# PROGRAM INFORMATION DOCUMENT (PID)
## APPRAISAL STAGE

August 26, 2015
Report No.: 100890

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| **Operation Name** | Strengthening Management of Public Finances |
| **Region** | LATIN AMERICA AND CARIBBEAN |
| **Country** | Dominican Republic |
| **Sector** | Public Administration, Law, and Justice - General public administration sector- 100% |
| **Operation ID** | P155425 |
| **Lending Instrument** | Development Policy Lending |
| **Borrower(s)** | Ministry of Finance |
| **Implementing Agency** | Ministry of Finance |
| **Date PID Prepared** | August 4, 2015 |
| **Estimated Date of Appraisal** | September 25, 2015 |
| **Estimated Date of Board Approval** | November 11, 2015 |
| **Corporate Review Decision** | Following the corporate review, the decision was taken to proceed with the preparation of the operation. |

## I. Key development issues and rationale for Bank involvement

Over the past decade, the Dominican Republic (DR) has experienced strong economic growth, accompanied by a reduction in poverty. Following a severe crisis between 2003 and 2004, which resulted in 1.5 million Dominicans falling into poverty, consistent economic growth at an average rate of 6.4 percent during the period from 2005 to 2013 allowed for a decline in moderate poverty, from 49.9 in October 2004 to 41.8 as of October 2013, according to national poverty figures. In 2014, the DR grew at 7.3 percent, the fastest among Latin American and Caribbean economies. This resulted in the creation of 165,000 net jobs between October 2013 and October 2014, and a 5-percentage point fall in the headcount poverty rate to 35.5 percent in 2014, following a period of virtual stagnation since 2011. Limited upward social mobility, persistent regional disparities, gender inequalities, and low quality of public services continue to be among the factors that dampen the impressive growth record that the country has exhibited during this period.

Despite improvements in macroeconomic management, the state continues to suffer from limited fiscal space to effect pro-poor policies. The commitment of the authorities to fiscal discipline is evident, as the Government met its central government deficit target of 2.8 percent of GDP in 2013 and 2014. Nonetheless, public finances continue to suffer from insufficient revenue collection and a range of constraints on the expenditure side. The Government introduced a new tax package in November 2012, and renegotiated its agreement with Barrick Gold, which increased tax revenue collection to 13.1 percent of GDP in 2013 and 14.2 percent in 2014, from an average of 12.4 percent in 2011 and 2012. Despite these efforts, tax revenue collection still remains approximately two percentage points below the regional average. On the expenditure side, inefficiencies in the electricity sector pose a severe financial burden, constituting

Government transfers to this sector averaging 1.4 percentage points of GDP annually between the period 2009 and 2014. Additionally, as a consequence of the 2003 crisis, the state has devoted around one percent of GDP to the recapitalization of the Central Bank since 2007. Finally, coupled with rapid economic growth, the consolidated public sector debt has expanded significantly, from 31.2 percent of GDP in 2007 to an estimated 51.3 percent in 2013. The result is an increasing debt service burden that poses a potential threat to fiscal sustainability over the medium term.

The limited fiscal capacity of the state is worsened by limitations in the management of public finances towards quality public service delivery to citizens. Despite improvements in access to public services in recent years, weaknesses in public expenditure planning, execution, and monitoring continue to hamper the quality of service delivery. The initial response of the Government to social discontent with the quality of public services has been to increase budgetary allocations for key sectors, to four percent of GDP for education and about 1.7 percent of GDP for health. Despite a notable expansion in school enrollment and health service coverage in recent years, outcomes in both sectors continue to underperform. Persistent lack of quality in public services despite increasing coverage and budgetary allocations, brings into question the effectiveness with which public resources are managed, today at the forefront of national debate.

A number of structural weaknesses in the overall public financial management environment limit the effectiveness with which public resources are managed. Public institutions display limited capacity to manage public expenditures in line with national development priorities. While the legal frameworks provide for a strategic and orderly allocation and results-oriented execution of public resources, public programs are primarily “output” driven, largely aiming for “products” and “outputs” rather than “outcomes” and “results.” The traditionally weak level of coordination between the planning, monitoring and evaluation functions across different government institutions affects the alignment between the National Development Strategy (NDS) and the national budget. A Public Expenditure Management and Financial Accountability Review (PEMFAR) that the World Bank carried out for the DR in 2013 highlighted continuing difficulty in establishing a multiannual perspective for planning and budgeting and implementing the strengthened legislation for the PFM system. In this context, expenditure management continues to be characterized by considerable variances between budgeted revenue and expenditure. Expenditure control and procurement systems are fragmented, and enforcement is weak. Together, these issues represent a critical challenge for ensuring a strategic and controlled management of public resources, which this operation seeks to address.

A sustainable and orderly public finance environment constitutes the backbone of the Government’s ability to effect pro-poor public policy, safeguard the resilience of economic and social programs, and deliver better public services. With this in mind the Government has introduced measures to contain debt service outlays and continued to reduce its Central Bank recapitalization obligations. The Government’s Multiannual Plan for the Public Sector for the period 2013 to 2016 has called for initiatives to enable public sector institutions to improve their management of public finances and service delivery. These initiatives include the introduction of medium term, results-based planning and execution practices in sector entities, especially in the health sector, where, with World Bank support, results-based financing mechanisms are already producing promising results. The plan further calls for initiatives to improve competition and controls in public procurement through the establishment of a e-procurement portal, enhance controls in the commitment of public expenditures through the consolidation of public accounts into a treasury single account, streamline public accounting through the gradual introduction of international public sector accounting standards, consolidate PFM transactions through the expansion of the coverage of the integrated financial management system, and enhance transparency and accountability in the management of public resources through fostering greater civic engagement and oversight. To consolidate gains further, the NDS has called for three major Pacts (in education, electricity and fiscal issues) as mechanisms to forge broad social consensus on systemic, longstanding challenges. An Education Pact was signed in April 2014 across all segments of the stakeholders involved in the sector. An Electricity Pact is currently being pursued with a diverse range of stakeholders, with the overall objective to reduce electricity sector losses and improve service quality.

The supported policy measures under this operation are aimed at locking in prior to the Presidential elections of May 2016 the core elements of the PFM reform agenda that have pro-poor implications. Pillar 1 policy measures, centering on improving debt management, will enhance fiscal sustainability, an important cornerstone of avoiding economic crises, which affect the poor disproportionately as social spending is typically one of the first items to be cut when crises hit. The measures supported under Pillar 2 will support results-based, orderly execution of public expenditures, particularly in the health sector. The improvements in public expenditure management under this Pillar will contribute to enhancing the quality of public spending, which has direct consequences on poverty as the less well-off are often unable to opt out of public services and low quality public services translate into inequities, constraining the set of human "opportunities" available to the poor. The reforms under Pillar 3 will enhance transparency in government operations through improved statistics and monitoring of the use of public funds, including those for the Education Pact, which is the major multi-sectoral platform on which comprehensive sector reforms are being built. This Pillar will support making accurate information regularly and publicly available, which will allow for more informed and evidence-based design and evaluation of public programs. Together, these Pillars support measures that will enhance the strategic allocation and results-oriented use of public resources and strengthen the enabling environment to engage in longer term development planning.

## II. Proposed Objectives

The Program Development Objective of this operation is to support the Dominican Republic's efforts to strengthen the management of public finances and to enhance transparency in government operations. It aims at supporting the Government in (i) improving flexibility and transparency in the management of public debt; (ii) strengthening planning, budgeting, and execution of public expenditures; and (iii) enhancing transparency in Government operations.

The conceptual framework of the proposed operation stems from the premise that a good PFM system is essential for the implementation of public policies and the achievement of development objectives by supporting aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. Effective controls of the budget and the management of fiscal risks contribute to maintaining aggregate fiscal discipline; planning and executing the budget in line with Government priorities contributes to the implementation of the Government's objectives; and managing the use of budgeted resources transparently contributes to efficient service delivery and value for money. The reforms that this operation will support in the context of sustainable debt management, results-oriented budgeting, competitive public procurement, and regular monitoring and evaluation of public programs are expected to have direct positive impact on the achievement of the Government's budgetary goals and outcomes.

The proposed operation targets improvements in the management of key social sectors towards quality of public services, which is expected to benefit the poor and vulnerable. Despite improvements in access to public services in recent years, weaknesses in public expenditure planning, execution, and monitoring continue to hamper the quality of public service delivery. While there has been a significant increase in budgetary allocations for key sectors and a notable expansion in school enrollment and health service coverage in recent years, outcomes in both sectors continue to underperform. According to the National Demographic and Health Survey, despite having high coverage rates for prenatal care at 99 percent and births assisted by skilled professionals at 98.5 percent, maternal mortality rate was at 100 per 100,000 live births in 2013. This is higher than the regional average in LAC, at 87. In education, despite an aggressive construction policy that greatly expanded coverage at all levels since 2004 (net enrollment rates are now 36 percent in preschool education, 89 percent in basic, and 62 percent in intermediate), poor student learning outcomes plague the system as Dominican students consistently perform well below regional averages in all subject areas. Persistent lack of quality in public services despite increasing coverage and budgetary allocations brings into question the effectiveness with which public resources are managed, which is today at the forefront of national debate.

## III. Preliminary Description

The proposed operation is a standalone US$60 million development policy loan designed to support the Dominican Republic's efforts to strengthen the management of public finances and to enhance the transparency of government operations. The program has three Pillars that stem from the existing reform agenda of the Government and the 2015-2018 Country Partnership Strategy (CPS) of the World Bank: (1) improved flexibility and transparency in the management of public debt; (2) strengthened planning, budgeting, and execution of public expenditures; and (2) enhanced transparency in government operations.

**Pillar 1** and **Pillar 2** are aimed at strengthening the management of public finances. Pillar 1 is built on policy actions that relate to improving flexibility and transparency in the management of public debt, while Pillar 2 focuses on strengthening planning, budgeting and execution of public finances across the central government in general and the health sector in particular. Actions supported under Pillar 2 include the institutionalization of results-based planning and budgeting practices in the health sector, the establishment of a National System for Monitoring and Evaluation, and the improvement of competition and controls in public procurement practices. The improvements in medium term debt management, planning, budgeting, and expenditure practices will contribute to establishing the enabling environment for a more strategic allocation of public resources, as well as a more orderly execution of public finances in line with development priorities.

**Pillar 3** focuses on enhancing the transparency in the management of government operations. This Pillar will support regular publishing of official poverty figures, which is a crucial input into the design and monitoring of development programs and interventions. It will also support monitoring publicly the performance of initiatives under the Education Pact, which will enhance the accountability of the actors involved in reform initiatives in this important sector that receives significant public funds. Similarly, the action this Pillar will support in the context of the adoption of a results-oriented allocation of public funds to the non-profit sector will enhance transparency and citizen engagement in a sector that plays a highly visible role in public service delivery.

## IV. Poverty and Social Impacts and Environment Aspects

The poverty and social impact of the policy measures supported by this DPL is expected to be positive. The supported policy measures address vulnerabilities of different parts of the economy and are meant to contribute to poverty reduction and shared prosperity.

Pillar 1 policy measures are expected to have a positive poverty and social impact. The improvements in medium term debt management are aimed at impacting positively debt levels and transparency. This policy is likely to contribute to preventing excessive indebtedness, attaining debt sustainability and holding debt quality and costs at desirable levels to avoid excessive volatility and potential crises.

The enhancement of the management of public finances through improved medium-term planning, budgeting and execution of public expenditure under Pillar 2 are policies aimed at increasing the efficiency and effectiveness of public spending. These reforms are expected to strengthen the quality of public spending, and improve the provision, quality and citizen oversight of public services. Weak management of public finances lowers the quality of service delivery, and, as the less well-off are often unable to opt out of public services (such as schooling), low quality public services translate into inequities, constraining the set of human "opportunities" of the poor. Similarly, the expansion of the implementation of the results-based financing mechanisms at primary care level aims at enhancing management and monitoring of commitments and outcomes in the health sector. This reform is likely to have positive poverty and social impacts as health coverage is lower for the poor, and the focus on primary care will likely provide incentives for individuals of lower income levels to seek preventive treatment such as medical check-ups more often. The establishment of the NSME aims at increasing capacity for medium term expenditure planning and execution through the regular monitoring and evaluation of the performance of sectoral programs. By tracking public policy results in social sectors this reform is likely to allow for a more efficient use of resources towards the desired ends, reduce waste and increase coverage of the targeted poor and vulnerable population

The impact of the reforms supported under Pillar 3 is also expected to be positive in the medium to long term. The adoption of mechanisms to enhance accuracy and transparency in the publication and use of poverty information will enhance transparency in the process of poverty calculation. It will allow for a better estimation of the magnitude and size of the poverty population as well as their geographic location to improve policy targeting, monitoring and program evaluation. A formal institutionalization of the Poverty Committee through a Presidential Decree will ensure the sustainability of transparent, best-practice methodologies for estimating household welfare, poverty and shared prosperity.

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The adoption of the mechanism to formally monitor the implementation of the Education Pact is aimed at enhancing management and monitoring of commitments and results made under the Education Pact. This reform is likely to increase transparency and efficiency in the achievement of the different objectives of the Education Pact, including universalization of pre-tertiary education and expansion of tertiary education, ensuring adequate financing and infrastructure for the system, reforming the teaching career and improving the quality of teaching, and adopting a culture of evaluation and accountability. This reform will likely have a positive poverty and social impact. Similarly, the reform efforts to improve the allocation of public resources to the non-profit sector should contribute to the Government's ability to rationalize the strategic allocation of resources, while enhancing the accountability of outcomes in a sector that has high visibility in key social sectors that impact the poor and the vulnerable.

The DPL is expected to have a neutral environmental impact. The reforms are designed to improve the institutional and policy framework of the Government as it relates to improving the governance of public resources, and as such have no direct bearing on the environment.

## V. Tentative financing

| Source: | ($m.) |
|---|---|
| Borrower | 0 |
| International Bank for Reconstruction and Development | 60 |
| Borrower/Recipient | |
| IBRD | |
| Others (specify) | |
| Total | 60 |

## VI. Contact point

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