

## TC Document

### I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ TC Name:	Support to improve the quality of expenditures in LAC
▪ TC Number:	RG-T4490
▪ Team Leader/Members:	Astudillo, Karen (IFD/FMM) Team Leader; Zaltsman, Teodoro Ariel (IFD/FMM); Jimenez Mosquera, Javier I. (LEG/SGO); Navarro Portocarrero, Zoila Victoria (IFD/FMM); Yoon Jang (IFD/FMM); Roman Sanchez, Susana (IFD/FMM); Rasteletti, Alejandro Gabriel (IFD/FMM); Lora Rocha, Oscar (IFD/FMM); Llampen Lopez, Zoila Cristina (IFD/FMM); Lee Hyuna (IFD/FMM); Blanco Urbina Luz Inmaculada (IFD/FMM); Calderon Ramirez, Ana Cristina (IFD/FMM); Chamorro Montes, Jessica Andrea Del Carme (IFD/FMM)
▪ Taxonomy:	Client Support
▪ Operation Supported by the TC:	N/A
▪ Date of TC Abstract authorization:	March 27, 2024
▪ Beneficiary:	Ecuador and Paraguay <sup>1</sup>
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	OC SDP Window 2 - Institutions(W2C)
▪ IDB Funding Requested:	US\$440,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	36 months of disbursement period that includes the execution period
▪ Required start date:	August 30, 2024
▪ Types of consultants:	Individual consultants and firms
▪ 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 IDB Group Institutional Strategy: Transforming for Scale and Impact	Institutional capacity and rule of law

### II. Objectives and Justification of the TC

2.1 **Objectives.** The objective of this Technical Cooperation (TC) is to support Ministries of Finance in the region improve countries quality of spending with the goal to increase public value,<sup>2</sup> avoid wasteful spending, and promote economic growth. Specifically by: (i) identifying and addressing inefficiencies that affect the allocation of public spending; (ii) designing evidence-based tools to ensure the efficient use of limited public resources to improve equity; and (iii) providing strategies for better planning, robust

<sup>1</sup> Although this CT is designed for two governments (Ecuador and Paraguay), other governments through their respective agencies may participate by expressing their interest directly to the Bank and contingent to the alignment of their respective country strategy.

<sup>2</sup> Public value refers to the concept that governments provide services to the community as a beneficiary and that the beneficiaries are not just the direct recipients of services, but a broader community that benefits from the collective goods provided by the government (Moore, 1990; Mazzucato 2018, OECD, 2019).

ex-ante and ex-post evaluations, and enhanced accountability mechanisms to address gaps in attaining results to improve the fiscal sustainability of Latin American and Caribbean (LAC) countries while fostering equitable and sustainable economic growth.

- 2.2 **Justification.** The LAC region faces two interrelated challenges in public expenditure. The **first challenge** is the inefficiency and ineffectiveness of public spending that impedes achieving optimal results mainly due to weak technical and allocative mechanisms. Technical inefficiency pertains to the suboptimal use of available resources arising when public sector activities are not executed effectively, given the resources at hand. This inefficiency results from various factors, including outdated technologies, poor management practices, overstaffing in public sectors, and inadequate procurement processes. The result is higher costs and lower outputs, diminishing the overall impact of public spending. Recent estimates indicate that the average loss due to technical inefficiency in LAC is 4.4% of GDP or approximately 17% of public spending in the region.<sup>3</sup> Governments can address these inefficiencies by reducing leakages in transfers, combating waste in public procurement, and addressing the high public sector wage premium (these specific inefficiencies in the region amount to about 0.4% of GDP<sup>4</sup>). For example, the countries that waste the most are those with the highest salary premiums and a lower proportion of unskilled workers: El Salvador, Guatemala, Honduras, Mexico and Ecuador (more than 20%), and Colombia and Costa Rica (more than 15%).
- 2.3 Allocative efficiency, often overlooked in the region, involves prioritizing expenditures across various sectors, such as education, health, and infrastructure, to maximize productivity and growth.<sup>5</sup> Allocative inefficiency occurs when resources are not directed toward their most productive uses, leading to suboptimal outcomes in terms of economic growth and social welfare. The lack of evidence-based policymaking and prioritization means funds are frequently allocated to politically motivated projects rather than those with proven high social or economic returns. This misallocation of resources diminishes the potential economic returns that could be achieved if funds were directed toward high-impact area. Additionally, the region faces several trade-offs, including balancing expenditures between generations, physical and human capital, and different government levels. For example, many Latin American countries spend significantly more on the elderly than on the young, posing challenges as populations age and pension and health spending is expected to double.<sup>6</sup> Public spending also tends to overemphasize school spending (1.1% of GDP) rather than in the early years of the life cycle (0.4% of GDP), which can generate higher rates of return (Carneiro and Flores, 2018; Cerda and Pessino, 2018; Carneiro, Vytlačil and Heckman, 2011, and Berlinsky et. al., 2008).
- 2.4 The **second challenge** involves deficiencies in public finance management systems, which stem from the primary issue of technical and allocative inefficiencies. Technical operational efficiency pertains to how public services and goods are provided at reasonable cost and quality, while allocative efficiency relates to the alignment of

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<sup>3</sup> Izquierdo, Alejandro; Pessino, Carola; Vuletin, Guillermo. Better spending for better lives: How Latin America and the Caribbean can do more with less. IDB. September 2018.

<sup>4</sup> Pessino, Carola. Allocative efficiency of government spending for growth in Latin American countries. IDB Working Paper Series #1287. June 2022.

<sup>5</sup> *Ídem*, June 2022.

<sup>6</sup> *Ídem*, September 2018.

budget allocations with strategic priorities. Effective management systems are crucial for channeling public resources from taxpayers to meet the region's developmental and socio-economic needs and overseeing their implementation, monitoring, and evaluation. The region's challenges, including: (i) fragmented and outdated financial management systems; (ii) weak budget planning and execution; (iii) lack of transparency and accountability; (iv) corruption and leakages; and (v) human resource constraints, are compounded by poor management institutions that waste resources, erode public trust, and limit opportunities for growth and poverty reduction. While institutions are almost universally weak in LAC countries, the extent of these weaknesses varies widely across the region (Izquierdo, Pessino and Vuletin, 2018).

- 2.5 The two interrelated challenges of: (i) inefficiency and ineffectiveness of public spending; and (ii) deficiencies in public finance management systems, coupled with the ever-increasing levels of public expenditures, pose significant threats to long-term economic growth in LAC. Primary government expenditures reached 25.8% of GDP in LAC in 2021, a sharp increase from the 1990s, which averaged 17% of GDP.<sup>7</sup> Despite this substantial rise in spending, there has been little improvement in the quality of physical and human capital. This suggests that increased expenditures are not being effectively channeled into high-impact areas that foster sustainable development and economic growth. Instead, resources may be diluted across various programs without strategic prioritization, resulting in inefficiencies and missed opportunities for enhancing the region's developmental outcomes. The effectiveness of expenditure institutions and the feasibility of reforming them are limited without strategic interventions. Internal and external pressures further complicate these reforms. Within governments, spending entities typically seek to increase their budget allocations, while finance ministries aim to maintain overall spending ceilings. This tension creates competition and contention in the allocation process, highlighting the need for effective coordination to achieve successful spending reforms.
- 2.6 Implementing expenditure reforms is often challenged by private special interests, including unions, firms, and aid beneficiaries, who may be adversely affected by changes. Overcoming these challenges requires comprehensive strategies involving better planning, robust ex-ante and ex-post evaluations, and enhanced accountability mechanisms to address gaps in procurement systems. Improved transparency and accountability can build public trust and ensure efficient and effective use of public funds. While there is much to be gained from resolving inefficiencies, public spending is not only about efficiency but also about equity—particularly, equity that leads to equal opportunities. LAC's taxes and public expenditure do little to reduce income inequality compared to advanced countries. While tax and spending policies reduce inequality in LAC by about 5%, they do so by 38% in advanced economies.<sup>8</sup>
- 2.7 This TC emphasizes the importance of “smart” public expenditure in beneficiary countries and others seeking assistance to address prevalent challenges in reducing wasteful spending. Smart spending can be comprehensive, encompassing most major expenditure programs, or it can focus on specific programs that offer the greatest potential impact. Rather than implementing across-the-board expenditure cuts, a more effective approach involves dissecting the budget sector by sector to identify and

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<sup>7</sup> Powell, Andrew, and Oscar Valencia. *Dealing with Debt: Less Risk for More Growth in Latin America and the Caribbean*. Washington, DC. IDB. 2023.

<sup>8</sup> Izquierdo, Alejandro; Pessino, Carola; Vuletin, Guillermo. *Better spending for better lives: How Latin America and the Caribbean can do more with less*. IDB. September 2018.

address technical and allocative inefficiencies. This approach entails reallocating resources from non-priority to priority activities that are oriented toward sustainable growth.

- 2.8 Considering the growing fiscal sustainability concerns and high debt levels, which have reached 64% of GDP,<sup>9</sup> LAC's budgets are likely to remain tight for some time. In this context, all levels of government will have to learn to spend more wisely. Growing citizen concerns, aging populations, tax burdens that have reached efficiency limits, and international economic volatility have put pressure on governments to increase the value for money of public services.<sup>10</sup> Trending literature and experts in the matter suggest that the solution lies in improving the quality of spending in the region, which is not to restrict spending across-the-board cuts and without a spending guide but rather to spend better and smarter. This means doing more with less and not mortgaging the future. It involves consolidating the treasury, providing better services, and allocating spending to promote growth and equity.
- 2.9 **Strategic Alignment.** This TC is consistent with the IDB Group Institutional Strategy: Transforming for Scale and Impact (GN-3159-12) and is aligned with the objective of reducing poverty and inequality by ensuring the quality of public expenditure and the better management of public funds. The TC is also aligned with the operational focus area of institutional capacity, rule of law, and citizen security. Moreover, this TC aligns with the Fiscal Management Sector Framework (GN-2831-13). Specifically, it addresses the challenge of spending inefficiencies that diminish the quality and relevance of public expenditure. Additionally, the program contributes to Line of Action 1 and 3 by enhancing the contribution of fiscal policy and management to economic growth and bolstering the sustainability of public finances through the reinforcement of fiscal institutions. Finally, it is aligned with the Ordinary Capital Strategic Development Program (GN-2819-14), in the Priority Area 3: Effective, Efficient and Transparent Institutions, through the objective that seeks to contribute to public policies and institutions that are more effective, efficient, transparent, and citizen-centered through the support to national governments improve countries quality of spending with the goal to increase public value, avoid waste, and achieve economic growth.
- 2.10 **Country strategy.** This is aligned with Ecuador's Country Strategy 2022-2025, (GN-3103-1) Priority Area II of stabilization of public finances and institutional development through the provision of tools to allow flexibility in public expenditure management decisions to better address scarce resources and ensure equity in public spending. This proposal is also aligned with Paraguay's Country Strategy 2019-2023, (GN-2958) strategic objective of strengthening public management capabilities through the provision of tools to ensure an efficient spending of public resources.
- 2.11 **Contribution to the Bank's operational program.** This TC will coordinate with other on-going projects that support activities aimed at strengthening the quality of expenditures and the impact of fiscal policies such as: (i) Fiscal Policies for Equity (ATN/OC-19695-RG); (ii) Tools to Design Fiscal Transition and Recovery Policies in Response to the COVID-19 Pandemic (ATN/OC-18381-RG); (iii) Public Procurement Transformation to Strengthen Fiscal Sustainability and Efficiency: Korean Experience

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<sup>9</sup> *Ídem*, IDB, 2023.

<sup>10</sup> Izquierdo, Alejandro; Pessino, Carola; Vuletin, Guillermo. Better spending for better lives: How Latin America and the Caribbean can do more with less. IDB. September 2018.

for El Salvador and Honduras (ATN/KR-20327-RG); and (iv) Better Data, Smarter Technologies, and More Efficient Processes: A Roadmap for Greater Fiscal Transparency to Fight Corruption (ATN/KR-18570-RG). The TC will contribute with future operations supporting fiscal reforms, as the methodologies and tools to be financed will inform the policy advice provided by IDB fiscal specialists to countries in the region in improving the quality of expending and creating public value. The TC will also take into consideration during execution lessons learned from current projects in beneficiary countries to ensure consistency with proposed results of this TCs.

### III. Description of activities/components and budget

- 3.1 As a response to the challenges of inefficient and ineffective public spending, from both a technical and allocative perspective, and public expenditure management systems that could be improved and that are responsible for channeling public resources, this TC will support governments in strengthening their fiscal policy to achieve more efficiency, effectiveness, innovation through four components.
- 3.2 **Component 1. Design and implementation of tools to improve the efficiency and effectiveness of public spending (US\$180,000).** The objective of this component is to provide governments with tools and better practices to strengthen their capacities, enhancing technical and allocative efficiency of public spending to promote smart spending that generates value for money. The expected result of this component is to have a greater focus on performance-based public finance management, identifying deficiencies, leaks, and barriers that prevent meeting the needs of end users, ensuring public spending is more effective and efficient. This component will finance: (i) diagnostics to assess and quantify technical and allocative inefficiencies in public spending, alongside frameworks for identifying key areas of inefficiency and their root causes in beneficiary countries; (ii) country-tailored road maps to improve the quality of public expenditure, focusing on both technical and allocative efficiency; (iii) develop quantitative and qualitative indicators to monitor the status and performance of public spending, providing continuous feedback, and tracking progress in improving efficiency and effectiveness; and (iv) develop organizational and operational lines of action and progressive milestones to achieve results in the short term but within a medium-term vision.
- 3.3 **Component 2. Strategies to improve public finance management system to enhance public sector productivity (US\$100,000).** The objective of this component is to develop strategies to enhance technical and operational efficiency in public spending by optimizing participant country's budget structure. The expected result of this component is to support beneficiary governments achieve productivity and impact on improving their public finance management systems. This component will finance: (i) consultancies to examine the budget structure of participating countries and identify key benchmarks such as rigid expenses and the balance between operational costs and expenses associated with products; and (ii) consultancies to develop efficiency indicators for budget execution in public finance management systems to identify opportunities for the appropriate utilization of administrative data in the evaluation and decision-making process of budget execution.
- 3.4 **Component 3. Institutional strengthening support to improve expenditure decisions (US\$100,000).** The objective of this component is to strengthen the institutional framework of ministries of finance, leading to more effective and accountable expenditure decisions. This include improving the legal framework, institutional quality, and accountability in public spending. Specific activities include:

(i) review of better practices to improve the legal framework of the budget cycle; (ii) provide technical assistance to promote the creation and implementation of institutions that ensure the quality of expenditures; and (iii) support to improve accountability of budget decisions, ensuring transparency and responsibility in public spending.

3.5 **Component 4. Dissemination and exchange of lessons learned (US\$60,000).** Based on the previous components, a synthesis of good practices and lessons learned will be presented in the countries and at a regional level.

3.6 **Expected results.** At the conclusion of the execution period of this TC, the funded initiatives will result in recommendations and policies to improve public expenditure management, conducive to enhanced technical and allocative efficiency in LAC. These improvements include the provision of flexible tools for better public expenditure management, identification of inefficiencies affecting allocation, efficiency, and equity, and ensuring sustainable resource allocation through comprehensive diagnostics and tailored plans. Advanced analytics and innovative evaluation systems will support these efforts, optimizing budget structures and leveraging efficiency indicators and administrative data to enhance decision-making and execution processes, thereby improving public sector productivity. Strengthening the institutional framework of ministries of finance will result in more effective and accountable expenditure decisions during the budget cycle, supported by improved legal frameworks, institutional quality, negotiating capabilities, and accountability measures. Additionally, the TC will synthesize and disseminate good practices and lessons learned at both national and regional levels, fostering policy dialogues and knowledge sharing among policymakers to support continuous improvement in public finance management. Thus, these efforts aim to address inefficiencies, promote smart spending, and ensure the strategic and impactful use of public resources, ultimately improving fiscal sustainability in LAC countries while fostering equitable and sustainable economic growth.

3.7 **Indicative budget.** The total cost of this TC is US\$440,000, which will be financed by the Bank through window 2, priority area 3: Effective, efficient, and transparent institutions (W2C), of the Strategic Development Program financed with Ordinary Capital (OC-SDP). No local counterpart is expected.

**Indicative Budget (US\$)**

<b>Component</b>	<b>Description</b>	<b>IDB/W2C</b>	<b>Total Funding</b>
Component 1	Design and implementation of tools to improve the efficiency and effectiveness of public spending	180,000	180,000
Component 2	Strategies to improve public finance management system to enhance public sector productivity	100,000	100,000
Component 3	Institutional strengthening support to improve expenditure decisions	100,000	100,000
Component 4	Dissemination and exchange of lessons learned	60,000	60,000
<b>Total</b>		<b>440,000</b>	<b>440,000</b>

3.8 **Supervision, monitoring, and evaluation.** The project team leader of IFD/FMM will supervise, monitor, and execute the operation financially. A project completion report will be prepared summarizing the activities carried out and the achievement of the

expected results. This report will be shared through the Convergence system. The project team leader will closely coordinate the activities of this TC with participating country offices during the execution.

- 3.9 **Lessons learned.** In the monitoring and evaluation of TC, lessons learned, and good practices derived from the proposed interventions will be identified and systematized. These lessons learned will serve as input for future operations.
- 3.10 **Sustainability.** To give continuity to the results of this TC, once the project is concluded, guides, documents, events, and training will be prepared that will allow the knowledge generated in this TC to be disseminated over time to beneficiary institutions in beneficiary countries.

#### **IV. Executing agency and execution structure**

- 4.1 **Executing agency.** Due to the regional nature of this TC and at the request of participant countries, the Bank will be the executing agency through IFD/FMM in accordance with the Bank's Technical Cooperation Policy (GN-2470-2), the Procedures for the Processing of TC Operations (OP-619-4). The Bank is recognized for its highly specialized technical knowledge in addressing the topics of the required studies and its expertise in international best practices related to the matters addressed by the TC, facilitated through networks of experts and efficient contracting processes.
- 4.2 **Execution structure.** The technical and fiduciary responsibility of this TC will be led by the team leader, who will coordinate with (i) the counterparts in the Governments (see Annex I); and (ii) the specialists in both FMM, COFs, and other relevant sectors in the country offices, in which technical or financial assistance will be granted. The project team will also coordinate with similar or complementary efforts of other institutions (i.e. other MDBs or IFIs) in beneficiary countries.
- 4.3 The knowledge products generated within the framework of this TC will be the property of the Bank and may be made available to the public under a Creative Commons license. However, at the beneficiary's request, the intellectual property of said products may also be licensed to the beneficiary through specific contractual commitments that will be prepared with the advice of the Bank's Legal area.
- 4.4 **Procurement.** All procurement to be executed under this Technical Cooperation have been included in the Procurement Plan (Annex IV) and will be hired in compliance with the applicable Bank policies and regulations as follows: (a) Hiring of individual consultants, as established in the regulation on Complementary Workforce (AM-650) and (b) Contracting of services provided by consulting firms in accordance with the Corporate procurement Policy (GN-2303-33) and its Guidelines.

#### **V. Risks**

- 5.1 Among the risks of the project are the low appropriation by countries of the studies, tools, models, and solutions developed by his TC. To mitigate this risk, the TC team will coordinate closely with the beneficiary countries and with the country offices, to ensure the relevance of the products for the countries, promoting their appropriation. There is also a risk that the applications and solutions developed and implemented in the field of this TC are not sustainable over time. To mitigate this risk, TC products will be disseminated among countries and FMM will promote the continued use to the tools developed. Furthermore,

- 5.2 There is a risk that difficulties may arise during the development of methodologies, due to timely availability of information. This risk will be mitigated by establishing close contacts and frequent dialogues with the agency's owners of the relevant data, and by hiring professionals with extensive experience in the subject, who guide counterparts in the collection of data.

**VI. Exceptions to Bank policy**

- 6.1 No exceptions to the Bank's policies have been identified.

**VII. Environmental and Social Aspects**

- 7.1.1 This Technical Cooperation is not intended to finance pre-feasibility or feasibility studies of specific investment projects or environmental and social studies associated with them; therefore, this TC does not have applicable requirements of the Bank's Environmental and Social Policy Framework (ESPF).

**Required Annexes:**

[Request from the Client\\_24001.pdf](#)

[Results Matrix\\_89614.pdf](#)

[Terms of Reference\\_80836.pdf](#)

[Procurement Plan\\_78513.pdf](#)