Technical Cooperation (TC)-ABSTRACT

I. BASIC PROJECT DATA

Country/Region:	Regional
TC Name:	Construction of a Fiscal Quality Indicator for LAC
TC Number:	RG-T2329
Team Members:	Gustavo García (IFD/FMM), Team Leader; María Cecilia Deza (IFD/FMM); Luis Marcano (IFD/FMM); and Marina Massini (IFD/FMM).
Operation type:	Research & Dissemination
Date of TC Abstract:	April 2013
Beneficiary:	Latin America and Caribbean countries (LAC)
Executing Agency:	Inter-American Development Bank
IDB Funding Requested:	US$145,000
Disbursement period:	18 months
Required start date:	April 2013
Types of consultants:	Individual
Prepared by Unit:	IFD/FMM
Unit of Disbursement Responsibility:	IFD/FMM
TC included in CS or CPD	No
GCI-9 Sector Priority:	Institutions for Growth and Social Welfare

II. OBJECTIVE AND JUSTIFICATION

2.1 The positive impact of fiscal policy on long term growth is a well-documented fact in the literature.[1] The availability of fiscal data makes it possible to test empirically this relationship using statistical and econometric tools. The Fiscal and Municipal Management Division (IFD/FMM) is currently working on a research project aimed at evaluating the efficiency and effectiveness of fiscal policy as a driver of sustained and more equitable economic growth in LAC.[2]

2.2 There are broad sources of information on fiscal data. Each area of public finances (see ¶3.1 below) has an extensive variety of indicators which are available for relatively long time horizons and different levels of public sector coverage. However, 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 effect on long term growth and how it compares with the rest of the region.

2.3 Composite indicators are frequently used to measure several aspects of economic and social development, such as competitiveness, ease of doing business, central bank independence and technological progress, among others. One advantage of

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

[2] "Fiscal Policy for Sustainable and More Equitable Growth in Latin America and the Caribbean" (RG-T1920 – ATN/SF-12586-RG) and "Support to Fiscal Policy for Sustainable and More Equitable Growth" (RG-X1144 – ATN/CF-13250-RG).

composite indicators is that it enables summarizing complex, multi-dimensional realities, easing its interpretation and the decision-making process. Additionally, it becomes possible to establish rankings among countries based on the definition of benchmarks. Concerning public finances, the European Commission (EC) have used this tool to measure the quality of fiscal policy in the EU and its influence on macro and social aggregates.[3] In fact, the EC jointly with the Organization for Economic Cooperation and Development (OECD) have prepared a handbook that compiles the theoretical background and the methodological steps required to properly construct composite indicators.[4]

2.4   Despite the availability of fiscal data, no similar attempt has been done for LAC. To overcome this shortcoming, this Technical Cooperation (TC) will finance the construction of a composite indicator aimed at measuring the quality of fiscal policy in LAC, based on a considerable number of quantitative and qualitative variables in four areas of public finances (see ¶3.1 below), as well as exploring its impact on growth on solid and consistent technical grounds. Such an effort will support the activities of the Bank, especially the definition of Country Strategies. In particular, the TC will be a key input in the preparation of the Fiscal Sectorial Strategy to be delivered by IFD/FMM in 2015, which will be focused on the quality of fiscal policy and management and its links to economic and social development in the region. In general, this project will provide a useful tool to gauge the overall performance of public finances, its main weaknesses and strengths, leading to a better focalization of IFD/FMM's fiscal operations. Thus, this TC is aligned with the priorities of the Public Capacity Building Korea Fund for Economic Development.

III. DESCRIPTION OF ACTIVITIES AND OUTPUTS

3.1   **Component 1. Data collection, construction of sub-indexes and the aggregate indicator.** The activities to be financed under this component include the compilation of statistics and the construction of a database following the criteria established in OECD (2008). Additionally, a cautious review on the consistency and comparability across countries and years of the selected variables will be necessary. The four areas of fiscal policy considered for the goals of this TC are: (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. For each area, sub-indexes will be constructed and aggregated into a composite indicator thereafter. This stage also comprises an analysis of the sensitivity of the composite indicator to changes in the normalization, weighting and aggregation methods. This component will be executed by a full time consultant based at IDB Headquarters.

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[3]   Barrios, S. and Schaechter, A. Gauging by numbers: A first attempt to measure the quality of public finances in the EU. Directorate-General Economic and Financial Affairs. European Commission. Economic Papers 382. July 2009.
[4]   OECD and EC. Handbook on Constructing Composite Indicators. Methodology and User Guide. 2008.

3.2   **Component 2. Econometric contrasts.** As a final step, an analysis of the composite indicator's power to explain main macroeconomic and/or social aggregates should be carried on. Through this component, econometric exercises will be performed to assess the relationship and causality between the composite indicator and long-term growth as well as its robustness. This task will require the participation of an econometrics-specialized consultant.

3.3   **Component 3. Dissemination and publication.** This component will support the organization of a BBL (Brown-Bag Lunch) to discuss the preliminary findings of the TC. Also, a working paper with the final results will be prepared and released in a seminar to a wide audience of relevant stakeholders beyond the Bank.

IV. BUDGET

Component	Description	IDB (US$)	Total (US$)
Component 1	Individual consultant services: data collection, construction of sub-indexes and the aggregate indicator.	100,000	100,000
Component 2	Individual consultant services: econometric tests and contrast.	30,000	30,000
Component 3	Dissemination and publication of intermediate and final results.	15,000	15,000
Total		**145,000**	**145,000**

V. EXECUTING AGENCY AND EXECUTION STRUCTURE

5.1   The TC will be Bank-executed. The project team will be headed by Gustavo García, Principal Fiscal Economist and Coordinator of the Fiscal Cluster of IFD/FMM, who will lead and supervise the execution of the components.

VI. PROJECT RISKS AND ISSUES

6.1   The TC could face two main risks: i) the compilation and construction of the database could take more time than initially expected, and ii) the results of the econometric tests may not be satisfactory. As mitigation measures for the first, previous exercises of identification of available statistics, sources of information and time coverage for a small number of countries are being performed.[5] The second risk is mitigated by the evidence provided in the literature about the impact of fiscal policy on long term growth.

VII. ENVIRONMENTAL AND SOCIAL CLASSIFICATION

7.1   There are no environmental or social risks associated with the activities outlined in this TC, since it is limited to the hiring of consulting services. Therefore its environmental classification is "C".

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[5]   As an additional mechanism to mitigate the risk, the data-development phase will be reinforced by similar initiatives undertaken by IFD/FMM in this field, such as the TC proposal to construct a regional database on public expenditure and the development of a set of indicators on public financial management, among others.