different countries have evolved as the sector's operations become more complex. In this sense, the institutional frameworks have sought to strengthen the separation of the roles of the regulator, the administrator of resources and the state oil companies. This transformation has allowed to purify the state oil companies from the regulatory and administrative role, assigning this task to institutional structures, of a technical nature and oriented to the efficiency in the management of the hydrocarbon asset.

9 A fiscal regime is the set of instruments (taxes, royalties, dividends, etc.) that determines how the income from extractive industries projects is going to be distributed between the State and companies in the sector. The detail on how and when these instruments and tools are used are part of what constitutes the country's legal framework and includes the laws, regulations, and contracts of general and sector-specific application.

bonus payments, property taxes, taxes on goods and services, stamp / transaction fees, transportation fees, capital dividends, capital gains taxes, fines and penalties. Commodity prices are subject to multi-year cycles with high volatility, which are difficult to predict and behave pro-cyclically with the world economy. Thus, extraction projects that are profitable in some ranges of the cycle, where international commodity prices (hydrocarbons and metals, in particular) are high, may not be so when prices drop dramatically having a greater impact on the tax revenues of the affected countries.

2.5 Recently along with the COVID-19 crisis, countries heavily relying in revenues from the extractive industries have to cope with a significant decrease of public revenues associated with the collapse in oil prices[10] and reduction in the price of strategic metals such as copper. Economic difficulties around the world and the disruption of global value chains reduced demand for the region's good and services, mostly notably hydrocarbons, metals, and tourism.[11] Falling commodity prices will further depress demand, where EI (oil, gas and metals, in particular) are the most important economic sector. Some national and private sector companies in the hydrocarbons and mining industry are already slushing collective capital spending this year as the coronavirus rattles regional energy markets.[12,13] Most of the countries in the region already have limited fiscal space, making maintaining spending extremely challenging as public revenues from EI drop.[14] However, this will have a dual effect as in some economies the reduction in oil prices could provide a buffer for the balance of payments and the fiscal response of the COVID-19 related shock[15], and provide an opportunity for countries to manage risks derived from the transition to low carbon economies, prepare to face possible stranded assets[16] and promote more favorable conditions to comply with the Paris Agreement.[17]

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10 In addition to the shock from COVID-19, the breakdown in negotiations between the Organization of the Petroleum Exporting Countries (OPEC) and its allies led to what will likely be a persistent collapse in oil prices. The benchmark West Texas Intermediate (WTI) crude oil price reached a low of $22.39 per barrel on March 20 and maintaining since the average of $22 per barrel- less than half the price at the beginning of the month. The futures curve suggests that the market expects oil prices to recover slowly – not reaching $40 per barrel until the end of 2022. Source: Bloomberg L.P.

11 Source: Coping with a Dual Shock: COVID-19 and Oil Prices. World Bank Brief.

12 Latin American national oil companies (NOCs) will slow down or postpone investment in new projects or exploration activities and will instead focus on streamlining operations, reducing costs, and keeping existing fields pumping for as long as possible. At the same time, the fiscal revenue contraction caused by the reduced transfers from NOCs will force governments to consider fiscal, social and monetary mitigation measures. Source: An Illness in the Oil Market: the price crash and its impact in LAC. IADB 2020.

13 Brazil's Petrobras, Colombia's Ecopetrol, Argentina's YPF and Ecuadorian Petroamazonas have allocated US$ 17.7 billion to capital projects in 2020, down 17 percent from their 2019 joint outlay. Source: Oil collapse and COVID-19: The capital cost in Latin America. BNAmericas.

14 For Chile, Guatemala, Paraguay and Peru the fiscal adjustment required to stabilize the debt-to-GDP ratio is just 0.7% of GDP. For Bolivia, Costa Rica, Ecuador, Guyana Nicaragua and Trinidad and Tobago they require a higher fiscal adjustment of around 2.5% of GDP on average. For Colombia and Mexico do not need to adjust further to maintain stable debt levels. For Barbados and Jamaica are running considerable fiscal surpluses to bring down higher levels of debt. Eleven countries with adjustment plans were planning to improve primary balances by an average of 0.8% of GDP in the coming years, requiring 0.3% of GDP to keep debt constant. However, the demand for a greater focus on reducing poverty and inequality to fighting the coronavirus crisis and the exceptional fiscal programs to provide relief will put further pressure on fiscal balances. Source: Chapter 4 Fiscal Policy in the Time of Coronavirus. 2020 LAC Macroeconomic Report, IADB.

15 The fall of hydrocarbon prices for importers could be a good opportunity, for example, in the case of Caribbean countries to create a fiscal buffer in the short-term, but the effect may be dispersed or even null because of the contraction of the domestic consumption in the medium and long-term.

16 The risk of stranded assets being generated, resources that would remain unexploited due to the energy transition could have serious negative fiscal consequences and constitute financial vulnerability. To adequately manage this risk, it is important to design long-term national strategies that guide the decarbonization process and ensure the alignment of energy, climate and fiscal plans that allow an orderly transition to low-carbon economies.

2.6 To attend this crisis, the International Monetary Fund (IMF) have recommended short- and medium-term policy responses targeted to sectors and actors affected by the shocks. In the short-term, (i) oil exporters should mobilize the necessary resources to mitigate the direct health, social and economic effects; (ii) should accommodate temporary increases in spending through use of buffers (drawing on existing liquid assets, new borrowing, or grants and elimination of subsidies); (iii) should measure the fiscal response on country-specific factors, including health care needs, magnitude of the oil revenue loss, the extent of buffers and available fiscal space consistent with debt sustainability, and the room for response of other macroeconomic policies; (iv) suspend temporarily fiscal rules that could muster the oil exporters' ability to muster a fiscal response (for example, on withdrawing resources from oil funds or on increasing spending). The success of the short-term policy response would be enhanced by a commitment to preserve fiscal sustainability in the medium-term. In the medium-term, (i) oil exporters would need to prepare for a prolonged period of low oil prices requiring a medium-term fiscal adjustment, fiscal consolidation, strengthening of automatic stabilizers by expanding safety nets that could help quickly direct resources and fiscal adjustment to rebuild buffers; (ii) a credible fiscal framework will be essential to support a strategy of easing policy over the short run and a gradual consolidation over the medium-term, particularly for exporters with limited fiscal space by revising fiscal frameworks (including fiscal rules) and updating long-term anchors and medium-term targets.[18]

2.7 **Strategic alignment.** This TC is consistent with the Second Update to the Institutional Strategy 2020-2024 (AB-3190-2) and is strategically aligned to the cross-sectional area of Institutional Capacity and the Rule of Law, by strengthening the management and planning of public resources which supports an improvement in integrity and transparency, establish more distributive fiscal policies by improving revenue management and designing more progressive tax systems contributing to remediate the structural and emerging development challenges stemmed from social exclusion and inequality. The operation contributes to the Corporate Results Framework (CRF) 2020-2023 (document GN-2727-12) through the indicator of support to countries in strengthening tax and expenditure policy and management. Likewise, it is aligned with the priorities of the Sector Strategy on Institutions for the Promotion of Growth and Social Welfare (GN-2587-2), and is consistent with the Sectorial Frameworks for Fiscal Policy and Management (GN-2831-8) which underscores the importance of institutional capacity-building in the public sector to design and implement fiscal policies that improve efficient mobilization and allocation of resources that improve tax equity and social inclusion, strengthening of institutional capacity to design and implement fiscal policies to improve allocation of resource for investment expenditure in public infrastructure. The TC also aligns to the Strategic Programs for the Development of Institutions (INS) (GN-2819-1) financed with Ordinary Capital, by (i) contributing to the development of policies and public institutions that are more

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17 All LAC countries have ratified the Paris Agreement and have made commitments to reduce greenhouse gas emissions however most do not have an implementation plan. This is critical since the hydrocarbon and coal exporting countries in LAC are vulnerable to the energy transition process associated with meeting the objectives of the Paris Agreement given the high dependence that exists on the extractive sector.

18 Source: Fiscal policy responses to the sharp decline in oil prices. Special series on COVID-19. International Monetary Fund 2020.

effective, efficient, open and citizen-oriented, and (ii) improve the provision of services to citizens.

III. Description of activities/components and budget

3.1 **Component 1: Diagnostics of the dual impact of COVID-19 crisis and commodity price shock in LAC (US$ 70.000).** This component will finance diagnostics of the dual impact of COVID-19 crisis and commodity (hydrocarbon and metals) price shock in countries that are resource-dependent countries.[19] It will assist the formulation of fiscal policies and responses for immediate actions and reduction of fiscal stress in the medium and long-term.[20] To achieve this, this component will produce a diagnosis reviewing existing institutional framework linked to extractive industries, level of dependency of revenues and royalties coming from the extractive industries. Specifically, it will establish a taxonomy typical of the extractive industries revenue management systems that allows the classification and evaluation system of the countries to be analyzed. Studies will be produced to quantify the impact of COVID-19 crisis and the decline of oil prices in the economy, tax incentives (for example in tax expenditures) of the extractive industries and their implications in other sectors. The aim of these studies will be to strengthen the weak regulatory framework and institutional channels responsible in overseeing the extractives industries in the region and serve as a baseline to prepare public financial management systems for emergency response challenges.[21] This component will finance the following activities: (i) a working paper to review the fiscal impact caused by the COVID-19 and commodity price shock in LAC[22]; (ii) a technical note to strengthen the fiscal frameworks in the extractive industries.

3.2 **Component 2: Economic recovery plans post pandemic COVID-19 (US$50.000).** This component will support the formulation of a regional economic recovery plans (including short-and medium-term policy responses) targeted to sectors and actors[23] that allow the generation of sustainable fiscal revenues, rationalization, and effectiveness of public spending. Since the extractive sector is highly relevant to several economies in the region (i.e. Trinidad and Tobago, Ecuador, etc.), these industries will remain critical to allow not only the process of fiscal consolidation but also the recovery of the fiscal capacity. Therefore, it is important to understand the tax regimes and their administration to take advantage of their potential to generate equitable and non-distorting revenues by the state in a time of great need, help the countries to manage their extractive sectors more efficiently and make more effective

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[19] The selection criteria of the countries and scope of the diagnostics will fall under the frameworks set by the International Monetary Fund as Resource-Rich Developing Countries and Resource-Dependent Countries. See further: Macroeconomic Policy Frameworks for Resource-Rich Developing Countries (2012), Fiscal Frameworks for Resource Rich Developing Countries (2012).

[20] The major contribution of this TC will be to understand this dual effect impact that is out of the ordinary. Studies related to the volatility of oil prices have been conducted extensively, however the impact combined with the COVID-19 crisis in the medium and long-term is absent.

[21] There are three principal actors that are involved in the regulatory and management of the extractives industries: (i) Ministry of oil, energy and mining: in charge of long-term planning, policy definition according to the national development plan and sector regulation for each of the upstream, midstream and downstream segments; (ii) regulatory agencies: responsible for the administration of resources; (iii) Other ministries (environment, work, economy, finance, etc.): the operations of the hydrocarbon sector, like any other economic activity, is subject to the regulations established by each of the other Ministries in labor, social, and fiscal.

[22] The purpose of the study will be to conduct a regional analysis to identify the countries mostly impacted by this dual crisis. The identified countries could be considered as beneficiaries of a second phase project of this operation.

[23] The scope of this component will include governments (including ministries, tax agencies, statistic offices), industries (including state-owned enterprises and private sector) and civil society.

use of their revenues to improve their performance and mitigate their vulnerability to episodes of extreme volatility and environmental impact. Activities may include development of strategies and baselines, economic and fiscal recovery plans, methodologies to assess the impact of policies[24], and definition of role of the Ministries of Finance, Sectoral Ministries and regulatory agencies to cope with the macro-fiscal shocks of the pandemic. This component will finance the following activity: (i) formulation of regional economic plan including short and medium-term policy responses for the post-COVID period, solutions to consider a phased transition into renewable energy sources for a sustainable and long-term profitability to mitigate the research findings financed under Component 1.

3.3 **Component 3: Dissemination of diagnostics and plans (US$30.000).** This component will aims to manage the knowledge developed in Components 1 and 2 in order to enhance the lessons learned from the pandemic caused by COVID-19 and the oil price shocks in the region and create a space of policy dialogue and knowledge sharing for the post pandemic period. This will allow to assess the adaptability and scalability of the measures implemented during the pandemic and support countries mostly affected by these dual macro-fiscal shocks with the possibility to create a second phase operation. This component will finance activities such as: (i) dissemination of results of studies carried out virtually and through the channels currently used by the Bank for dissemination of knowledge; and (ii) policy briefs and blog articles to be shared with beneficiary countries and relevant policy makers to socialize research results.

IV. Estimated budget

4.1 The estimated budget for the operation amounts to US$150,000 which will come from the Program for the Development of Institutions (INS) financed with Ordinary Capital of the Bank. The execution period of this TC will be 24 months (24 months for execution and 25 months for disbursement). The products and results of this TC will also be shared with the Secretariat of the Program.

Indicative Budget

Activity/Component	Description	IDB/ INS Funding	Total Funding
Component 1: Diagnostics of the dual impact of COVID-19 crisis and commodity price shock in LAC	Through this component, the TC will generate knowledge and diagnostics of the dual impact of COVID-19 crisis and oil price shock in countries that are oil dependent. The findings will serve in assisting the formulation of fiscal policies and responses for immediate actions and reduction of the fiscal stress in the medium and long-term, and reestablish sustainable and equitable growth for the	US$ 70.000	US$ 70.000

[24] To ensure that the business continuity of the extractive industries respond to the environmental challenges, it will include policy guidelines and recommendations that allow fiscal revenues to finance sectors and climate commitments.

Activity/Component	Description	IDB/ INS Funding	Total Funding
	period during and after the pandemic in key areas affected by COVID-19.		
Component 2: Economic recovery plans post pandemic COVID-19	The objective of this component is to formulate a regional economic policy plan (including short-and medium-term policy responses) for the post-COVID period. Activities may include development of strategies and baselines, economic recovery plans, methodologies to assess the impact of policies, and definition of roles of the Ministries of Finance, competent line ministries and regulatory agencies to cope with the macro-fiscal shocks of the pandemic.	US$ 50.000	US$ 50.000
Component 3: Dissemination of diagnostics and plans	Through this component, the TC will generate knowledge dissemination of diagnostics and policy plans conducted in the component 1 and 2 and organize dissemination events such as a webinar for public officials and the public to create a space of policy dialogue and knowledge sharing for the post pandemic period.	US$ 30.000	US$ 30.000
Total		**US$150.000**	**US$150.000**

V. Executing agency and execution structure

5.1 Given the regional dimension of this technical cooperation and the lack of a regional entity with the capacity to execute and supervise it, the Bank, through its Fiscal and Municipal Management Division (IFD/FMM) will be the executing agency. The Bank's execution is justified by the regional nature of the response to the crisis caused by COVID-19 where the Bank is expected to receive multiple demands from different actors and with different coordination needs. The execution by the Bank has the additional benefit of taking advantage of lessons learned and collecting results from different experiences to disseminate knowledge to the region.

5.2 The activities will be closely coordinated by the fiscal specialists in the countries, who will present the country's requirement and will evaluate (i) the alignment with the objectives of the TC; (ii) the impact and additionality with the program in the fiscal area in the country; and (iii) the complementarity with other resources. In addition, FMM will closely coordinate with other areas in the Bank to ensure that there is no duplicity nor overlap in the research that is planned to be carried out with this TC. Given this TC is Research and Dissemination (RD) and a Bank initiative, hence it is responsible for the selection and hiring of consultancy services requiring no justification (Annex 10, GN-2629-1).

5.3 **Fiduciary regulations.** The financial management of the operation will be governed by the provisions of the Financial Management Guide for Projects Financed by the IDB (OP-273-12).

5.4 **Audited reports and financial statements.** Considering that the Bank will be the executing agency, in accordance with the provisions of the Financial Management Guide for Projects Financed by the IDB (OP-273-12), the presentation of financial audit reports is not required.

5.5 **Procurement and Contracts.** The activities to be carried out under this operation have been included in the Procurement Plan (Annex IX) and will be executed in accordance with the Bank's established procurement methods, namely: (a) hiring of individual consultants, as established in the regulations AM-650; (b) hiring of consulting firms for services of an intellectual nature according to GN-2765-4 and its associated operating guides (OP-1155-4) and (c) hiring of logistics services and other services other than consulting, according to the policy GN-2303-28.

VI. Major issues

6.1 The main risk associated to this TC is related to the availability of quality information from the Ministries of Finance or similar agencies for the development of the different products of the TC given the mitigation measures of the pandemic. To mitigate this risk, the TC will collect extensively existing information, databases, and secondary sources. However, considering the type of this operation is research and dissemination (R&D), the TC should consider a potential slow response from counterparts in collecting primary source of information, likewise it will focus on beneficiary entities that show interest in solving specific problems to face the economic, fiscal and social crisis, COVID-19, and will seek synergies with operations already approved by the IDB's Fiscal Management Division that allow for updated information. Moreover, the findings of this TC will complement in designing the demand of policy loans as per request of the countries affected by the macro-fiscal shocks.

6.2 There is a risk of delay in TC implementation activities given the current restrictions of the pandemic such as travel restrictions. This risk will be mitigated by maintaining an open and fluid dialogue with our counterparts in each participating country, consultancies that can work remotely will be hired, and virtual events will be organized to facilitate the exchange of information.

6.3 Any studies report or other material, graphic, software or otherwise, prepared as stated in the Procurement Plan (Annex IX) shall belong to and remain the property of the Bank. All intellectual property rights in the outputs produced under this TC are vested in the executing agency, the Fiscal and Municipal Management Division (IFD/FMM).

VII. Exceptions to Bank policy

7.1 This TC does not involve exceptions related to Bank's policies.

VIII. Environmental and Social Strategy

8.1 Given the nature of the TC, no negative environmental impacts are foreseen. The TC will support the strengthening of processes and capacities of the Ministries of Finance and similar agencies, for which reason public works or infrastructure will not be financed. In accordance with the Bank's Environmental and Safeguards Compliance Policy (OP703), this operation has been classified in category "C". See Safeguards Policy Filter Report (SPF) and the Safeguard Screening Form (SSF).

IX. Required Annexes:

Results Matrix_77379.pdf

Terms of Reference_6532.pdf

Procurement Plan_93474.pdf