

## TECHNICAL COOPERATION ABSTRACT

### I. BASIC PROJECT DATA

<b>Country / Region:</b>	Regional
<b>TC Name:</b>	Strengthening State Owned Enterprises Performance
<b>TC Number:</b>	RG-T2566
<b>Team Leader / Members:</b>	Emilio Pineda (FMM/CUR) Team Leader; Gustavo Garcia (IFD/FMM) Alternate Team Leader; Hyungon Kim (IFD/FMM); Gerardo Reyes-Tagle (IFD/FMM); and Marina Massini (IFD/FMM).
<b>Taxonomy:</b>	Research and Dissemination
<b>Date of TC Abstract:</b>	December 2015
<b>Beneficiary:</b>	Latin America and the Caribbean countries
<b>Executing Agency:</b>	Bank Executed
<b>IDB Funding Requested (KPR):</b>	US\$750,000
<b>Local Counterpart:</b>	US\$0
<b>Disbursement period:</b>	Disbursement period: 24 months Execution period: 30 months
<b>Required start date:</b>	January 2015
<b>Types of consultants:</b>	Individual
<b>Prepared by Unit:</b>	IFD/FMM
<b>Unit of Disbursement</b>	
<b>Responsibility (UDR):</b>	IFD/FMM
<b>TC included in Country Strategy:</b>	No
<b>TC included in CPD:</b>	No
<b>GCI-9 priority:</b>	Institution for growth and social welfare

### II. OBJECTIVE AND JUSTIFICATION

- 2.1 State-Owned Enterprises (SOEs)<sup>1</sup> have an enormous economic and social impact in Latin America and the Caribbean (LAC). Governments in LAC are controlling shareholders and minority investors in a large number and wide variety of corporations.<sup>2</sup> A survey done by the OECD (2012) shows that five of the seven countries reported have more than 100 SOEs (Argentina, Brazil, Colombia, Mexico and Peru), while even those countries with the fewest SOEs –Chile and Ecuador– were in the dozens. The assets of SOEs represent on average 12% of GDP in the Region while play a fundamental role in production, pricing, and exporting of non-renewable natural resources (oil, gas and minerals) and in the provision of public services (electricity, gas, water and sanitation).<sup>3</sup> Furthermore, these corporations absorb significant fiscal resources and in some cases have important contingent liabilities that can pose threats to the fiscal sustainability in various LAC countries.<sup>4</sup>

<sup>1</sup> Defined as those enterprises where the government is the controlling shareholder.

<sup>2</sup> See OECD (2012), "Ownership Oversight and Board Practices for Latin American State-Owned Enterprises".

<sup>3</sup> *Ibidem*.

<sup>4</sup> See, IDB (2012), "State-Owned Enterprises (SOEs) in Latin America and the Caribbean (LAC): Overview and Fiscal Risks".

- 2.2 The main justification for SOEs is as a way to solve market failures or address distributional concerns, where for example the government helps firms develop new capabilities, reduce their capital constraints, or delivers subsidized electricity.<sup>5</sup> However, there is a theoretical and empirical literature showing that on average, SOEs are less efficient than their private counterparts and that they are not the best vehicle to achieve distributional goals. This underperformance is generally attributed to: (i) SOEs having social objectives that sometimes conflict with profitability; (ii) SOEs managers lack incentives and monitoring; (iii) weak management capabilities; and (iv) SOEs do not have an incentive to perform efficiently because they know their governments will bail them out.<sup>6</sup> As a result, SOEs' contribution to the development of LAC, through an efficient and fiscally sustainable provision of public services is undermined.
- 2.3 The Ministry of Strategy and Finance of Korea (MOSF) and the Inter-American Development Bank (IDB) co-hosted four international forums to discuss policies and reforms regarding State-Owned Enterprises (SOEs) management. As a result, the IDB and the MOSF reached an agreement to establish a framework for continuous cooperation between Latin American countries and Korea in order to enhance the performance of SOEs.<sup>7</sup>
- 2.4 In the context of this framework of continuous cooperation, the objective of this Technical Cooperation (TC) is to have a better understanding on how SOEs in LAC can overcome some of the problems highlighted by the literature, by generating original research drawing on recent regional experiences, and facilitating knowledge exchange. In doing so, the TC will focus on:
- a. Fiscal and Financial Discipline. One of the key aspects for the SOEs to perform efficiently is to assure that they operate in a financially sustainable way. Attention will be placed in the trade-off between hidden subsidies and service quality.
  - b. Regional Database and Performance Indicators. The TC will produce a database with indicators on the performance of regional SOEs. This database may be used to develop indexes to measure the overall performance of the SOEs, and typologies of the challenges faced by SOEs.
  - c. Corporate Governance, oversight and management capabilities of SOEs. Effective Corporate Governance with innovative oversight structures, such as Public Holding companies, has been used in the region and internationally to address the problems mentioned. Furthermore, only around 7% of SOEs in the region are subject to the surveillance of stock and financial markets.
  - d. Pilot Cases. The TC will finance the strengthening the capabilities and framework to monitor and regulate SOEs in two Latin American or Caribbean countries.
- 2.5 The TC will benefit from the Korean ample experience in SOE reform and strengthening, particularly in those issues related to debt-management, corporate governance, and management systems and evaluation, among others.

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<sup>5</sup> For a review of this literature see Musacchio and Lazzarini (2014), *Leviathan Evolving: New Varieties of State Capitalism in Brazil and Beyond*, Harvard University Press.

<sup>6</sup> *Ibid.*

<sup>7</sup> Most recently the Regional Technical Cooperation , RG-T2486, financed a seminar in November 2014 in Mexico City, where a Latin American Network of State Owned Enterprises Reform was established.

### III. DESCRIPTION OF ACTIVITIES AND OUTPUTS

- 3.1 The TC will finance: (i) one seminar in the Region or Korea that will focus in lessons learned on SOE reform; (ii) one issues paper to outline the policy reform agenda in the region, four country case studies and summary report; (iii) data collecting efforts to create a new database with SOEs indicators; and (iv) a couple of pilot cases where the monitoring capabilities of SOEs in the region will be strengthened.

### IV. BUDGET

Description and type of the procurement contract	Source of financing	
	IDB (KPR)	Total
<b>Component I: Dialogue and sharing experiences</b> Consulting services 1: One seminar to be conducted in the Region or Korea, where the Country Case studies will be presented.	100,000	100,000
<b>Component II: Knowledge products</b> Consulting services: Policy Reform Issues Paper, 4 country case studies, and book publication; creation of the SOE database, and hiring assistance to assembling the book.	450,000	450,000
<b>Component III: Pilot cases</b> Strengthening the SOE's monitoring capabilities and framework of two pilot cases in Latin America and the Caribbean.	200,000	200,000
<b>TOTAL</b>	<b>750,000</b>	<b>750,000</b>

### V. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 5.1 The Bank will be responsible for the contracting of consultancies and will carry out the selection and hiring of the consulting services in accordance with Bank procedures established in document GN-2350-7.5. Technical and disbursement responsibility at the Bank will be under Emilio Pineda (FMM/CUR).

### VI. PROJECT RISKS AND ISSUES

- 6.1 One possible risk would be the lack of interest on the SOE topics from the participating governments. To mitigate this risk, the Bank created a network of regional officials in charge of the supervision of SOEs, in order to foster regional ownership with this initiative.

### VII. ENVIRONMENTAL AND SOCIAL CLASSIFICATION

- 7.1 According to the environmental policy and the safeguards this TC is under Directive B.13. Given its objective, this TC will not carry negative environmental nor social impacts, and that it is why it is not considered necessary to prepare an Environmental and Social Strategy.