

TC Document

I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ TC Name:	Strengthening of macro-fiscal frameworks in Latin America and the Caribbean
▪ TC Number:	RG-T4153
▪ Team Leader/Members:	Valencia Arana, Oscar Mauricio (IFD/FMM) Team Leader; Astudillo, Karen (IFD/FMM) Alternate Team Leader; Munoz Miranda, Andres Felipe (IFD/FMM) Alternate Team Leader; Canillas Gomez, Mariana Belen (IFD/FMM); Carmen Montesinos Ibanez (IFD/FMM); Juan Carlos Cardenas Valero (INE/ENE); Nathalia Gonzalez Sosa (IFD/FMM); Vila Saint-Etienne, Sara (LEG/SGO) Team Leader; Astudillo, Karen (IFD/FMM) Alternate Team Leader; Munoz Miranda, Andrés Felipe (IFD/FMM) Alternate Team Leader; Canillas Gomez, Mariana Belén (IFD/FMM); Carmen Montesinos Ibanez (IFD/FMM); Juan Carlos Cardenas Valero (INE/ENE); Vila Saint-Etienne, Sara (LEG/SGO)
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	.
▪ Date of TC Abstract authorization:	31 May 2022.
▪ Beneficiary:	Ministries of Finance in LAC
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	Public Capacity Building Korea Fund for Economic Development(KPC)
▪ IDB Funding Requested:	US\$350,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	24 months of disbursement period, and 24 months of execution period
▪ Required start date:	December 10, 2022
▪ 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:	No
▪ TC included in CPD:	No
▪ Alignment to the Update to the Institutional Strategy 2020-2023:	Institutional capacity and rule of law

II. Objectives and Justification of the TC

- 2.1 **Objectives.** The general objective of this technical cooperation (TC) is to strengthen the macro-fiscal framework¹ of the Ministries of Finance in Latin America and the Caribbean (LAC) so they can generate fiscal space to recover the path of fiscal consolidation, and design post-pandemic policies for sustainable growth in the medium term. The specific objectives of this TC are to (i) develop analytical tools to

¹ Macro-fiscal framework is a set of tools used to identify fiscal risks, management of public finances under fiscal sustainability principles, design, and implementation of fiscal strategies to achieve the fiscal goals. For example, fiscal responsibility laws, medium term fiscal frameworks, fiscal rules, fiscal council, independent budget offices.

identify major variables which impact fiscal sustainability; and (ii) create metrics to identify macro-fiscal risks and fragilities and provide countries with risk mitigation alerts and greater technical capacity for policy design.

- 2.2 **Justification.** Currently there are only ten² countries in LAC with medium-term fiscal frameworks, many of which lack a robust structure allowing them to generate a coherent multi-year fiscal strategy: (i) there is not a clear identification of the variables that most compromise fiscal sustainability, and (ii) the liquidity and solvency risks which the countries may be subject to have not been identified. After the 2008 international financial crisis, LAC's economies faced persistent fiscal deficits. During the commodity price drop from 2014-2016, this effect was magnified. Still, with the strengthening of the institutional framework, the introduction of fiscal rules in the region, and improved prospects for recovery, fiscal deficits gradually recovered. Thus, while the fiscal deficit was 4% of GDP in 2015, by 2019, it was 3.4% of GDP. During this period, some LAC's countries have entered into fiscal adjustment and balance of payments programs with the IFM, which include important institutional components to strengthen medium-term fiscal frameworks and fiscal rules. However, despite the fiscal consolidation efforts, the gross debt trend was increasing slightly. With the pandemic, this pattern was reversed. Fiscal deficits deepened to 7.5% of GDP, and debt increased 14 pp from 58% of GDP in 2019 to 72% in 2020 and a slight decrease in public debt in 2021 of 68% of GDP. This dramatically changed the fiscal outlook and presents challenges for the countries to avoid a debt overhang. While the region's real growth rate is expected to recover by around 6% in 2022, the outlook remains more complex.
- 2.3 Lessons learned from other countries could contribute to strengthening LAC macro-fiscal framework. For example, following the 1997 Asian crisis, Korea began its comprehensive institutional strengthening process by introducing performance budgeting, an integrated financial information system, and medium-term fiscal frameworks. These measures were introduced in the first "National Fiscal Management Plan" covering the period 2004-2008 and has been essential in improving fiscal responsibility and expenditure efficiency, helping to maintain fiscal stability in the medium term. In its ongoing commitment to sustainable fiscal management, Korea is now implementing a new fiscal rule, which would limit debt to 60 percent of gross domestic product and the fiscal deficit to 3 percent, starting in 2025. Considering the fiscal situation facing LAC, which has seen numerous fiscal rule suspensions, Korea's experience will be critical in the rule reshaping process that will challenge the region in the coming years. Potential partnerships with Korean organizations, such as the Korea Institute of Public Finance (KIPF) and the Korea Development Institute (KDI). The KIPF has created a body of knowledge about cutting edge topics in fiscal management. The Korea Public Finance Information Service

² Argentina, Chile, Colombia, Costa Rica, Jamaica, Mexico, Peru, Dominican Republic, Paraguay and Uruguay.

(KPFIS) has contributed to the enhancement of public finance by supporting the stable operation and management of the digital budget accounting system and by developing fiscal policy. The Fiscal Management Bureau (Ministry of Economy and Finance) has actively worked in implementing policies and practices to achieve fiscal efficient and transparency in the Republic of Korea. Creating a body of knowledge in cooperation with these partners, this program will contribute to the development of future actions conducive to improve fiscal responsibility and expenditure efficiency, and to help maintain fiscal stability in the medium term.

- 2.4 **Strategic Alignment.** This TC is consistent with the Second Update of the Institutional Strategy 2020-2023 (AB-3190-2) aligning the cross-sectional area of Institutional Capacity and the Rule of Law, by means of strengthening the Ministry of Finance through the development of models and tools that allow to identify them areas of macro-fiscal vulnerability to prioritize the resources allocated during the pandemic. The TC will contribute to the Corporate Results Framework (GN-2727-12) through the indicator of “countries with strengthened tax and expenditure policy and management”. This TC is also aligned with Sectorial Framework for Fiscal Policy and Management (GN-2831-8) which emphasizes the importance of strengthening institutional capacity in the public sector to design and implement fiscal policies with a sustainable path and economic development by developing analytical tools and creating metrics to identify major macro fiscal risks and fragilities. This TC also responds to the objective of the KPC (Public Capacity Building Korea Fund for Economic Development) stipulated in the Fund operational guidelines which is to strengthen public sector management in all fiscal related sectors through assistance aimed at facilitating efficient allocation and use of public sector resources to generate higher public value at the national and the sub-national government level.
- 2.5 **Contribution to the Bank’s operative program.** This TC will coordinate with other on-going projects that support activities aimed at strengthening macro fiscal institutions. For example, with ATN/OC-18398-RG (Macro-Fiscal Monitoring for LAC in the Pandemic and Post-Pandemic, RG-T3751) that provides technical support for Ministries of Finance to build macro fiscal frameworks and more robust fiscal strategies. Also, the proposed TC will complement the IDB’s knowledge agenda in fiscal sustainability and fiscal frameworks, which includes the book on Resilient Fiscal Rules in Latin America ([Barreix et al., 2019](#)) and the work developed by [Valencia & Ulloa-Suarez \(2022\)](#) on fiscal rule compliance in LAC. The TC’s research activities in macroeconomic management will advance the LAC’s literature on the impacts of implementing fiscal rules, which has shown their effectiveness in promoting fiscal and macroeconomic sustainability ([Argimón & Hernández de Cos, 2012](#); [Benito et al, 2013](#); [Milessi-Ferreti, 2004](#); [Neyapti, 2013](#); [Tapsoba, 2012](#); [Ardanaz et al, 2021](#)). The TC will also facilitate the design of fiscal rules accompanied by adequate institutional mechanisms, which should generate positive effects in terms of reducing the cost of financing and sovereign default risk ([Iara & Wolff, 2014](#); [Badinger & Reuter, 2017](#); [Thornton & Vasilakis, 2017](#); [Gomez-Gonzalez et al, 2022](#); [Valencia et al, 2022](#)).

III. Description of activities/components and budget

3.1 Component I: Research activities on macro-fiscal management (US\$ 125,000).

During the COVID-19 pandemic, the region's public debt grew substantially making it critical for countries' macro-fiscal frameworks to be consistent with appropriate debt levels that do not hinder growth and act as an anchor for a sustainable fiscal planning process. In this context, the purpose of this component is to conduct research to strengthen fiscal frameworks and fiscal rules in LAC that are consistent with sustainable debt levels. This component will finance the following activities: (i) conduct research on experiences inside and outside of LAC during macroeconomic crisis to extrapolate lessons learned applicable to LAC—for example, this may include conducting research work into the Korea case and the OECD experiences; (ii) evaluate mechanisms to strengthen macro-fiscal buffers that allow for counter-cyclical fiscal policy; and (iii) analyze efficiency issues in allocating fiscal resources, such as improvements in tax structures to enhance economic growth.

3.2 Component II: Gap analysis in fiscal/macro-economic/institutional variables in LAC (US\$ 125,000).

The purpose of this component is to strengthen fiscal institutions by analyzing macro-fiscal gaps in LAC. This component will finance the following activities: (i) development of databases that will be used to identify the macroeconomic, fiscal, and institutional gaps that generate persistent imbalances through a comparison with other emerging and advanced economies; (ii) conduct research to analyze the level of development of medium-term fiscal plans, fiscal rules (design and implementation), and the level of independence of budget offices, fiscal councils, and committees; (iii) conduct research to quantify main macro-fiscal risks in LAC and analyze mitigation measures compared to international benchmarks and best practices of advanced economies through econometric models that capture the probability of fiscal stress to distinguish crisis events versus normal periods; are based on early warning models, logit and probity, and models with structural change and nonlinearities; and include deeper analysis of gross debt (both domestic and foreign currency), fiscal revenues, the industrial competitiveness of the countries, adequate levels of international reserves (among other variables), as determinants of fiscal fragility y (iv) analyze the mechanism that the countries could use to overcome possible pitfall in the policy implementation.

3.3 Component III: Dissemination of results (US\$100,000).

The purpose of this component is to disseminate the results of the knowledge products financed in Components I and II above. This component will finance the following activities: (i) publication and communication about the products that are prepared with this TC, this will allow to create more awareness about the program among IDB member countries; (ii) producing an event (in-person, virtually or hybrid format) to present and foster collaboration among IDB specialists, public officials, academia, civil society, and other international organizations interested in this topic. It is expected that this event will be conduct in partnership with the Korean Government. Furthermore, all

publications, events and activities will refer to the KPC as financier in accordance with the Fund's guidelines.

- 3.4 All knowledge products derived from this TC will be the Bank's intellectual property. Any studies report or other knowledge products (e.g., material, graphic, software or otherwise), prepared as stated in the Procurement Plan (Annex IV) will be the Bank's intellectual property. 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). Knowledge products will be published through the Bank's web page and other official communication channels, providing long term outreach and sustainability to the TC's results and products.
- 3.5 **Expected results.** At the end of the execution period of this TC, it is expected that the products financed with the operation will make it possible to identify the main weaknesses of the macro-fiscal frameworks of the countries that were impacted by the COVID-19 crisis. In addition, it will enhance countries' institutional capacity by providing them with tools to design policies for generating fiscal space and a faster and more successful recovery in the post-crisis period. Institutions face the challenge of balancing the tradeoff between credibility and flexibility that is crucial for policymakers to provide short-term fiscal stimulus with medium-term sustainability. Korea's experience as a standard-bearer in macro-fiscal discipline sets an example for the adoption of better practices and original and more innovative methodologies to build the institutional capacity of the region's finance ministries.
- 3.6 The total cost of this TC will be US\$350,000, which will be financed by the Bank through the Public Capacity Building Korea Fund for Economic Development (KPC) fund. The execution period of this TC will be 24 months, and the disbursement period will be 24 months.

Indicative Budget

Component	Description	IDB/KPC (US\$)	Total (US\$)
Component I. Research activities on macro-fiscal management	The purpose of this component is to conduct research to strengthen fiscal frameworks and fiscal rules in LAC that are consistent with sustainable debt levels.	125,000	125,000
Component II. Gap analysis in fiscal/macro-economic/institutional variables in LAC	The purpose of this component is to strengthen fiscal institutions by analyzing macro-fiscal gaps in LAC	125,000	125,000

Component III. Dissemination of results	The purpose of this component is to disseminate the results of the knowledge products financed in Components I and II	100,000	100,000
Total		350,000.00	350,000.00

- 3.1 The Fiscal Management Division (FMM) at the IDB HQ will be responsible for the supervision, monitoring and evaluation of the TC. It will also be responsible for the financial execution of the operation. The project will be monitored and evaluated according to the annual goals and indicators of the results and products that make up the TC results matrix. The foregoing in strict compliance with the provisions of Annex II of document OP-619-4.

IV. Executing agency and execution structure

- 4.1 Given that this TC is a Bank-led initiative, the regional dimension of this TC and the lack of a regional entity with the capacity to implement it, the Bank will be the executing agency through the Fiscal Management Division (IFD/FMM) in close coordination with FMM country specialists. The intended beneficiaries of this TC are the Ministries of Finance of LAC.
- 4.2 The activities to be executed under this operation have been included in the Procurement Plan (Annex IV) and will be executed in accordance with the Bank's established procurement methods, namely: (i) Hiring of individual consultants, as established in AM-650; (ii) Hiring of consulting firms for services of an intellectual nature according to GN-2765-4 and its associated operational guides (OP-1155-4) and (iii) Contracting of logistics services and other services other than consulting, according to policy GN-2303-28.

V. Major issues

- 5.1 Risks for this project are low but the major risk 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. To mitigate this risk, the models' data will be based on public and official sources that allow the replicability of the estimates and the maintenance of the models. In addition, the data and the model will be used in the future for continuous monitoring analysis of the countries.

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 This TC will not finance feasibility or pre-feasibility studies of investment projects with associated environmental and social studies; therefore, it is excluded from the scope of the Banks's Environmental and Social Policy Framework (GN-2965-23).

Required Annexes:

[Results Matrix - RG-T4153](#)

[Terms of Reference - RG-T4153](#)

[Procurement Plan - RG-T4153](#)