

**Promoting Targeted Transparency Policies in Latin America. IDB's Support for
Transparency in Ecuador's Extractive Industries**

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EXECUTIVE SUMMARY

The paper discusses the IDB's tools and approach towards the implementation of Targeted Transparency (TT) policies in Latin America. Specifically it will address the case of Ecuador's Extractive Industries. Since 2008 the IDB has been providing support to the implementation of a project in Ecuador aimed at developing transparency standards to be adopted by public and private oil companies, as well as government agencies. These standards include designing and putting into practice information systems that would allow public institutions to disseminate information in a periodic and timely manner about contracts, reports on gross revenue, expenditures, sales volume, prices, tax payments, and environmental and social impacts.

Expanding access to information is a necessary first step, but does little to address the corruption issue if there are not accompanying processes, whether internal or external, for reviewing the accuracy, understandability and timeliness of the information. A greater volume of information does not necessarily imply greater transparency. A detailed review concerning the quality of information that is published by the extractive industries in Ecuador has proved that even though, according to the 2010 Revenue Watch Index, this country ranks among the top ten countries that provide greater information regarding the extractive industry, there is still a large quantity of data not understood by the great majority of the population, undermining accountability and opening opportunities for corruption to flourish.

Section I of the paper gives a brief overview of the conceptual background through which the IDB's approach towards TT policies was developed. It describes the design, validation and operational phases of IDB's main tool to promote TT in the region: the Anticorruption Activities Trust Fund (AAF), and the relevance of extractive industries in the context of AAF activities. Section II of the paper presents a specific initiative aimed at promoting TT policies in Ecuador's Extractive Industries, and specifically the oil sector. The project's main activities, results and implementation challenges are explained as they provide useful insights into innovative ways in which TT initiatives can be undertaken to prevent and control corruption in other Latin America and the Caribbean countries.

IDB'S APPROACH TOWARDS TARGETED TRANSPARENCY¹

Promoting Targeted Transparency in Latin America

In the last decade, more than ten countries in Latin America and the Caribbean have passed access to information laws. Most countries in the region have passed access to information legislation or are currently in the process of promulgating such laws.² The international community, governments in the region, and civil society are increasingly recognizing that the right of access to information is fundamental in democratic states and that the laws governing this right are key to promote accountability and transparency, and to strengthen the participation of civil society in public policy-making processes.³

However, the mere existence of legal instruments is not enough. Habits and cultures regarding both the demand and supply of information must be changed. Governments need to improve their ability to disclose information, while citizens have to learn how to take advantage of new access to information mechanisms, most of which have emerged from the widespread use of information and communication technologies (ICT), especially the internet.

Recent research indicates that an effective way to improve both the demand and supply of information is by implementing Targeted Transparency (TT) policies. TT is defined by Archon Fung, Mary Graham and David Weil as “the use of publicly required disclosure of specific information in a standardized format to achieve a clear public policy purpose.”⁴ The fundamental assumption in TT policies is the need for flexible information access tools that are driven by demand, that is, by what “users of information” identify as their priorities. This approach takes into account the incentives and capacities of relevant stakeholders in specific sectors to understand and use information in order to improve the effectiveness of their decision-making processes.

Over the past few years, the IDB has paid increased attention to research developments, practices and policies based on the concept of TT. This approach is particularly interesting for the IDB because TT can not only draw attention to shortcomings in public

¹ The authors would like to thank Roberto de Michele and Teddy Kahn for their useful comments and suggestions to this paper. Special thanks also to Grupo Faro, in particular to Orazio Bellettini, Juan Carlos Méndez and Sebastián Salgado for analyzing and consolidating the information presented here in relation to the project “Transparency in Ecuador’s Extractive Industries” (EC-T1185).

² Ernesto Villanueva “Leyes de Acceso a la Información en Lationamérica” (2009); Presentation at the Fifth Meeting of the Alianza Regional por la Libertad de Expresión e Información.
http://www.alianzaregional.net/site/images/pdf/reuniones/quinta_reunion/ppt_villanueva.pdf

³ Paloma Baena and Juan Cruz Vieyra, “Access to Information as a Tool to Prevent and Control Corruption”; IDB Working Paper (2011).

⁴ For more information on targeted transparency policies, see Fung, Archon, Graham, Mary, and Weil, David, New York: Cambridge University Press, 2007.

and private sector management, but it also allows governments, citizens and private sector institutions to encourage efficiency.

The Anticorruption Activities Trust Fund

The Anticorruption Activities Trust Fund (AAF), a US \$5 million multi-donor trust fund created in 2007, is the first initiative specifically aimed at supporting TT projects in Latin America and the Caribbean.⁵ The Bank experience with the AAF can be divided into three phases: (i) the design of the AAF strategic approach; (ii) its validation; and (iii) operation of the AAF. The following section describes specific activities and results of the main phases of the AAF.

I. Design of the AAF Strategic approach

The first step was to create a multi-disciplinary team responsible for design of the AAF strategic approach.⁶ Its first activity was to develop a *concept note* that described the basic areas of intervention for the AAF in view of the challenges posed by the fight against corruption in LAC. This concept note paved the way for a series of studies and interviews intended to steer the design of the AAF toward a more specific area. The second activity for the team was to conduct desk-based research on one specific area identified in the concept note: TT. Research was oriented to identify possible areas of intervention in which the IDB could promote TT policies.⁷

II. Validation of the Strategic approach

Having identified TT as the main approach for the AAF, the IDB conducted several rounds of interviews to validate the premises of TT in a wide range of sectors and countries in the region. The main idea was to achieve greater understanding of the problems and the specific opportunities to implement TT initiatives at the sector level. As part of the validation process, the AAF Technical Team also conducted the Workshop “Access to information as a Tool for fighting Corruption” (September 17-18, 2007).

A group of fourteen experts came to Washington for the discussion. Speakers included six public officials and six NGO representatives from a sample of six countries in the region, as well as a representative from the Government of Norway and the Carter Center. Based on the workshop debate the IDB systematized the challenges and

⁵ For more information on AAF activities go to:

[http://www.iadb.org/aboutus/trustfunds/Fund.cfm?Fund=AAF&Lang=En&FDescr=Anticorruption Activities Trust Fund](http://www.iadb.org/aboutus/trustfunds/Fund.cfm?Fund=AAF&Lang=En&FDescr=Anticorruption%20Activities%20Trust%20Fund)

⁶ The technical team consisted of Paloma Baena (ICF/ICS); Maria Bouroncle (VPC/GCM); Roberto de Michele (PRE/OII), Arnaldo Posadas (ICF/ICS); Leyda Fajardo (INT/INT); and Juan Cruz Vieyra (ICF/ICS).

⁷ See the Anticorruption Activities Trust Fund (AAF) Report on Preparatory Activities: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1363521>

opportunities to implement TT in several areas of intervention, including: political financing; formulation and adoption of public budgets; transparency in judiciary decisions; transparency in pension systems; and transparency in extractive industries.

III. Operation of the AAF

One of the key products of the design phase was the AAF Operational Guidelines. This document explains the main criteria for eligibility and selection of project proposals and gives examples of possible initiatives to those entities interested in soliciting funding from the AAF⁸. As of December 2010, the AAF has eight TT projects in execution. Each project was designed for a specific area or sector of intervention in which the implementation of policies, mechanisms, and/or practices that promote access to information can have a high impact in controlling or preventing corruption. Among others, areas of intervention include the allocation of subsidies in Argentina; fiscal transparency in Belize; the monitoring of federal public expenditures in Brazil; the oil sector in Ecuador; and the selection and employment of civil servants in Guatemala.

Transparency in Extractive Industries

One of the sectors of intervention that has received increased attention since the inception of the AAF is transparency in extractive industries, as these are key drivers of economic growth in Latin American countries. The diagnostic studies carried out during the design phase of the AAF indicated that there is a great deal of concern by civil society organizations as well as governments of the region regarding both the investments in, and the profits from extractive industries (oil, mining and gas). Opacity and discretionality in such industries are present from contracting for resource extraction, transportation, and refining to the distribution of profits.

The validation phase of the AAF approach discussed the need to improve the quality of information regarding (i) investments, expected returns, and profits made in the oil industry; (ii) social and environmental consequences; (iii) quantities, prices and buyers of the oil that is exported; and (iv) the distribution of additional profits coming from a higher than expected price of oil.

One of the main conclusions of the above mentioned workshop to design the AAF strategic approach was that users of information (both citizens and public sector officials) must be able and motivated to make decisions based on public information. In the oil sector, where the information is highly technical and complex, it is important to reinforce efforts to build up the capacities of local governments to track revenues, but it is also important to support civil society organizations that can process such information in a manner that appeals to and can be understood by the general public.

⁸ This document can be found at: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1189482>

Soon after the AAF addressed the importance of implementing TT policies in extractive industries, specifically in the oil sector, the IDB officially endorsed the Extractive Industries Transparency Initiative (EITI)⁹. EITI sets voluntary standards and principles aimed at promoting transparency and accountability in government revenues and extractive company payments in the oil, gas, and mining industries.¹⁰ The EITI is a global effort to take advantage of natural resource wealth to achieve better development outcomes. It entails the collection, disclosure and dissemination of fiscal revenues, and can be a useful platform for bringing together champions of reform in extractive industries, and for strengthening the capacity of institutions to bring about more sustainable energy development.

⁹ See <http://eiti.org/news-events/inter-american-development-bank-becomes-eiti-supporter>

¹⁰ For more information, see <http://eiti.org/>

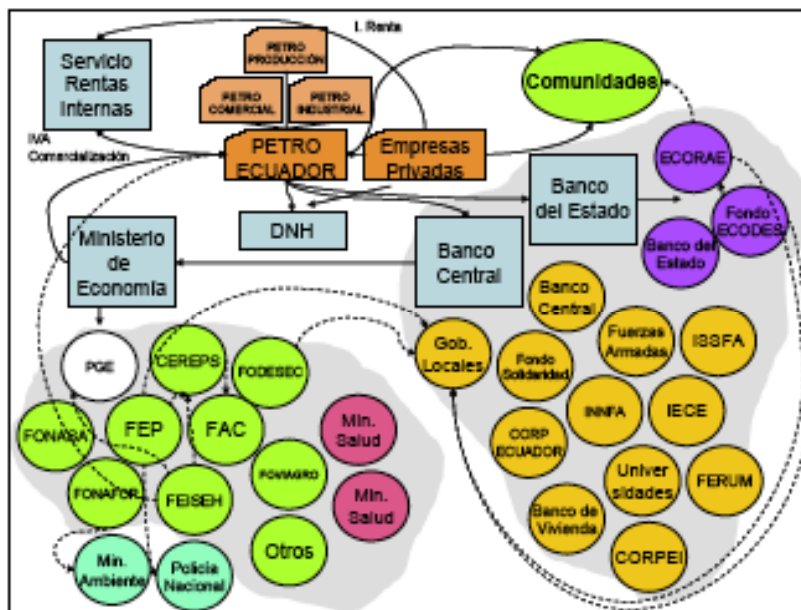
TRANSPARENCY IN ECUADOR'S EXTRACTIVE INDUSTRIES

The Diagnostic

As part of the preparatory activities of the AAF, Grupo Faro, a civil society organization, was invited by the Bank to discuss challenges and opportunities to enhance transparency in Ecuador's oil sector, which represents approximately 12% of the nation's GDP. This organization presented a technical note which argued that in spite of having a Law on Transparency and Access to Public Information (LOTAIP), data on these industries is not presented in a way that facilitates its analysis, impeding accountability and undermining the institutional capacity to prevent and control corruption.

Proceeds from the exploitation of oil resources are distributed in a fragmented and disorganized way with little transparency, generating opportunities for discretionary use of resources, inefficiency, and politicization. Additionally Grupo Faro indicated that revenues from the oil industry were directly distributed to more than 30 public agencies, public-private entities and special programs, which in turn distributed those revenues internally or to other institutions, without any tracking of how funds are used.

*Graph I: Income distribution of Ecuador's Oil Industry*¹¹



Furthermore, Grupo Faro identified a set of deficiencies in the information made available regarding the processes for adjudicating the exploitation of oil fields and mining

¹¹ Grupo Faro 2007, technical note presented to the IDB for the Workshop “Access to Information as a Tool to Prevent and Control Corruption”.

licenses, and the information on the environmental impact of such activities. In addition, Grupo Faro indicated that the flows of information between business, the State and the local communities was not articulated in a way that allowed easy understanding of who submits, orders and approves a contract or report, which gives a great deal of discretion to the decision makers.

The Initiative

Based on the challenges identified surrounding transparency in Ecuador's oil sector, Grupo Faro presented a project proposal to be financed by the AAF. This proposal incorporated the premises of TT with the goal to develop transparency standards to be adopted by public and private companies as well as government agencies. These standards included the design and implementation of information systems that would allow public institutions to disseminate information in a periodic and timely manner about contracts signed between companies and the government, as well as reports on gross revenue, expenditures, sales volume, prices, tax payments, and the industry's environmental and social performance and impact.

The AAF recommended the financing of this proposal on June 9, 2008. The resulting project "Transparency in Ecuador's Extractive Industries" (EC-T1185) represents the first Bank operation in extractive industries strictly based on the concept of TT, marking a milestone for IDB endorsement¹² of the Extractive Industries Transparency Initiative (EITI) in 2009.

EC-T1185 focuses on promoting collective action between public sector entities, private companies and civil society, combining activities that enhance both vertical and horizontal accountability. The project's main assumption is that transparency is reliant on the capacities and incentives of both providers and users of information. The main purpose of the project is to strengthen the capacities of public and private institutions to design, endorse, and implement transparency standards.¹³

The project's specific objectives are to (i) strengthen the capacities of public and private institutions to design, endorse and implement transparency standards; (ii) enhance the capacities of public and private stakeholders to monitor and evaluate compliance with transparency standards; (iii) support transparency in policy decision making by developing a public policy proposal to strengthen transparency in extractive industries.

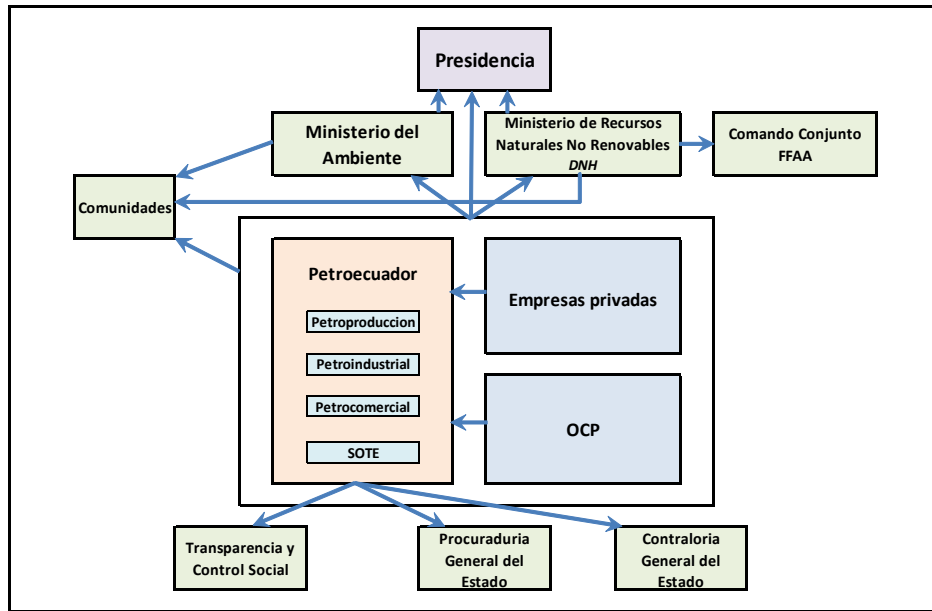
The project's first activity was to conduct research studies in order to develop the project's baseline. These studies focused on: (i) determining the institutional map of relevant entities in the framework of the public and private sector; and (ii) determining the quantity, accessibility, and quality of available information for civil society within a specific sector of the extractive industry. The institutional map demonstrated that both the flows of information and the transfer of resources from extractive industries are

¹² For more information, see <http://www.iadb.org/document.cfm?id=2091625>

¹³ The Project profile of EC-T1185 can be found at <http://www.iadb.org/document.cfm?id=1649278>

extremely complicated, making it very difficult for different stakeholders to keep track of such information flows. Baseline studies also allowed the project team to identify ways in which public and private actors, and civil society could cooperate. This was critical to promoting the strategic alliances mentioned above.

Graph II: Extractive industries information flows¹⁴



The methodology used to develop the baseline was based on the value chain of the extractive industries, which is divided in the following stages: 1) Seismic Prospectives and Extraction; 2) Refinery; 3) Transportation; and 4) Commercialization. Analyses of phases 1 through 3 have been achieved through collaboration with the Administration Council of Petroecuador. Preliminary results up to this point have shown that there is no lack of information in the strict sense; on the contrary, there are huge amounts of data that, most of the time, are released on the web without any categorization or organization that would be necessary for the average user to understand it.

The project produced information that demonstrates that more data does not automatically imply more transparency. The goal of more transparency should be achieved through selected data that convey relevant and updated information on the sector to relevant stakeholders. In every step of the value chain there are “information issues” that weaken transparency. Information issues could be related to lack of access to information, lack of dissemination, outdated information, etc. In some cases the obligation to address these problems falls on public and semi-public entities (regulatory issues, bidding processes, etc); and in other cases on private sector companies. Understanding what the project has described as “information issues,” and the roles of

¹⁴ Grupo Faro, 2009 reports on baseline studies.

each actor along the oil industry value chain, creates the baseline for enhancing collaboration and coordination between multiple stakeholders.

The project team also conducted a cost-analysis study regarding the lack of transparency within Ecuadorian extractive industries. The study employed a methodology based in game theory where stakeholders within the value chain of the oil sector are considered players whose main aim is to maximize utility or minimize loss. Although certain assumptions are made for the development of the paper, the results produced were a concrete estimation of the costs associated with the lack of transparency. The next table is a summary of the main findings:

Table I: Lack of Transparency Costs in Ecuador's Extractive Industries¹⁵

Information issue	Type	Annual costs (in % GDP)
Regulation and control discrimination	Bidding process	0.10 – 1.03
	Exploration and exploitation	0.12 – 1.17
	Transport	0.15 – 1.46
	Refinement, storage and commercialization	0.19 – 1.83
Pressure by interest groups	ECORAE	0.27
	Subsidies	0.48
	Gas contraband	0.53
Extractive activity information asymmetry issues	Under-exploitation costs	11.4 (max)
	Over-exploitation costs	1.03(min)
Accumulated costs	Max	18.17
	Min	2.87

According to this study, the costs linked to the lack of transparency could oscillate between 2.87% and 18.17% of GDP annually, which reflects the importance of including information standards that improve transparency, not only for revenue-based stages, but all throughout the oil value chain. Understanding the costs of lack of transparency in a disaggregated way creates opportunities to identify ways in which the overall performance of the sector could be improved. Those actors that are highly affected by the conduct or misconduct of others (private and public) can therefore create alliances to advocate against the causes of these inefficiencies and losses.¹⁶

The design of transparency standards implied collaboration and validation processes with public and private stakeholders. Grupo Faro took advantage of this occasion for interaction among various stakeholders and created a network of public and private sector actors. Incentives were created to be part of the network, including public recognition of advancements made by each stakeholder. Participants included the Ministry of Non-renewable Natural Resources, the public oil company Petroecuador, the Internal Revenue Service of Ecuador, and the ECORAE. Additionally, a number of private firms became

¹⁵ Rafael Donoso and Grupo FARO “Ciudadanizando las Políticas 2: ¿Cuánto se ahorra al ser transparente?”, Grupo Faro, 2010.

¹⁶ For more information, see: <http://www.extrayendotransparencia.org/>

involved in the network, such as REPSOL-YPF and several civil society organizations with an interest in the extractive industries.

The linkages made between these public agencies, public-private entities and civil society groups are based on a redefinition of the traditional “watchdog” profile of civil society organizations. The process focused on building up the institutional capacities of relevant stakeholders, through the utilization of consulting and working groups that promoted the API System (Activity, Process, Information). The modality of API implies knowledge of the regular activities of the petroleum industry, the processes through which these activities are realized, and how information is generated. The objective is to create an informal network of available information.

Implementation Challenges and Lessons Learned

A six-month mid-term review on AAF-financed projects was carried out during 2010. This exercise permitted the identification of some of the key aspects that enabled (or impeded) the implementation of EC-T1185. While not all implementation challenges and lessons learned are strictly related to the adoption of TT policies, we address some of the most important operational aspects regarding implementation of the project in Ecuador, as they have influenced the success or failure of some of its activities.¹⁷

For the purpose of this paper, implementation challenges were divided into those driven by external factors, and those driven by internal factors. *External Factors* are defined as political economy considerations that need to be taken into account by the executing agencies during the design and implementation phases of the project. They include but are not limited to (i) the need to address domestic priorities and find viable entry points; and (ii) the likelihood of sudden legal and institutional reforms. *Internal Factors* relate to operational considerations that need to be taken into account during the design and implementation phases of the projects. They include, among others, (i) creating sound diagnostics and baselines; (ii) the need to incorporate flexibility into the program design and (iii) enhancing communication and managing expectations between donors and executing agencies;

External Factors

Addressing domestic priorities

When project programming coincides with domestic priorities and is developed around the existing institutional and legal structures, it is more likely that projects will be backed by strong political will. Supporting country priorities eases the implementation process and will likely make interventions more sustainable. In this regard, “fighting corruption”

¹⁷ For more information on the mid-term review exercise see Juan Cruz Vieyra and Paloma Baena: “Focusing on Implementation. Mid-Term Review of Technical Cooperation Projects in Ecuador and Belice” at www.iadb.org/transparency

may not necessarily be the most useful entry point to enhance transparency. At the public sector level, the idea of improving efficiency and responsibility is more likely to receive full support from decision makers.

Demand can emerge not only from governments, but also from other actors. This process facilitates the alignment of incentives between governments, civil society and private sector. Grupo Faro identified multiple entry points at the public sector level. Activities were coordinated with the Ministry of Non-Renewable Natural Resources and other relevant public sector agencies. However, shortly after project implementation began there were several institutional changes due to the adoption of a new national Constitution. Consequently, Grupo Faro had to re-think the strategy with respect to most of the entry points identified at the design stage. The team had to knock on new doors, such as high-level officials in the Secretaria de Transparencia de Gestión (Secretary of Transparency in Public Management), whose participation was not foreseen at the design phase.

Preparing projects for legal and institutional changes

In addition to Constitutional changes that occurred during the first year of project implementation in Ecuador, the legal framework of the country's hydrocarbon sector underwent important changes in 2010. The Government introduced a new model aimed at private enterprises working in the hydrocarbon sector. This model compelled all firms to undertake structural changes that entailed redefining their contracts with the state from a strategic partner role to a service-based jurisdiction. This move was part of a national strategy that has increased and enforced the role of the state since the start of the Correa government. According to the executing agency, Grupo Faro, the new model implied complete ownership of natural resources by the State, and therefore all firms operating in Ecuador had to endure a long process of negotiation. The negotiation process was complicated, and it was difficult to stake out a middle ground between the Government's and the companies' positions.

Grupo Faro saw these changes as an opportunity to address the need for transparency, proposing the design and implementation of transparency standards.¹⁸ This was widely accepted throughout the public and private sector, but there were delays in finalizing official agreements between Grupo Faro and the public institutions involved. Grupo Faro and the Ministry of Non-Renewable Natural Resources have held a number of meetings, especially with the minister's legal advisor, to work out the details of an official agreement to implement transparency standards. Given that the executing agency has developed the standards previously, these agreements have revolved around identifying a database of information to apply the transparency standards to in the pilot program. The Ministry maintains a significant information database; nonetheless, one of the main

¹⁸ On Sunday January 23, 2011, the Ministry ended the final round of negotiations with the oil corporations. Grupo Faro has been actively following up on this process and will use commitments for lobbying with public sectors representatives. Although the Ministries main focus has been the renegotiation process, Grupo Faro has ensured a positive response regarding a legislative reform that would bring more transparency to the extractive industries sector.

principles of the standards is that large quantities of information can in many cases actually reduce transparency, hence the need to narrow down and improve the database.

Internal Factors

Diagnostics and Baselines

Diagnostic activities, baselines and indicators need to be shared and validated by all relevant stakeholders at the outset, or else the projects will run the risk that key actors will not feel like they are part of the proposed solutions. This validation process takes time and resources. However, the time invested in researching and preparing baselines for the project is crucial to clearly understand the problems the program is trying to solve and identify the best solutions and the risks involved.

Activities intended to reduce opportunities for corruption by rendering processes more efficient and enhancing access to information typically have the concomitant result of saving money and generating revenues. It is important to address the relevance of studies on the economic impact of transparency (or lack thereof) to help understand the incentives, positive and negative, of key stakeholders to collaborate. Studying the economic cost of lack of transparency was critical to create awareness in Ecuador, and to reinforce the relationship between the executing agencies and other actors such as ECORAE and the media.¹⁹

Incorporating flexibility into the program design

One of the main findings of the mid-term review exercise mentioned above was the need to incorporate flexibility into the program design in order to avoid delays during execution. The design of Ecuador's project indicated that a consortium of civil society organizations, lead by Grupo Faro, would have to sign a formal agreement with the Ministry of Oil and Mining (today the Ministry of Non-renewable Natural Resources) to start implementing transparency standards along the value chain of the oil sector. Although this agreement was deemed necessary by the project team, especially given frequent institutional changes, the design phase of the project did not contemplate that the signing of a formal agreement should have been understood as the result of ongoing support, rather than a condition to start coordinating activities between civil society and the public sector. Formal agreements are sometimes difficult to reach and, if not based on trust already built between key stakeholders, the process could in fact impede cooperation.

Another example of the need to incorporate flexibility into the program design was the creation of baseline studies. These studies were originally planned to occur sequentially, but a few months after the project was initiated, it was clear that many of the studies

¹⁹ For more information see <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=35395725>

needed to be done simultaneously, not only to allow the project team to gain a basic understanding of the value-chain involved in the sector, but also to establish relationships between different stakeholders that were key for the viability of the project's successive milestones.

Enhancing Donor-Executing Agency Collaboration and Managing expectations

Both the donor and the executing agency should enhance collaboration towards achieving the project goals. Straightforward communication on project implementation challenges must be encouraged, beginning with the project design phase. This is one of the most powerful ways for donors to solicit feedback to be used in future programming and, at the same time, generate solutions to bottlenecks that usually occur during implementation. Enhanced communication also allows the executing agency to develop new platforms for disseminating project results and/or to find consultants with a specific expertise, etc.

It must also be taken into account that programs should manage expectations. At the beginning of implementation, the executing agency in Ecuador and its counterparts seemed to try to tackle too many problems at the same time. Although increasing transparency usually requires interventions at many levels, the participation of all relevant stakeholders must be enhanced first. In addition, a project that reaches conclusions prematurely or exaggerates the impact of reforms could impair the effectiveness of the program and/or the executing agency. It is important that the messages sent to the beneficiaries are factual, avoiding making any projections or promising immediate impact. It is always difficult to quantify the extent to which program activities led to a reduction of corrupt practices. That's why it is important to clearly define baselines and indicators that could be measured against specific deliverables.