



The process of Structural Adjustment Reform in the Argentinean Provinces

The Case of the Provincial Reform Loan

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The process of Structural Adjustment Reform in the Argentinean Provinces: the Case of the Provincial Reform Loan¹

Abstract

The process of Structural Reform in Argentina began during the late 80s, but this attempt was not replicated in Subnational governments until 1995. This was made possible thanks to the sponsorship of the first World Bank (WB) loan addressed to the Argentinean provinces: the Provincial Reform Loan (PRL). The present work proves that, despite the first years' enthusiasm and voluntarism, the PRL showed disappointing results compared to the initial aims of reform. Most important, the analysis carried on proves that the PRL loan was not as successful as the WB evaluations suggested. A closer study of the problems affecting the PRL's performance suggests that there are clue design insufficiencies in this loan, which are a common denominator in most Adjustment operations, the most important of which was the lack of long term sustainability of the reforms. In such a way, a proposal was put forward so as to remedy this insufficiency and improve Structural Adjustment lending performance, which links loan's disbursement on past loans' outcomes. Under this new scenario, provinces are encouraged to maintain the reforms so as to be eligible for future loans, extending their horizon of action and improving Adjustment lending overall performance.

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CHAPTER ONE: *Introduction*

The boom of Structural reform in Argentina began with the Menem administration around 1989 and saw its end, (at least that seems to be the impression until now), with the conclusion of the convertibility era in 2001. During the first years of the decade, there was a strong conviction, within the National Executive, that a program of reform of this type was necessary, both at national and subnational levels. This period coincided with the economic flourishing of Argentinean economy and with the rush of foreign investment and financing, making this enterprise even more attractive. But it was not until the year 1995 that the real impetus for reform was evident. With the Tequila crises, this current of external financing was interrupted and the provincial governments (which had shown reluctant to implement reforms until now) were forced to introduce them in order to obtain the desired external funds.

A quick glance at the economic and institutional situation of the provinces today, suggests that the program of Structural reform in the Argentinean provinces failed, or at least was not able to maintain the achievements harvested during the first years. Many explanations can be elaborated to give an answer to this disappointing result. The exceptional growth of the first promising years of the Convertibility had ceased and other priorities were designated according to the times running, allocating effort to other matters and away from the structural reform initiative. The unique alignment of interests of the different levels and institutions of government, that characterized the first years of the period, was broken together with the changing administrations. The new Ministry of Economy, no longer in hands of Domingo Cavallo, was now dedicated to attending other policy objectives. With the change of administration in 1999, this situation became more real than ever. Additionally, the World Bank had failed in generating the necessary incentives in order to maintain the accomplishments of the first programs of reform sponsored by it.

In spite of this and against the evidence that will be presented in this work, the World Bank considered the program successful and has recently diversified its business through the creation of a whole new branch of Adjustment Lending aimed at subnational governments and inspired in the Argentine experience.

In Argentina, the first Adjustment loan addressed to subnational governments was the Provincial Reform Loan (PRL). It was meant to be a pilot test upon whose success depended the launch of other loans in the provinces. A detailed study of the results and accomplishments of this loan concludes that it was not as successful as the final evaluation of the Bank, the Implementation Completion Report (ICR) suggested:

“The operation has been highly instrumental in improving resource mobilization, containing public spending while improving efficiency, and reducing the size of the provincial banking sector among participating provinces. All but one of the PRL conditions have been satisfactorily met and even exceeded.” (World Bank, Implementation Completion Report, 1999: 3)

This study shows that the conclusions of these evaluations as regards the success of the reforms were overestimated. An independent evaluation was carried on, three years after the closing date of the loan in June 1998, and several discrepancies with the official evaluations were detected. The results of the analysis show that some of the reforms implemented were only partially concluded because of lack of time or other external circumstances affecting the outcome, such as the financial crises of the provinces. Additionally, the evidence reveals that some of these reforms were reversed in the long run and that many of the conditions that were agreed were not consistent with the initial objectives.

A more comprehensive study would probably include a comparison of the situation of the provinces adhered to the PRL loan against those who were not, before the PRL was approved in 1994 and after its conclusion in 1998. However, this is not the aim of this work, which has only focused on providing evidence in support of the conclusion that the World Bank's evaluations were not completely truthful to the results of the reform effort.

This study demonstrates that many of these shortcomings were caused by problems in the design of these loans which are common to most Adjustment Operations, together with the absence of a systemic approach to World Bank lending where the advantages of taking into account the synergy of projects is considered. An important aim of this study is therefore, to examine these design insufficiencies and suggest possible solutions. A series of problems in the design of the Provincial Reform Loan were studied closely and some policy recommendations were formulated based on the conclusion of this analysis. One of the

problems was considered in greater detail due to its importance for the present operation and its relevance for future SNALs. A proposal for modifying the actual approach to Bank lending was elaborated, based on the insufficiencies detected and inspired in the solutions studied by the economic literature in relation to efficiency wage problems and their influences on workers' incentives.

In order to achieve this aims, interviews were held with members of the Ministries of Economy and Interior, as well as with World Bank staff. Additionally, the information gathered from the World Bank Documents and Reports, together with the releases formulated by the SAREP (the office in charge of the program on the side of the Ministry of Interior), the Ministry of Economy and other government dependencies, served as important sources for this study. The literature on Repeated Agency Problems and Efficiency Wages also shed some light on the analysis and conclusions of the present thesis.

In addition to the Provincial Reform Loan (PRL), the World Bank (WB) strategy of structural reform of the provinces was composed by seven other loans, although different in nature to their predecessor. The following Subnational Loans had nearly no intervention on behalf of the Ministry of Interior and the Bank dealt practically exclusively with the provinces. It is not the aim of this thesis to analyze these later loans; instead it has circumscribed its study to the PRL case. The purpose for this choice is justified in the fact that the WB considered this loan as having had an exceptionally good performance, against what the empirical evidence suggests three years after the closing date of the loan.

Furthermore, because of an extension restriction this study has chosen to concentrate on the problems in the design of the PRL loan, leaving unconsidered the shortcomings of the implementation stage of the operation. The desire to focus on the former aspect is justified in the fact that it is here where the economic analysis can have more valuable contributions.

It is important to highlight the difficulties that arose when attempting to gather evidence of the results of the implementation phase of the PRL. Since this loan was implemented many years ago, the access to this type of information was in several occasions very difficult. The data available was many times scarce and often inaccurate. Files were sometimes lost or inexistent. Nevertheless, in most of cases these shortcomings could be overcome by the information

provided in the interviews, although in this case it became necessary to watch for possible biases arising from the interviewee's testimony.

Finally, there are few precedents of Documents where this type of loans were studied. In general, the reports available are basically those from the World Bank internal release, from the *Secretaría de Provincias* in the Ministry of Interior, or from the *Secretaría de Coordinación Fiscal con las Provincias* in the Ministry of Economy. Practically no independent studies were made on the effectiveness of these type of loans, or on the Structural Adjustment Lending Policy of the World Bank. It is for this reason that this thesis is considered to be an important contribution in this sense.

As was already said before, this work understands that the Provincial Reform Loan was not as successful as the available evaluations suggested. Therefore, its first aim is to provide the supporting evidence for this hypothesis. This is made on Chapter two of this thesis. Further on, on Chapter Three, some of the problems in the design of this loan, which were considered partly responsible for the deficient outcome, are analyzed and the corresponding policy recommendations are suggested as ways to overcome the insufficiencies detected. Moreover, on Chapter four, one of these problems, the most important according to this work, is examined in greater detail and a proposal for restructuring World Bank loan disbursing policy is elaborated, as this thesis believes this will serve as a way to improve the overall achievements of Structural Adjustment Loans. Finally, on Chapter five, the main results and conclusions of the study are presented.

CHAPTER TWO: *A Retrospection to the PRL's Main Achievements*

An insight to the Subnational Adjustment Lending Policy of the World Bank

Five years ago, Subnational Adjustment Loans (SNALs), as we know them today, did not exist as an independent business unit of Adjustment Lending². Only a few operations of this kind were approved for Argentina and Brazil. In the case of Argentina, these loans were classified as Structural Adjustment operations³ and were based on agreements with the National authorities on generic eligibility criteria and universal access by any subnational government that qualified. On the other hand, Brazil's first subnational government loans were, at that time, negotiated as part of Investment Loans⁴.

Later, in 1998, after having reviewed the previous loans' performance, the Subnational Adjustment Lending approach was finally materialized. In contrast to the previous loans, these new SNALs, were prepared, negotiated and supervised by Bank staff directly with a specific subnational government⁵.

The aims of Subnational Adjustment Loans are basically to support policy changes and institutional reforms at the subnational level, with a focus on the incentive and regulatory framework, institutional capability, expenditure programs and mitigation of social costs. These loans are generally focused on introducing reforms in the areas of public finance, public administration, public infrastructure, health, education, etc.

² Adjustment Loans are one of the two main categories in which World Bank lending is divided. For more information on this loans see Appendix II.

³ Name given to one type of Adjustment loan (for more information refer to Appendix II)

⁴ The other big category in which World Bank lending is divided, besides Adjustment loans. For more information see Appendix II.

⁵ The name subnational government is a common denominator to address all the different types of political subdivisions of a country, immediately beyond the National level. In the case of Argentina this units receive the name of provinces, and total a number of twenty four. In Brazil, for instance the name they give to these subdivisions is states, while in Uruguay they are named departments.

Figure 2.1: Subnational Loans for period 1997-2001

Country/state	Amount (US\$ millions)	Key conditions	Assessment and Status
Argentina			
Salta	75	Fiscal, education and health reforms	Satisfactory implementation based on ICR ⁶ (20698-AR)
San Juan	50		Unsatisfactory implementation based on draft ICR
Tucumán	100		Satisfactory implementation based on ICR (20699-AR)
Río Negro	75		Unsatisfactory Implementation based on draft ICR
Catamarca	71		Under implementation
Córdoba	303		Under implementation
Santa Fé	330	Public Finance, Public Administration, health and education	Under Implementation
India			
Uttar Pradesh	251	Fiscal reforms, public sector restructuring	ICR pending
Mexico			
State of Mexico	505	Fiscal reform, privatization, pension reform, utilities sector reform	Under implementation

Source: Adjustment Lending Retrospective Final Report, Document of the World Bank, June 15, 2001

In the case of Argentina, this late SNALs had an overall disappointing performance. As **Figure 2.1** shows, two out of four loans evaluated had an unsatisfactory implementation. This study suggests that this deficient outcome was the result of a combination of factors, which made the continuation of these operations impossible to justify. In the first place, there were some design problems in these loans that had already been present in the case of the first operation addressed to provincial governments, but since at that time (1995-96) the macroeconomic situation in Argentina was much more promising than during 1997-2001 (when these later SNALs were implemented) the final outcome was not as disappointing as it was in these last cases.

⁶ Implementation Completion Report (A Document presented after the closing date of the loan containing the overall evaluation of its performance).

Additionally, there were other problems that the different design of this later SNALs had, which were not present in the first operation, and which also contributed to the unsatisfactory outcome. As a result, two of these later SNALs were interrupted during their implementation stage and were never accomplished. This study sustains that the evaluation procedures of the Bank did not change during those years (something that might be inferred from the results above). The problems that were detected in the first loan's evaluations were still present in the case of these later loans, and were magnified with the country's worsened macroeconomic situation, making the continuation of these loans unattainable.

However, it is not the purpose of this study to evaluate these later loans' performance. This thesis will, exclusively concentrate in the analysis of the first loan directed to Argentinean provinces, which received the name of Provincial Reform Loan (PRL).

Nevertheless, many of these later SNALs had many similarities with the PRL and some of the problems that are analyzed in what follows for the case of the latter loan were also present in the former ones, probably contributing to the disappointing result showed in the previous table.

The history of Structural Adjustment Lending in Argentina

Today, a few months after the exit from the Convertibility Law⁷, the Subnational Adjustment process in Argentina appears to have been destined to the same fate that the old monetary regime. The exit from the Convertibility Plan⁸ meant the final blow to this initiative that saw its most prosperous times during the first years of the 90s. The impossibility to access external financing due to the enormous costs of having to face repayment with a devalued currency stopped all projects sponsored by multilateral credit institutions abruptly, with a few exceptions. Many Subnational Adjustment programs were initiated and completed during the past decade, in spite of this, the impression today is that this initiative did not have the impact that was expected when the whole process started.

⁷ A legal instrument authorizing the monetary system of currency board (where each peso is backed by one dollar)

⁸ The main pillars of this plan were: (1) monetary reform, including fixing the exchange rate (2) fiscal reform, especially tax law and administrative reform, (3) state reform, through privatization and deregulation of factor and product markets, (4) social security reform and (5) trade reform, through such measures as elimination of export taxes, import restrictions and reduction of the level and range of taxes.

Structural Adjustment Lending in Argentina (at the National level) was first introduced at the end of the decade of the 80s, as a response to the high level of inflation and recession that the country was exhibiting. There was a need to eliminate the fiscal deficits that had reached very high levels, as well as a desire to put an end to the increasing tendency that the external debt had been experiencing. As a result, a series of Structural reforms were carried out by the Central Government: public employment was reduced, public enterprises were privatized, tax reforms were implemented, tax administration was modernized, trade liberalization fostered and markets' deregulation was accelerated. The Convertibility Law of 1991 helped in the process of reform by recovering macroeconomic stability through fixing the exchange rate, desindexing contracts and requiring the monetary base to be fully backed by international reserves. With this monetary system the government could no longer finance its fiscal deficits through printing and was forced to deepen the structural reforms already initiated. The macroeconomic program brought price stability and economic growth during the first years of the decade, following growth rates of 8.9 and 8.7 percent in 1992 and 1993 respectively. Inflation was reduced from a monthly 200 percent in July 1989 to an annual rate of 7.5 percent in 1993. Stability and declining interest rates helped to attract investments.

Although macroeconomic stability was recovered during the first years of the decade, the consolidated budget continued to show a bad fiscal condition, partially affected by high provincial deficits and increasing provincial debt. This situation persisted despite the growth in the coparticipation funds⁹ that the provinces received from the National Government. Provincial fiscal deficits were very difficult to finance and as a result the provinces increased their indebtedness with national and foreign private banks, with guarantees coming from coparticipated funds. One of the most important problems affecting provincial finances was the lack of correspondence between provincial tax collection capacity and local expenditures. The system of intergovernmental fiscal relations was not conducive to fiscal efficiency at the provincial level, provinces tended to rely too much on transfers from the Federal government and neglected the potential of their own tax revenues. This problem was partly due to the unclear distribution criteria characterizing the intergovernmental fiscal agreements ("Argentina: The Fiscal Dimension of the Convertibility Plan, A Background Report", World Bank, 1998:45)

⁹ A system of tax revenue sharing between the different levels of government (Federal Government, provinces and municipalities)

Reform was needed in different fronts. On the fiscal arena, it was important to improve the efficiency of fiscal expenditures while increasing fiscal revenues and reducing the distortions that the actual system of Federal transfers generated. In what concerns public enterprises, these were generally inefficient and survived thanks to public financing from provincial governments. Many of them were even insolvent. Another important risk was the fragile financial situation of provincial public banks. The Convertibility Law and the Central Bank's Charter that supported it, had an important impact on provincial public banks, as Dillinger and Webb suggested (Dillinger and Webb, 1999:16)

“This meant that the provinces could no longer count on the Central Bank to rediscount loans by provincial banks to provincial governments, ending their access to seniorage and the inflation tax”

The problems of the banking sector together with the decreasing pace of foreign capital inflows (intensified during the Tequila crisis of 1995) was a powerful mix that threatened with the rise of interest rates and a general contraction of the economic activity. More specifically, the problem was that a financial crisis could cause a systemic fall of all provincial public banks. With the Tequila crises, the danger that had been threatening all along, became true and the banking crises occurred, thus the course of action left to the government was the privatization and liquidation of these banks. As Clarke and Cull (Clarke and Cull, 1999:7) state:

“The Tequila Crises had a large impact on the performance of the provincial banks, imposing substantial fiscal costs upon the provinces. Nervous depositors withdrew deposits from weak banks in both the public and private sectors, hitting the weak public provincial banks hard.”

Because of these reasons and the need to improve public sector efficiency and administration, a program of reform aimed at the subnational governments was needed at that time.

The strategy of Structural Reform in the Argentinean Provinces

The program of structural reform in the provinces was an extremely ambitious one. It was a project designed by the *Secretaría de Asistencia para la Reforma Económica Provincial*

(SAREP) of the Ministry of Interior. Its main building block was the Transformation Fund¹⁰, a kind of reservoir that was meant to administrate centrally the different multilateral credit loans that were aimed at the provinces. This Fund was supervised by the SAREP and was thought to serve as a source of financing for those provinces willing to introduce Structural reforms. Initially, it was meant to be financed through three different channels which included: credits from multilateral organisms, other foreign governments financing, like the Japanese government, and from the proceeds of the privatization of several federal financial institutions. As the Country Officer for Argentina, **Mark Hagerstrom**, confirmed: *“At that time, the Bank was thinking of a Transformation Fund of nearly a billion dollars.”*¹¹ Finally, the only source that really made it to the Fund was the US\$ 300 million Provincial Reform Loan of the World Bank in January 1995. In the end, this program ended up being much modest than the original plan, and it functioned thanks to the funds from the PRL loan. It is important to note that the Transformation Fund did not have a closing date and continued to operate even after the Provincial Reform Loan and the agreement with the Bank were finished. Today the Fund is still operating with the capitalized funds from the PRL loan (the PRL contributed with US\$ 300 million, but due to the capitalization of interests and the more accelerated repayment, the funds actually available were superior in amount to the initial loan).

The Provincial Reform Loan

As was said before, a fundamental pillar of the strategy of Structural Reform in the provinces was the Provincial Reform Loan (PRL). This was the first World Bank loan of its type, aimed at provincial governments. This institution had been working with the Argentinean Federal Government for long but had never extended loans to finance structural reforms in subnational governments. The PRL was approved in January 1995. It was an agreement between the World Bank, the Argentinean National Government, and twelve Argentinean provinces¹². The National Government was the borrower of the loan and administrated the funds through the Transformation Fund coordinated by the Ministry of Interior. Additionally,

¹⁰ Created through the Decree N°678/93 of April 1993

¹¹ A detailed report on the interviews carried on in this thesis is available if requested at the following e-mail address marcelatf@fibertel.com.ar

¹² For more information on the provinces participating and the terms of each one's individual contract, see Appendix I

this Ministry, through the SAREP, was in charge of the implementation and evaluation phase of the project a responsibility shared with staff of the Bank. The Ministry of Economy was also involved in the implementation of some conditionalities concerned mainly with fiscal issues.

The Provincial Reform Loan consisted on three tranches¹³ or disbursements, previous compliment with certain conditionalities. In order to apply for the program, some provinces were asked to implement certain reforms for presentation to the Board of Governors of the Bank, before the agreement was actually in place. The loan was designed to have 15 years of repayment at a variable interest rate and five years of grace. It was aimed at four provinces initially: Catamarca, Chaco, Entre Ríos and Misiones. These were the ones that had compromised to initiate reforms before project presentation to the Board of governors of the Bank. Three of these provinces, Chaco, Entre Ríos and Misiones together with Corrientes, had also to implement reforms before receiving the second tranche disbursement. These same provinces, with Tucumán instead of Chaco, did the same for the third tranche and additionally, for this last tranche, four other provinces were required to initiate the first set of reforms: Catamarca, Salta, San Juan and Santiago del Estero (see provinces addressed in each tranche in the Policy Matrix of the PRL loan, in page 19 of this thesis). Three other provinces also entered the program but were not considered forming part of neither of these groups: Río Negro, Chubut and Santa Cruz.

PRL's Achievements: Some contradictory Evidence

The World Bank Implementation Completion Report (ICR) of May 1999 concluded that the Provincial Reform Loan had successfully completed and even exceeded its initial objectives. According to this document, the whole outcome was classified as highly satisfactory (on a highly satisfactory, satisfactory and deficient bases), with all areas of reform experiencing substantial achievement by the closing date of the loan (with categories being substantial, partial and negligible). Additionally, Bank's performance was described as highly satisfactory, and project sustainability as likely (on a likely, unlikely and uncertain bases).

Contradictorily, this study sustains and proves that this excessively optimistic evaluation

¹³ Each of the three monetary disbursements contemplated in the Provincial Reform Loan

overestimated the real achievements of the program. An independent evaluation was carried on, three years after the closing date of the loan, and several discrepancies with the ICR were detected. While some of the reforms implemented during the program were reversed after it was finished, others were not concluded on time. Furthermore, some reforms had no relation with the objectives of the program and in some extreme cases they had no relevance whatsoever for the reform effort.

The aim of this section is to evaluate the success of the program based on compliance with the conditionalities stated in the Policy Matrix of the PRL loan, while highlighting the evident discrepancies with the World Bank's conclusions.

The information for this analysis was obtained from interviews carried on to a series of members of the World Bank, who were in charge of the program at that time, as well as to members of the Secretary of the Provinces, that were involved in the program. Information was also collected from data bases from the Ministries of Economy and Interior.

The following Policy Matrix states the objectives, conditionalities, and broad results of the implementation stage (categories being achieved, partially achieved and not achieved), according to the independent evaluation carried on. Following, each objective with its corresponding conditionalities is analyzed closely and the evidence of the evaluation is presented. The results obtained are discussed and contrasted to those gathered by the World Bank in the ICR of 1999. Finally, some of the insufficiencies that were perceived in the design of the policy matrix are also studied in what follows.

Before explaining each objective in detail, three important points must be clarified. Firstly, the objectives stated in the Policy Matrix were divided according to whom they were addressed (the Federal Government or Provincial Governments). The Provincial Reform Loan concentrated its efforts in the provincial objectives, although it was necessary for the National Government to maintain some of the outcomes it had already attained, in order to be successful in the achievement of provincial goals. This was the real *ley motif* of including conditionalities addressed to the Federal Government. Because of this reason, this study only concentrates its analysis in the reforms aimed at provincial governments, while it is assumed that mostly all the conditions imposed to the National Government were maintained during the period.

Secondly, it is important to note that, although the conditionalities of the different tranches of the loan were addressed to different groups of provinces, the evaluation that follows has been made on a general bases, looking at the state of completion of the reforms in all PRL provinces, in order to have a better idea of the impact of the reforms in all of them.

Finally, as was mentioned in the Introduction of this thesis, a more comprehensive analysis would have probably included a comparison between PRL and non PRL provinces' outcomes, before and after the loan was introduced. However, this aim exceeds the objectives of this study, which has exclusively focused on proving that many of these reforms were not successfully implemented, as the World Bank suggested. Nevertheless, for those cases in which this comparative approach was particularly useful to highlight the counterfactual of what would have happened without the loan (provincial public enterprises and banks privatization), the comparison between PRL versus non PRL provinces' performance was included.



Table 2.2: Policy Matrix

Objective	Conditionalities			Results of the implementation
I. Federal Government	For Board Presentation May 1995	Second Tranche January 1996	Third Tranche February 1996	
A. <u>Macroeconomic Stability</u> Maintain macroeconomic stability to facilitate further fiscal reforms in the provinces	Maintenance of a sound macroeconomic framework consistent with policy objectives and programs described in the Letter of Development Policy	Maintenance of a sound macroeconomic framework consistent with policy objectives and programs described in the Letter of Development Policy	Maintenance of a sound macroeconomic framework consistent with policy objectives and programs described in the Letter of Development Policy	Achieved ¹⁴
B. <u>Transfers to Provinces</u> Reduce incentives for inefficient provincial spending and help finance provincial reforms.		Provide financial support to provinces implementing agreed adjustment programs through the Transformation Fund. Audit provincial expenditures under FONAVI and FEDEL. Provide Bank with reports on budgetary performance of all provinces. Comply with its agreements and enforce its rights under the Transformation Fund Agreement.	Provide financial support to provinces implementing agreed adjustment programs through the Transformation Fund. Audit provincial expenditures under FONAVI and FEDEL. Provide Bank with reports on budgetary performance of all provinces. Comply with its agreements and enforce its rights under the Transformation Fund Agreement.	Partially Achieved
C. <u>Provincial Banks</u> Increase incentives for privatization/closure by eliminating special treatment by the Central Bank (BCRA)	Maintain BCRA regulations that treat provincial banks the same as other banks	Maintain BCRA regulations that treat provincial banks the same as other banks and inspect or audit provincial banks during the fifteen months prior to tranche release	Maintain BCRA regulations that treat provincial banks the same as other banks and inspect or audit provincial banks during the fifteen months prior to tranche release	Achieved
II. Provincial Governments	At least four provinces have met the conditions below. This are: Catamarca, Chaco, Entre Ríos and Misiones	At least four provinces have met the conditions below. This are: Corrientes, Chaco, Entre Ríos and Misiones	At least four provinces have met the conditions below. This are: Corrientes, Tucumán, Entre Ríos and Misiones.	

¹⁴ Following this table a more detailed explanation of the implementation results is presented

			At least four additional provinces have met first tranche conditions. These are: Catamarca, Salta, San Juan and Santiago del Estero	
A. <u>Improve resource mobilization</u>	Formulate system to monitor largest taxpayers	System monitors at least 50% of large taxpayers	System monitors at least 75% of large taxpayers	Achieved
i. Improve tax administration	Legislative approval of the Fiscal Pact	Adhere to timetable to achieve reforms	Tax reforms substantially implemented	Partially Achieved
ii. Change the structure of fiscal taxes in line with the Fiscal Pact	Formulate plan for downsizing	Achieve a reduction of 10000 public employment positions form end 1992 level.	Reduce public sector employment positions by an additional 10000	Not achieved
B. <u>Improve efficiency of expenditures</u>	Formulate improved accounting and budgetary system compatible with that of the Federal government.	Draft legislation to reform provincial financial management law in accordance with the principles of Federal Law N°24156	Submit legislation to reform provincial financial management law in accordance with the principles of Federal Law N°24156	Partially Achieved
i. Reduce the number of public provincial employees	Approve legislation for privatization/concession of eight provincial public enterprises	Offer eight enterprises for sale, concession or liquidation, with environmental audits or reports satisfactory to the Bank for enterprises involved in manufacturing, extractive or power-generating activities. Draft legislation on revenue sharing with the municipalities incorporating incentives that base at least 30% of transfers on fiscal performance.	Eight enterprises have been privatized or concessioned, or are under liquidation. Recommendations of environmental audits undertaken. Submit legislation on revenue-sharing with the municipalities incorporating incentive rules that base at least 30% of transfers on fiscal performance.	Partially achieved
ii. Strengthen management, information and control systems.				
iii. Reduce size of the public sector and improve efficiency of transfers				
iv. Improve fiscal performance			Execute balanced budget in 1995 and subsequent years; submit balanced budget for 1996 and subsequent years.	Not achieved
C. <u>Provincial Banks</u> Reduce size of provincial public banking sector.	Approve legislation for privatization of four provincial banks	Four banks have been offered for sale or legally declared under liquidation	Four banks have been privatized or are under liquidation	Achieved

Source: Secretary of Provinces Final Evaluation Report and World Bank Final Evaluation Report

(1) Implement system to monitor largest taxpayers

In reference to this particular objective the World Bank Implementation Completion Report (ICR) sustained that the condition was satisfactorily met with 50 to 75 percent of the largest taxpayers in each province being satisfactorily monitored in each tranche. (World Bank, ICR, 1999:6)

Before beginning the analysis, it is important to mention that the system of largest taxpayers was exclusively designed for the gross receipt tax (a turnover sales tax levied at both the retail and wholesale stages), while other provincial taxes were excluded from this system.

The access to information as regards this particular subject was extremely difficult since no records were available at the Ministry of Interior's archives. The only information at hand was the testimony of a member staff of the implementation team of the SAREP who participated in the evaluation of this conditionality, **Domingo Vesprini**. He suggested that all PRL provinces implemented in some degree a system of control of largest taxpayers. It is important to highlight that this information may be subject to biases, however, it is the only source that was available at the time.

According to the information obtained, this system was first introduced at the Federal level, sponsored by a World Bank's loan and later replicated in provincial governments. The provincial *Direcciones de Rentas* (the office in charge of the implementation), applied this systems and monitored the largest provincial taxpayers, although the percentage of those monitored varied in each province. In most of the cases, the provinces monitored those taxpayers that concentrated most of the provincial tax collection.

(2) Change the structure of fiscal taxes in line with the Fiscal Pact

When evaluating the performance of the loan as regards this objective, the ICR concluded that all of these conditions were satisfactorily met with compliance reaching more than 80% (World Bank, Implementation Completion Report, 1999:6)

The *Pacto Federal para el Empleo, la Producción y el Crecimiento*¹⁵ was initially signed the 08/12/93 by the Federal and all Provincial Governments. In contradiction to the World Bank statement, the implementation of the reforms contemplated in this Pact were postponed many times. The final deadline was extended until 12/31/98.

The situation of the implementation of these reforms until March 1999 (Gaggero, Gomes Sabaini: 1999), suggests that most of the reform targets of the Fiscal Pact, were not concluded and in many cases never implemented. The state of completion of these reforms is presented in **Appendix VI** of this study.

The provinces have repeatedly postponed the elimination of the agreed tax exceptions to the gross receipt tax, so as to avoid what otherwise would have been an inevitable fall in provincial tax collection, since no alternative tax was designed to replace it. In general, there was no big difference as regards compliance with this condition, between PRL and non PRL provinces. The provinces with the best performance were Misiones, La Rioja, Tucumán and Tierra del Fuego (Misiones the only PRL province). Moreover, many of the compromises assumed concerning the stamp tax (a state administration tax) were not fulfilled. The provinces still use this tax for certain activities, and in general there was similar progress as regards its elimination in all of them. In what concerns the property tax, there was no differential performance between PRL and non PRL provinces. Eight provinces did not make the agreed modifications, and three of them did not conclude this process. Out of these provinces, seven of them had an agreement in the context of the PRL.

The elimination of the payroll tax is still an unresolved issue in many provinces, such as Chaco, Chubut, Entre Ríos, Salta, Santa Fe, Santiago del Estero, Tucumán (all PRL provinces except for Santa Fe). The grade of completion of enterprises' privatization (mainly those related to energy and water generation and distribution) suggest no differential outcome between PRL and non PRL provinces. However, provincial bank privatization was more successful among PRL provinces. Those provinces that had not privatized their provincial public banks by March 1999 were: G.C.B.A, Buenos Aires,

¹⁵ The name given to the Fiscal Agreement signed in December 1993 by the Federal and all subnational governments

Córdoba, La Pampa and Neuquén. Finally, the pension system transfers¹⁶ were not completed in thirteen provinces, six of them PRL provinces, what suggests a similar performance between both groups of provinces as regards this condition.

In general terms, the implementation of the Fiscal Pact was an important objective to improve tax collection in the provinces; nevertheless some problems appeared in the design of the reforms. Most generally, these included the elimination of some very important taxes such as the stamp tax and the deduction of other taxes, such as the gross receipt tax and the property tax, for certain activities. However, the program design in many cases did not contemplate the replacement of these taxes for other less distortive, in order to avoid the fall in tax collection and the political problems inherent in this.

Another problem with this Pact, was that some reforms were easily reversible, causing the quick readoption of these distortive taxes in moments of fiscal constraint. For example, some of the provinces studied, adopted the contemplated exemptions for the gross receipt tax during the time the PRL was active, although they were later forced to implement them again because of their worsened financial situation. The same happened with some specific taxes: fuel, gas electricity transfers.

Finally, another insufficiency was the excessive number of issues of reform covered by the Pact, making the implementation of all of them difficult to be completed in such a short time. Some of these reforms were initiated but not finished, as for example, the transfers of the provincial pension funds to the National government.

(3) Reduce the number of public provincial employees

The position of the World Bank as regards the achievement of this objective was that this target was “**amply surpassed**” with 55,000 public sector positions being eliminated in the provinces. The ICR also sustained that this reductions had a positive impact in current expenditures and that they were decreased 3.49 percent over the period 1995-97 (World

¹⁶ This makes reference to the transfer of provincial public employee pension funds to the National streamlined fund.

Bank, ICR, 1999:7) In contrast to the above statement, this study proves that this objective was **not achieved**, since the number of public employees increased from 1996 to 1998 in five out of nine provinces analyzed. This conditionality was only met during the period 1995-1996. As **Table 2.3** shows, during this period, all provinces analyzed with the exceptions of Chaco and Entre Ríos, decreased their number of public employees. However, during the period 1996-1998, six of them reversed this situation and experienced a growing tendency in these numbers. Examples are: Misiones (10.38%), Santiago del Estero (8.68%) and Corrientes (6.20%)¹⁷.

Table 2.3: Evolution of the number of public employees in the PRL provinces for the periods 1995-1996 and 1996-1998.

Province	1995	1996	% growth	1996	1998	% growth
Corrientes	41.051	39.872	-2.87	39.872	42.343	6.20
Chaco	39.150	39.344	0.50	39.344	40.637	3.29
Entre Ríos	46.745	47.850	2.36	47.850	49.595	3.65
Misiones	32.609	32.231	-1.16	32.231	35.577	10.38
Tucumán	48.191	45.195	-6.22	45.195	46.107	2.02
Catamarca	23.237	22.456	-3.36	22.456	22.145	-1.38
Salta	40.721	38.916	-4.43	38.916	38.094	-2.11
San Juan	29.569	28.851	-2.43	28.851	27.866	-3.41
Santiago del Estero	31.961	31.535	-1.33	31.535	34.272	8.68

Source: Dirección Nacional de Coordinación Fiscal con las Provincias, Ministry of Economy

However, this study sustains that a more accurate study of the situation of this conditionality should evaluate public employment expenditure figures rather than public employees downsizing. In this case too, this work found that this aim was not accomplished. Five out of nine provinces analyzed increased their public employment expenditure during 1995-1998. This objective was only met during the period 1995-1996, since all PRL provinces decreased their public employment expenditure during that time, but this situation did not last for long and was reversed the following year. **Table 2.4** shows that, in general, all provinces increased public expenditure in salaries a 10% during

¹⁷ A more detailed analysis could compare PRL and non PRL provinces' performance as regards this conditionality, however this aim exceeds the objectives of the present work which has concentrated on proving that this requirement was not met.

the period 1996-1998, except for Salta (-0.97%). The one that experienced the largest growth was Corrientes (30.61%).

Table 2.4: Evolution of public employment expenditure in the provinces of the PRL in the periods 1995-1996 and 1996-1998 (in thousands of current \$)

Province	1995	1996	% growth	1996	1998	% growth
Corrientes	395.973	364.833	-7.86	364.833	476.511	30.61
Chaco	508.580	505.987	-0.51	505.987	556.521	9.99
Entre Ríos	597.528	551.512	-7.70	551.512	597.096	8.27
Misiones	361.635	360.666	-0.27	360.666	418.033	15.91
Tucumán	514.145	507.825	-1.23	507.825	522.253	2.84
Catamarca	279.661	266.695	-4.64	266.695	273.247	2.46
Salta	504.950	467.366	-7.44	467.366	462.831	-0.97
San Juan	425.645	317.480	-25.41	317.480	386.195	21.64
Santiago del Estero	383.264	361.845	-5.59	361.845	389.985	7.78

Source: Dirección Nacional de Coordinación Fiscal con las Provincias, Ministry of Economy

Additional evidence on this behavior was presented by Gabriel Esterelles (Esterelles, 2001:15). In this document, he suggested that the increasing expenditure of provincial governments was principally absorbed by current expenditure, through its category human resources, which increased 114% between 1991 and 1999.

One problem detected in the case of this conditionality, as was already mentioned before, was that it studied the evolution in the total number of public employees and not on the average wage spending, which is a much accurate indicator for this purpose. Additionally, audits of public employment spending and hiring policies should have been included in this type of reform in order to improve management and help control expenses.

Finally, another problem was that this quantitative type of conditionality was easily reversible and new hiring occurred in the provinces after the program finished, as is evident from the increase in the number of employees in six of the nine provinces studied, during the period 1996-1998.

(4) Draft legislation to reform provincial financial management law in accordance with the principles of Federal Law N°24156

The aim of this reform was to change the way financial administration systems operated during the 80s, isolated and autonomous, while improving resource management and generating a more transparent and efficient public administration.

As Gabriel Esterelles suggested, two unresolved problems became more evident as the government incorporated new functions and became more complex. (Esterelles, 2001:10) One of these problems was the lack of opportunity and faithfulness of financial information. The other one was that this insufficiency generated centers of power strengthened by the possession of the scarce and valuable good.

This situation raised the need to improve the outdated system. It was important to recognize that the financial administration system operated through independent units which had objectives and concepts of their own¹⁸, but which nevertheless needed to interact with each other in order to improve the efficiency and opportunity of the information.

In general, improvements were achieved in this respect although, in contrast to the World Bank's conclusions, few provinces were actually implementing or executing these programs by the closing date of the loan.

The Bank, through the ICR declared that ten of the PRL provinces were implementing financial administration systems with the help of the World Bank investment loans PDP I and II¹⁹, the Secretary of Finance or with their own resources. (World Bank, ICR, 1999:8)

The situation of these reforms up to September 2001 is presented in **Table 2.5**. At the beginning of the year 2000, only two projects were in execution in the provinces of San Juan and Santa Fe (the latter not part of the PRL), three other programs were finished:

¹⁸ This units being: Budgeting, Public Credit, Treasury, Accountability, Human Resource Management, Purchases and Patrimony systems.

¹⁹ Provincial Development Loans I and II

Buenos Aires, Corrientes and Río Negro (Buenos Aires was not a member of the PRL and Río Negro entered at the end of 1996), and finally, three programs had been approved but delayed: Entre Ríos, Neuquén and Santa Cruz (Neuquén was not a PRL province either and Santa Cruz entered the program in 1998).²⁰ By September 2001, nine projects were approved, five of them were in implementation in the provinces of Formosa, Entre Ríos, Salta, San Juan and Santa Fe; two were being designed in Tucumán and Misiones, and finally, one was being reformulated in the province of Neuquén.

Table 2.5: State of Progress of Provincial Financial Administration Systems (September 2001)

PROVINCE	SITUATION	TOTAL AGREED (in US\$)	TOTAL FINANCED (in US\$)
SAN JUAN	In execution	3.340.082	2.974.586
SANTA FE	In execution	3.495.942	3.495.942
ENTRE RÍOS	In execution	1.390.000	1.390.000
SALTA	In execution	3.536.085	2.684.304
FORMOSA	In execution	2.290.180	2.019.646
TUCUMAN	In formulation	2.000.000	1.400.000
MISIONES	In formulation	2.500.000	2.000.000
NEUQUEN	In formulation	2.300.000	1.800.000
RIO NEGRO	Finished	4.688.500	3.187.300
CORRIENTES	Finished	4.226.400	2.962.200

Source: Secretary of Provinces, Ministry of Interior.

One problem that this type of conditionality presented was that in the majority of cases the drafting of a law or legal agreement, even its legislative approval, did not guarantee that it would be implemented in the future. Therefore, the fact that these laws were being drafted or presented to the legislature in some of the provinces of the PRL did not mean that those systems were going to be implemented soon. In fact, as was said before, some PRL provinces were still implementing even formulating these systems by September 2001.

²⁰ This information was obtained from an internal report belonging to the Secretary of the Provinces, in the Ministry of Interior

(4) Privatize or give in concession provincial public enterprises, and draft and submit legislation of revenue sharing with the municipalities²¹ based on fiscal performance.

The first of this aims was achieved in the majority of the PRL provinces, although, according to the evidence obtained, this initiative was not limited to them, since the rest of the provinces followed the same path. According to the “Secretaría de Programación Económica y Regional” of the Ministry of Economy, up to the year 1999, eight provinces had not privatized their electric energy generation and distribution enterprises, four of whom were PRL provinces: Chaco, Corrientes, Misiones and Santa Cruz. In addition, **Appendix IV** shows that only eight provinces completed their privatization processes in the case of water distribution and drainage enterprises, these were: Buenos Aires, Córdoba, Formosa, Mendoza, Santa Fe, Santiago del Estero, Salta and Corrientes, of whom only the last three were PRL provinces. In general, the majority of provinces privatized or gave in concession public enterprises during that time, as part of what appears to be a general tendency and not a unique goal of the PRL loan. Nevertheless, the Provincial Reform Loan may have been helpful in pressuring for these reforms, and this is witnessed in the fact that those that did not complete these processes were, in most of cases, non PRL provinces.

As regards the second objective, the ICR recognized that although some of the projects of coparticipation were approved in the legislature, finally none of them were implemented (World Bank, ICR, 1999:8)

The independent evaluation carried on analyzed the situation of five Argentinean provinces up to December 1997, since this was the last version available at the Ministry of Economy. These provinces (Chaco, Corrientes, Entre Ríos, Misiones and Tucumán) were asked to comply with the conditionalities of the second and third tranches of the loan. This analysis suggests that only three of them: Chaco, Corrientes and Entre Ríos presented coparticipation systems that considered in some way the municipalities own resources or

²¹ The name given to the political subdivisions beyond the provincial level of government.

tax collection capacity as a coparticipation criteria (See **Appendix III**). The other two, Misiones and Tucumán, had a system based on fixed coefficients.

A more comprehensive analysis of the twenty three provinces (G.C.B.A is excluded) showed that at least ten did not have systems based on fiscal performance: Misiones, Tucumán, Buenos Aires, Córdoba, Chubut, Jujuy, La Rioja, Salta, San Juan and Santa Cruz, six of which were PRL provinces. The rest of them included to some extent this concept as a distribution criterion, although in none of these provinces this was the prevailing methodology used. In general, the most used coefficient for secondary coparticipation²² was the demographic one (Tomasi, 1997:6)

Finally, this conditionality suffered from the same problem described above for the case of the financial administration systems. These coparticipation laws were many times not implemented. In addition, it seemed quite improbable that a law of the type would have been implemented despite the lack of a coparticipation law at the National level. The changing fiscal conditions between nation and provinces, made the sustainability of this law very improbable.

(5) Improve fiscal performance

As was said before in this thesis, one of the main problems affecting provincial finances was the lack of correspondence between local expenditures and provincial own resources, which opened a disproportionate gap between these two concepts. (World Bank, The Fiscal Dimension of the Convertibility Plan: A Background Report, 1998:54) In other words, there was no clear relation between what the local population paid and the services it received in exchange.

One possible solution to the problem of the excessive provincial deficits, which was suggested in the previous document, was to increase the correspondence of federal revenues based on the devolution principle (provinces receive through coparticipation a percentage of their own tax collection). This would probably help to increase

²² The distribution of the pull of centrally collected taxes between the municipalities of a certain province

correspondence, since local voters would be paying a larger share of the provincial governments' costs, and in this way, induce the provinces to harden their budget constraints and control their expenditures so as to narrow their financial gap.

The spirit behind the present conditionality was to reduce provincial deficits through increasing correspondence between provincial revenues and expenditures. The design of a coparticipation system that took into account provincial tax collection capacity as a distribution criteria was directed at this aim. In spite of the expectations that this law generated, this aim ended up being the clearest failure of the program. The reasons for this were, on the one hand, the enormous repayment that the provinces had to face during those years due to the high level of indebtedness that they had accumulated the previous ones, and on the other hand, the negative impact in provincial finances of the Tequila crises of 1995. This last argument was the one used by the World Bank to justify this disappointing result (World Bank, ICR, 1999:4)

Some evidence on the fiscal performance of the provinces during those years is provided in **Appendix V**. The debt of Corrientes passed from initial \$72.539 thousands in 1992 to \$241.799 thousands in 1998, Tucumán passed from an initial debt of \$83.111 thousands in 1992 to \$309.969 thousands in 1998. This resulted in important deficits in the provinces analyzed (as **Table 2.6** shows), with the only exemptions of Santiago del Estero from 1996 onwards and Tucumán in 1998. However, these levels have been decreasing in the period 1995-1998. Río Negro passed from a deficit (calculated as a percentage of total provincial expenditure) of 31.8% in 1995 to a 13.8% deficit in 1998. San Juan experienced a 30.5% deficit in 1995 and a 5.5% one in 1998, while Tucumán passed from an initial 23.5% deficit in 1995 to a surplus of 0.3% in 1998.²³

²³ A more exhaustive work should adjust these deficits according to the cycle. However, the approach used in this case is sufficient to illustrate the point. Additionally, a comparison between PRL and non PRL provinces' performance could be carried on in a further analysis with the aim of measuring the impact of the PRL loan's intervention in this particular aspect.

Table 2.6: Provincial Deficit (Current Income – Total Expenditures) as a percentage of Total Expenditures for the years 1995-1998²⁴

Province	1995	1996	1997	1998
Corrientes	12.7	1.1	10.4	10.2
Tucumán	23.5	15.7	6.7	0.3 ²⁵
Entre Ríos	18.7	1.2	5.0	1.5
Chaco	15.2	9.0	11.0	21.9
Catamarca	15.1	15.7	5.7	8.4
Río Negro	31.8	25.0	11.9	13.8
Salta	15.3	4.3	10.4	6.1
Santiago del Estero	5.0	6.5	7.8	0.5
San Juan	30.5	3.5	6.4	5.5
Misiones	24.6	12.7	12.2	11.6

Source: Dirección Nacional de Coordinación Fiscal con las Provincias, Ministry of Economy

In spite of the fact that this conditionality was expressed in nominal terms in the Policy Matrix (the requisite was to reach fiscal balance in 1995 and subsequent years), the previous analysis was made based on relative comparisons. The rationale behind this approach is that it gives a more accurate idea of the seriousness of each province's financial condition and its evolution during the period, something that a comparison based on nominal terms would have missed.

As was said before, an impediment to the achievement of this objective was the contrast between the decentralization of expenditures in hands of provincial governments, and the centralization of tax collection in the National Government. This is evident from the fact that no PRL province surpassed the 30% limit of own tax resources/total tax resources (see **Appendix V**). The incorrect incentives that this fostered resulted in a rising debt that became the principal reason why the fiscal balance could not be achieved in the provinces during the time of the program. Although in the years that followed, the level of debt decreased in many provinces, the high level of repayment that they had to face as a consequence of the amount of debt taken during the previous years, threatened the achievement of the desired fiscal balance.

²⁴ Santa Cruz and Chubut were left out of the analysis because they entered the program later, in 1998

²⁵ The numbers highlighted in blue indicate fiscal surpluses in those provinces during those periods

Due to the lack of money to face the problem of the indebtedness of the provinces (more than US\$300 million were necessary to give a solution to this problem), this issue was left unconsidered in the program, although vital to its objectives.

(6) Reduce size of provincial public banking sector.

A whole branch of the economic literature has studied the problems and rationale behind public banks' privatization. In this sense, Provincial Public Banks' privatization in Argentina during the 90s, nurtured this literature of empirical evidence on this process, which began during the first years of the decade encouraged by the need to give a solution to the unsustainable financial situation of this banks, whose performance was inflicting serious damage to provincial fiscal administrations. (Clarke and Cull, 1997:7)

Several reasons have been suggested in the literature for the bad performance of these banks. Within these explanations, political incentives have explained to a great extent many of the shortcomings present in the provincial public banking sector. Some of which were: the lack of incentives in managers accentuated by the absence of competitive pressure and low supervision and regulation procedures, the soft budget constraints that these managers faced due to the possibility of receiving government subsidies in response to bad performance, etc. As Clarke and Cull state in a later study:

“Because managers of public enterprises do not own stock or stock options and are not subject to corporate takeovers that could cost them their jobs, they typically have less reason to adopt a sufficiently long-term perspective focusing on productive efficiency.” (Clarke and Cull, 1999:7)

The most important reason for privatizing these banks was the need to eliminate a very important source of deficit financing for provincial governments. Other reasons for privatizing these banks, mentioned in the literature, were: the impossibility to sustain the large provincial fiscal deficits, provincial governors' political affiliation (peronist

provinces are considered more conservative than its radical counterpart and therefore more willing to privatize), etc.

In general, this condition has been met. According to the “Secretaría de Programación Económica y Regional” of the Ministry of Economy, until the year 1999, thirteen provincial public banks had been privatized, two of them, those of Chaco and Corrientes, concluded the process of privatization around the year 1992, but in 1995 were forced to acquire them once again as a consequence of the Tequila effect. The rest of the provinces that did not privatize their public banks were in general non-PRL provinces with the exemptions of Catamarca and Chubut, showing that the Provincial Reform Loan might have been important in accelerating the privatization process in the participating provinces. The results of the privatization of provincial public banks are shown in **Appendix IV**.

Nevertheless, a few things have to be taken into account before evaluating success in this issue. In the first place, during the time the PRL was active, another World Bank Investment loan was also aimed at accelerating the process of Provincial Public Banks’ privatization: the **Provincial Banks Privatization Loan**. Therefore, the success in the implementation of these reforms was a double achievement of these two loans, although the last one was the most effective in this respect due to the larger amount of money it involved (US\$ 1300 million), and because as an Investment loan, its focus was exclusively on provincial public banks privatization and its duration was much longer than in the case of the Provincial Reform Loan. As the PRL Task Manager, **David Vetter**, stated: *“The conditionality of the PRL concerning the privatization of Banks was done mainly by the Provincial Banks Privatization Loan, which was larger than the PRL”*

Finally, it is important to mention the fact that in many cases, the money from the privatization was not enough to cover the enormous debts of these banks and other administrative expenses. Very little of the proceeds from this privatization process reached provincial governments; they only serve to eliminate a traditional source of provincial fiscal imbalance.

Conclusion

To sum up this section, the PRL's main achievement had been to initiate the process of reform in multiple sectors in the provinces. Some reforms that occurred during the period of implementation of the PRL were very successful, as was the case of the provincial public enterprises and Bank's privatization process, although the scope of the PRL's intervention in this matter is questionable. Nevertheless, some other aims of reform could not be achieved, as for example provincial fiscal balance, or were reversed as public employment expenditure, or were half implemented as those related to financial and tax administration reform.

As was mentioned in several occasions throughout this section, a comparative study between PRL and non PRL provinces' performance would have been useful as a way to measure the effectiveness of the loan. However, this was not the primary aim of this thesis whose principal objective was to prove that many of these reform efforts were not as successful as was stated in the official reports.

The conclusion of this section is that this loan's performance was not as successful as the final reports of the Bank and the Ministry of Interior stated. This result can be attributed to a combination of aspects from the implementation and design stages of the program. This thesis will be only concentrating on the design aspects of the loan, focusing on some of the most important and recurrent design problems detected in the case of the Provincial Reform Loan and in Adjustment operations in general. In the following chapter we shall study this matter in depth.

CHAPTER THREE: *Main Problems and Suggested Solutions*

As the previous section confirms, the Provincial Reform Loan was not as successful in some aspects as the Final Evaluation Reports of the World Bank stated. Therefore, the aim of this section is to study some of the problems that could have influenced the performance of the program, since this is the area where the most fruitful contribution can be made. One of these problems, the most relevant for this case, will be analyzed in detail in chapter four of this thesis based on the explanations provided by the economic theory.

The design insufficiencies that will be studied closely in what follows are the following: the presence of an excessive number of conditionalities, a tendency to delay implementation, the existence of few provinces completing the implementation phase, the presence of objectives which are repeated in different loans, the absence of an integrated approach to evaluation and the lack of long term sustainability of reforms.

I. An excessive number of conditionalities

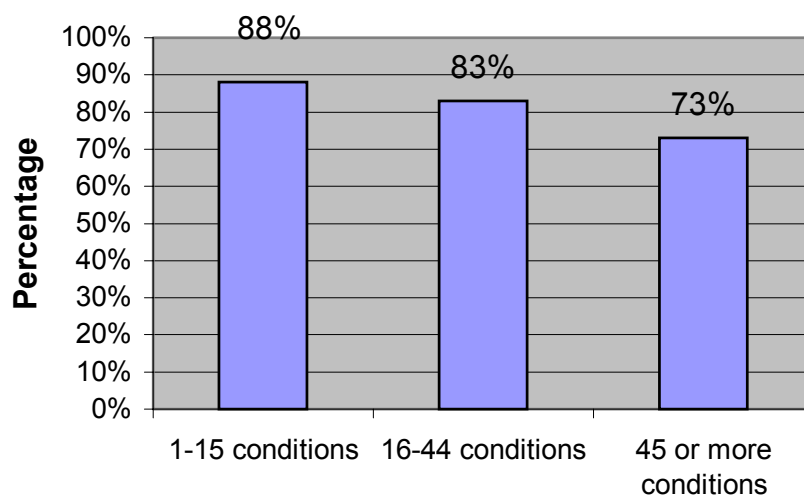
This study understands that there were too many conditionalities in the program: seven for the Federal Government and eight for provincial governments, one of which was the Fiscal Pact implementation, which included many actions of reform. This shortcoming was also recognized by the PRL Task Manager, **David Vetter**, who, when he was asked about the loan's main insufficiencies suggested that *"there were too many conditions, maybe it would have been better to concentrate on a few very important ones"*.

In the economic literature, the theory on multitask problems has addressed this issue. This literature suggests that due to the excessive amount of objectives, only some end up being monitored and these are those whose compliance is easy to measure. (Holmstrom and Milgrom, 1991:33) In this particular case, the program involved so many conditionalities that those that were easy to measure ended up justifying the success of the program, and those that were not, were left unconsidered. The following example may serve to clarify this point. The ICR emphasized the Provincial Reform Loan's principal successes as being those related to public enterprises and banks' privatization. However, other objectives, a

little more sophisticated, like the implementation of certain laws related to municipal coparticipation or financial administration systems were not as successful. Additionally, some conditionalities were designed in a way that ended up being easily verifiable although they sometimes lost relation with the initial objectives of the program. The design of a conditionality based on reduction in public employment instead of in the level of public expenditure in salaries (more difficult to control), offers an example of this type of behavior.

According to the official statistics, the general tendency in Adjustment Lending, has been to reduce the number of conditionalities: “*..higher numbers of conditions are generally associated with poorer outcomes.*” (World Bank, Adjustment Lending Retrospective Final Report, 2001:80). **Figure 3.1** shows that Adjustment loan’s effectiveness was reduced as the number of conditions increased, emphasizing even more this point.

Figure 3.1: Outcome ratings of Adjustment Loans by number of conditions (90-00)



Source: Adjustment Lending Retrospective Final Report

In addition, another weakness of the Provincial Reform Loan and in Adjustment Lending in general, has to do with the lack of specificity of the reform procedures of many of the conditions involved. As was stated in the report mentioned above: “*Not only do the policy matrices often contain a multitude of conditions, but also they tend to mix key reform*

measures, desired actions, and detailed processing steps.” (World Bank, Adjustment Lending Retrospective Final Report, 2001:79)

An example of this type of shortcoming was evidenced during some of the Provincial Public Banks privatization process. **David Vetter**, the PRL Task Manager, also shed some light on this issue. When asked about the Ministry of Interior staff performance during this implementation he said: *“...there were too many economists biased on what to do rather than how to do it. It would have been useful to have more engineers, people projected on reforms. They knew what to do but didn’t have much skill on how to do many of these reforms.”*

One should expect that the reduction in the number of conditionalities, together with the exclusion of reforms which are very demanding in monitoring capacity or difficult to implement, should help to improve outcome ratings. Reforms of high complexity or very ambitious should be excluded from the program and left for future consideration as part of an Investment Loan or a Special Structural Adjustment loan (SSAL), which have both a longer duration and a narrower scope of action.

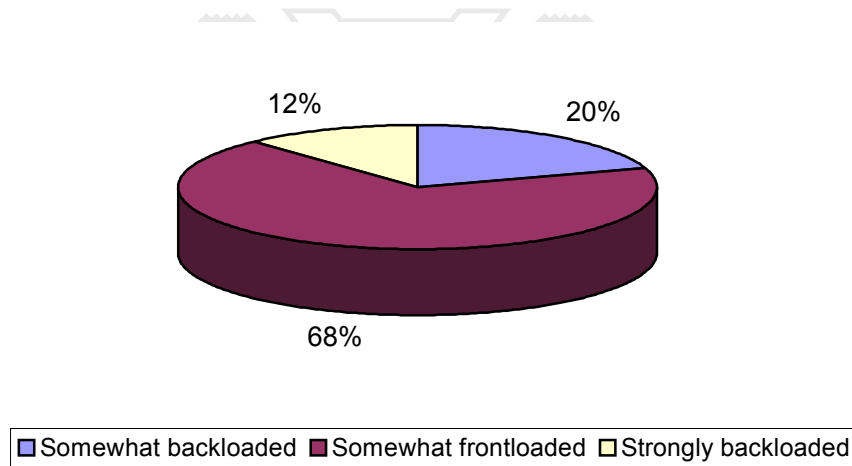
II. Implementation concentrated in last tranches

In the previous section, this study proved the easily reversible nature of those conditionalities related to drafting and legislative approval of laws, such as those ruling coparticipation regimes and tax exemptions in the provinces. Furthermore, in these last two cases, these laws were not followed by concrete implementation procedures, and ended up as no more than reform attempts, since they were never materialized or were partly reversed. All the conditions of the first tranche involved planning or drafting of legislation and systems and none of them were aimed at concrete implementation. In the majority of cases this was done later, in the following tranches, but in others, this was not even contemplated (as in the case of the coparticipation laws). Only **seven** provinces were asked to comply with the conditions of the first tranche. In other word, they were never asked to implement the reforms. The only provinces, out of the twelve participating, that were

actually asked to complete the implementation phase were: Corrientes, Chaco, Entre Ríos, Misiones and Tucumán.

In general, this tendency to delay implementation has been common to all Adjustment operations. As the Adjustment Lending Retrospective Report suggested: “*Many multitranche loans have tended to be backloaded with future actions, with few up-front actions completed before loan effectiveness.*” In addition, the report confirmed that many of the up-front actions often focused on formulating plans and strategies or establishing working groups, but left the actual implementation to the second tranche. As **Figure 3.2** shows, 80% of Adjustment loans’ conditionalities were somewhat or strongly backloaded.

Figure 3.2: Timing of Policy Conditionality (all multitranche Adjustment loans)



Source: *Adjustment Lending Retrospective Final Report*

This study concludes that conditionalities related to drafting or legislative approval of legislation are useful when these laws are implemented as part of the same program of reform. It is generally inefficient, and in some cases useless, to include this type of conditionalities as the only requirement, and leave the implementation for some later time, since what ends up happening is that these reforms are never implemented. If, because of lack of time, they can not be concluded as part of the same loan, and if there is no way to generate a compromise on the provinces’ behalf to implement these reforms, it would be better not to include them.

III. Reform effort concentrated in few of the many provinces involved

The Provincial Reform Loan was designed in a way that any province could enter the program, as long as it complied with certain conditionalities. The loan only asked for a group of provinces to meet these conditions previous to each tranche release, and the members of each of these groups were later chosen by the Ministry of Interior. As the Country Officer for Argentina, **Mark Hagerstrom** admitted, this design was chosen so as to respond to the financial aid demands of the Argentinean provinces affected by the Tequila crises. *“At that time, focusing on some provinces only would have been losing a major opportunity.”*

Despite this unconstraint design, only five of the twelve PRL provinces were asked to implement the reforms belonging to the second and third tranches of the loan. These provinces were: Corrientes, Chaco, Entre Ríos, Misiones and Tucumán. They were the ones that had the real conviction to reform, even before the Provincial Reform Loan was in place, and in whom the reforms contemplated by the PRL were mainly concentrated on. The rest of the provinces participated principally because they needed the money and this was the best way to get it, but were not expected, on the side of the Bank at least, to introduce reforms in the manner that the previous provinces had done. As **Mark Hagerstrom** suggested *“The Universe that the Bank was aiming to cover was very limited. They wanted to see something happen in four provinces and at the end something happened in other four”*.

This open design had both advantages and disadvantages. On the first hand, it reduced the negotiation power of the provinces involved with respect to the situation in which the program was directed to certain predetermined provinces, probably limiting the speculative behavior of provinces aiming at pressuring the National Government. Furthermore, the failure to follow the conditionalities and the immediate elimination of that province from the program (without affecting the total number of provinces participating since other province took its place) was supposed to serve as an example for the rest and prevent them from cheating on loan's conditions. On the other hand, this flexibility of design also reduced the conditioning capacity of the loan, making it as a result less effective. The

question that this design raises is whether these elite of provinces could have carried on the reforms despite the existence of the Provincial Reform Loan. If this happened to be so, then the PRL was not as effective as it seemed at first sight. If this was the case, many resources were spent in these less reformist provinces that could have been addressed to those really willing to reform, increasing the conditioning power of the loan and probably improving the final results. This point was made by **David Vetter**, the PRL's Task Manager, in the first of a series of Infrastructure Notes, when he suggested as a lesson of experience for the Bank to: *"Maximize reform leverage by focusing on a few reforming subnational governments, especially in the case of adjustment lending."* (World Bank, Report N°21108, 1997).

This study concludes that a design aimed at certain specific provinces, which can not enter and exit the program freely, as the one of the later SNALs, is the most effective. The lack of conditioning power, characteristic of the PRL, was determinant for this conclusion. Some provinces did not implement all the reforms present in the policy matrix, specially the later ones: Santa Cruz and Chubut, or others such as Santiago del Estero, Río Negro and San Juan, but since they were later excluded from the groups of provinces selected by the Ministry of Interior for the second and third tranches, this did not represent a problem for the achievement of the PRL goals. On the other hand, the provinces exercised pressure on the National Government all the same, and in several occasions the latter one gave up on their demands, as happened in 1997 with the extension of compliment deadlines and the reduction of interest rates. Nothing was gained, in this sense, from the free entrance and exit design. A layout aimed at predetermined provinces should work more efficiently, controlling for other drawbacks that it presents and that should not be left unconsidered.

IV. Objectives repeated along different programs

As was explained before, the proceeds of different loans went to the Transformation Fund where the money was administrated and distributed to the different provinces. This design had both advantages and disadvantages. On the one hand, it gave the possibility to have a unit to administer all the funds centrally and to allocate them more efficiently. On the other hand, some of the objectives of the different loans were repeated, making it difficult to say

if each one separately was successful in achieving them. As member staff of the tax collection area and responsible for evaluating the implementation of the conditionalities related to this domain, **Domingo Vespriani**, confirmed that, the reforms which were not concluded during the time a program was active, were finished with the help of other loans. This combination of funds sometimes resulted in the absence of clarity in the achievement of objectives.

An example of this conjunction of aims appeared in the Provincial Reform Loan and the **Provincial Banks' Privatization Loan**. Despite the inclusion of this conditionality in the former loan, practically all provincial banks were privatized with the latter loan's funding (US\$1300 million). The juxtaposition of objectives between the PRL and the subsequent SNALs stresses further this point. In particular, the similarities in the financial objectives between the PRL loan and the Third Provincial Reform Loan addressed to Catamarca probably suggest that many of these objectives were not completed in the first place. Some of these objectives were mentioned in the loan's description report "*Measures in public finance would focus on reducing the level of personnel expenditures to provide for more investment spending, achieving a sustainable equilibrium in current spending, improving own resource mobilization and improving debt management and levels.*" (World Bank, Report N°PID9574, 1999:3) A further example is given by the fact that the system of control of largest taxpayers in the provinces (a conditionality mentioned in the Provincial Reform Loan), was entirely financed by the **Tax Administration Technical Assistance Project**, which was approved on 1992 and finally closed on 1998.

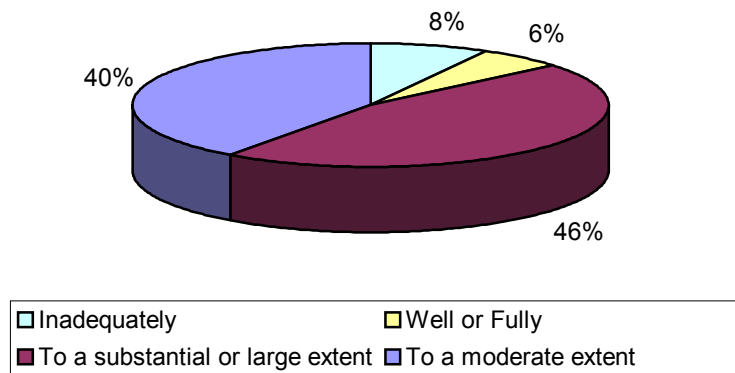
To conclude, what appears to be most appropriate for this case is to delegate to a central office in the Ministry of Interior, the responsibility to watch for these insufficiencies. In the case of the Provincial Reform Loan, the unit in charge of centralizing the different provincial loans was the Secretary of the Provinces of the Ministry of Interior. However, this office had no control over this problem, as is evident from the examples mentioned above. Additionally, the Bank, through its regional office, should be able to keep record of the different loans extended to the provinces and prevent this type of things from happening.

V. Evaluation based only on compliance with conditionality

The method that the World Bank uses to evaluate the success of an Adjustment loan is mainly based on compliance with conditionality. As the Adjustment Lending Retrospective report stated: *“Few Adjustment operations include up-front agreement on specific monitoring indicators; in most of cases, progress in program implementation is measured simply by compliance with loan conditionality”*. (World Bank, Adjustment Lending Retrospective, 2001:88) In few exceptional cases, some projects are also evaluated by an independent evaluation unit of the Bank: the Operations Evaluation Department (OED). Only in the cases of special operations, they are subject to an impact evaluation some years after their closing date.

Figure 3.3 shows the degree to which the present evaluation indicators monitor objectives. Approximately half (48%) of the objectives in Adjustment Loans are inadequately or moderately monitored, showing that much progress needs to be achieved in this issue.

Figure 3.3: Degree to which indicators monitor objectives



Source: *Adjustment Lending Retrospective Final Report*

This thesis sustains that there are other aspects of an operation of this kind that might be interesting to monitor. Firstly, the conditionalities designed were not always the best way to achieve the initial objectives, as was mentioned before in the example on the reduction

of the number of public employees. Furthermore, the institutional impact of the reforms in the whole process of structural reform is also an important aspect of the success of an operation that might be interesting to evaluate. A quick overview of the impact of provincial public banks' privatization suggests that this process was successful in eliminating a traditional source of fiscal imbalance for the provinces and, in this sense, had a positive effect on provincial finances. On the other hand, the reforms introduced to the tax administration regimes did not have a significant echo on provincial finances, mainly due to the lack of clear processing steps in the implementation of reforms, especially as regards the elimination of some important provincial taxes.

The problem with this type of evaluations is that they are very expensive and time consuming; these reports make take up to two years to be completed. A number of World Bank impact evaluations have ranged from US\$200,000-US\$900,000, depending on program size, complexity, and data collection requirements. (World Bank, Monitoring & Evaluation, 2001:20)

Finally, another important aspect of evaluation should be sustainability. Although some progress in this respect was witnessed in the evaluation procedures of the Bank, the final reports still base the sustainability of an operation on estimations made at the end of the implementation phase of the program, but a long term evaluation of the sustainability of the reforms is still missing.

VI. Lack of conditioning over long term reforms

This was probably one of the most important problems present during all the Structural Adjustment process in Argentina. It was one of the main menaces threatening the Provincial Reform Loan's achievements, and was later accentuated in the SNALs that followed.

The problem was that although the reforms were implemented, as part of their respective projects of structural reform, years after their closing date, because of lack of adequate monitoring and the presence of more immediate priorities, they were reversed. A clear

example was the tendency evidenced in the level of public expenditure in salaries. During the period 1995-96 five provinces in nine studied, reduced their expenditures in relation to the 1995 figures, although these levels increased again the following years and successively after, until the closing date of the loan. Another clear example is the failure to maintain the reforms implemented in the case of some of the Fiscal Pact's reforms, especially those related to the exemptions introduced to the gross receipts tax and certain specific provincial taxes. The provinces implemented the exemptions contemplated in the Pact, although in some cases they were forced to readopt them because their income was sensitively reduced, in part due to the fact that there was no other tax with which to replace them. Finally, another evident example was that of some public bank's privatization. Two of the PRL provinces: Corrientes and Chaco, who had privatized their public bank's, were forced to acquire them once again in 1995, due to the financial blow received from the Tequila crises. The evidence of this is presented in **Appendix IV**.

Due to the importance of this problem and its relevance for future Adjustment operations, it will be studied in detail in the following section, where some policy recommendations in relation to it will be discussed too.

Conclusion

Some of the problems discussed above were submitted for review in the World Bank *Adjustment Lending Retrospective Final Report* of May 2001, where some of the insufficiencies detected were discussed. However, many others were left behind in spite of their relevance to the Adjustment Lending Policy of the Bank.

This section has outlined some of the most important design problems of the Provincial Reform Loan. Although some of them were only pertinent for this particular loan, as for example, the excessive amount of provinces involved and the concentration of the reform effort in few provinces; some others are of critical relevance to modern SNALs. Examples of these are: the excessive amount of conditionalities present in these loans, the unclear processing steps that they involve, the existence of a tendency to delay implementation, the

continuous repetition of objectives, the absence of an integrated approach to evaluation and the lack of long term sustainability of reforms.

Following, section four evaluates this last deficiency in detail in search of a theoretical understanding of the logic behind this problem.



CHAPTER FOUR: *A Theoretical Approach to the Problem of Reform Sustainability*

The Problem of long-term sustainability of the reforms

One of the most important issues mentioned in this study is the problem related to the long term sustainability of the reforms. As was suggested previously, many of the actions initiated during the PRL and especially in the followings, were totally or partially reversed in the long term. The emphasis of this section will be made in some aspects of the design of these loans, more specifically in the internal procedures used by the Bank for loans disbursement that might have contributed to this result. The idea of what will be suggested further on has to do with taking into account the time dimension of projects and their synergy so as to generate the correct incentives for sustainability. The rationale behind this problem is that the Bank is not taking advantage of the benefits of baring in mind the record of long term performance of past loans for future disbursements.

As was already mentioned in the previous section, after loan's closing, an Implementation Completion Report (ICR) is done by staff of the Bank. In the PRL's case, this evaluation was carried on based on the information on the project files and from discussions with government at provincial and National levels, in addition to technical staff of the project implementation unit. In a few number of cases, projects are also evaluated by the Operations Evaluation Department (OED), an independent evaluations unit of the Bank. Exceptionally, a few projects are subject to an impact evaluation, after a few years from closing, but these are generally those with exceptional characteristics because of their risk or because of their innovative nature. This unit is also in charge of the country and sector evaluations, where Bank's country wide strategy, or the impact of the reforms in a particular sector, are respectively assessed. In all cases, evaluation is done at the projects' closing date and in some exceptional cases a few years later.

Under this scenario, bank loans are independent from each other. They are disbursed based on a diagnosis that, in most of cases, does not consider long term performance and sustainability of past related and non related loans. What this study suggests is that there

are advantages from internalizing loans' past performance for future disbursements. The idea is the following: by internalizing the temporal and horizontal dimensions of loans in the evaluation procedures we are recognizing that each loan is dependent on the long-term performance of the preceding ones, whether they are of the same type or not. With this state of things, new incentives are generated for long term sustainability of the reforms, even though the formal contractual relationship of the government and the Bank is concluded in terms of that loan. This long term sustainability is encouraged by the need to maintain a good reputation in order to be eligible for future loans.

Precedents in the literature on Agency Theory

The literature available on Agency Theory has not addressed this particular problem directly. The Multiperiod Principal-Agent model has been studied in the framework of labor contracts where the same one period agency problem is repeated throughout the whole duration of the relationship. In contrast to what happens in the firm setting, in this case, the reforms that the agents (provinces) are encouraged to implement and maintain are different in each period since they are part of different type of loans.

Moreover, this literature, has attempted to analyze the efficiency gains resulting from the design of different types of contractual agreements between the two parties. Traditionally, the aim has been to identify the circumstances under which long-term commitment to a contract signed in the first period is more efficient than spot contracts agreed at the beginning of each period or than other forms of intermediate commitment. This analysis will serve to illustrate some very important results that will be of relevance for the present model.

The literature has arrived to different results concerning the previous issue. One result suggests that, in the context of adverse selection problems, commitment to a contract ruling the entire agency relationship is found to be better than no commitment, since it induces a more progressive revelation of information held by the agent (see treatment by Salanié, 1997). When contracts are incomplete, these results change since long-term contracts are affected by future contingencies that were not contemplated ex ante when the

contract was designed. Other approaches suggest that short-term contracting, where parties successively negotiate limited-horizon contracts, can be as efficient as long-term contracting when there is no asymmetric information at the recontracting dates. Contradictorily, in the presence of asymmetric information, long-term contracts are likely to dominate short-term ones, since the incentive problems created by private information are generally best overcome through ex-ante commitment to ex-post inefficiencies. (Rey and Salanié, 1990). Finally, other literature emphasizes the fact that efficient contracting under moral hazard alone does not require long-term commitment by the principal. In this case, the repetition of the game is itself sufficient to achieve the first best so there is clearly nothing further to be gained from the formal use of long, rather than short, term contracts (Malcomson and Spinnewyn, 1988). Similarly, Fudenberg, Holmstrong, and Milgrom (1987) found that if payments are allowed to be conditioned on a verifiable outcome, and provided the principal and the agent have the same information about technology and about the agent's preferences over future contingent outcomes, short-term contracts are as good as long-term ones.

In our model's case, the problem of informational asymmetries is not present. The World Bank can know with certainty the effort made by the agents (provinces) in the implementation of reforms. There could be some private information on the agents' side, but this is definitely not a relevant characteristic in this case. In addition, this study shows that, committing to an ex ante rule of behavior that may be ex post inefficient is the best alternative available for the Bank, since it encourages the provinces to maintain the reforms, a result that would have been impossible to achieve in any other way.

The other important result for the present example is the one related to the memory effect of the optimal contract. Some authors have examined the role of long-term contracts in controlling moral hazard problems. In a game in which a type of binding precommitment was allowed, by deriving the optimal long-term contract they found that the agent's compensation in one period depended on his performance in the prior periods, and the interpretation of this result being that the principal uses the agent's performance over the entire history of his employment to diversify away some of the uncertainty surrounding the agent's actions (Lambert, 1983). A similar approach was given in Rogerson (1985), where

the moral hazard relationship created the opportunity for intertemporal risk sharing. Memory plays a role in the optimal contract. Therefore, whenever an outcome affects the current wage it also affects the future period's wages.

This result has important implications for the model that will be developed in the present section. It will be shown, that the World Bank would benefit from a situation in which all loan disbursements depend on the previous loans' outcomes, in contrast to the present scenario where the Bank does not bare in mind this results for loans' disbursement.

Finally, the literature on Efficiency Wages, has addressed the effects of compensation mechanisms on the agent's conduct. This is probably the most relevant effect for the purposes of the present model. Because of this reason, a more detailed treatment of its results will be carried on in what follows.



The Model: Commitment vs. No Commitment

Ideally, the World Bank would benefit from having a technology with which to penalize the provinces who implement Structural Adjustment reforms and later reverse them, for example through raising the agreed interest rate of repayment in case of non-compliance with the initial contract. In reality, there are political problems in doing this. In particular, this study assumes that there are no punishments available for the Bank, since the cost of punishing the province if it fails to fulfil the initial terms of the contract, is inefficiently high.

However, there are other ways to prevent the provinces from reversing the reforms. A mechanism of incentives could be designed in order to minimize this conduct, for example one that regards those provinces that maintain the reforms by raising the return they get from following the contract. This idea has been developed in the literature on Agency Theory (see treatment in Weiss, 1990), in the context of models that study the effect of wages on the level of effort of workers.

In these models, higher compensations correspond to higher levels of effort demanded by the firms; the workers' utility is decreasing in the level of effort, which requires monitoring on behalf of the firm to prevent workers from cheating and making lower efforts than those demanded. Workers derive utility from making less effort than the one demanded by the firm, and they will only follow the contract if the monitoring technology is 100% precise. Furthermore, the monitoring technology required to deter workers' cheating is costly, therefore affecting the level of wages and employment in the economy. If monitoring costs were sufficiently low, the firm would compensate its workers by giving them the reservation wage and still prevent shirking. The idea behind the model is that monitoring workers with a perfect effective technology is very costly, therefore firms prefer a contract by which each worker receives a higher wage in equilibrium, but, as a result, is tempted to follow the initial contract conditions and make the required level of effort so as to maintain the benefit of the higher wage. Therefore, the results of the model suggest that the firm will prefer a system by which the worker is penalized through being excluded from these

benefits if he cheats, rather than applying a perfect monitoring system in order to prevent this speculative behavior.

This model has clear implications for the example analyzed in this section. On the first hand, it could be assumed that the provinces benefit from making a lower effort in maintaining the reforms than the one demanded by the World Bank. In particular, they would prefer to reverse the reforms (in a manner similar to the action of shirking in the previous models) if they could, because maintaining them is costly. Additionally, as in the previous examples, the World Bank also has an imperfect monitoring technology for deterring provinces' cheating, and could benefit from a contract where the provinces are regarded for maintaining the reforms by being preferred (above the rest of the provinces) for next period's Investment loan. According to the results from the previous examples, this additional payment (the Investment loan), would probably decrease the rate with which provinces reverse the reforms once implemented.

However, the model of Efficiency Wages has an important difference with the present one. While preventing worker's cheating is costly for the firm in all cases, since it has to pay higher wages each period to all its workers, preventing the provinces from reversing the reforms is costly for the World Bank in some cases only, more specifically, in the case of those provinces who reverse the reforms, since the Bank is forced to deny them next period's Investment Loan. However, for the provinces who ask the loan and maintain the reforms, committing to an ex ante rule of behavior has no cost for the Bank, since they automatically receive the Investment loan.

In what remains of this section, the aim will be to study whether the conclusions from the previous models apply for the case analyzed in this chapter.

For simplicity purposes, the agency relationship between the World Bank and the provinces will be studied in the context of two different scenarios. The first setting is the one in which the Bank commits itself to an ex ante behavior rule that determines the eligibility criteria for future loans. This criterion sustains that only those provinces who maintain the reforms implemented in the previous period will be eligible for the following

loan. In this case, the Bank compromises to stick to the rule although it might not be ex post efficient. The advantage of doing this is that the provinces (agents) will be tempted to maintain the reforms because they know that if they do so they will receive next period's loan. The other possible situation is the one in which the Bank does not commit itself to an ex ante rule deciding in each period which provinces will be eligible for the next loan, and additionally chooses not to contemplate the provinces' previous actions for second loan disbursement. It is important to note that the Bank could be interested in considering provinces previous performance for future disbursements if there were synergies, in which case, there would be no need to commit ex ante to a rule of behavior. One possible synergy could be created if the Bank knows that the provinces who successfully maintained the reforms of the previous loans will be in a better position to repay this loan. Another possible synergy would arise if the provinces that successfully maintained past reforms are better able to take advantage from the new ones. In all cases, they act as a powerful incentive for the Bank that can now benefit from bearing in mind these synergies.

In this simplified world, the present behavior of the World Bank would be best described by the last scenario of the two mentioned above, since it assumes no commitment to an ex ante rule governing future loan disbursement criteria, and is neither interested in conditioning the disbursement of a loan on the long-term performance of the previous ones.

This study proves that this scenario is not efficient and that there are important gains from committing to an ex ante rule of behavior. The idea is that the scenario of commitment is more efficient because it minimizes the probability of the agents reversing, in the next period, the Structural reforms implemented in the current one.

The aim of the following model is to compare the no commitment and no synergies case to the commitment one, studying the efficiency gains derived from this last scenario in detail.

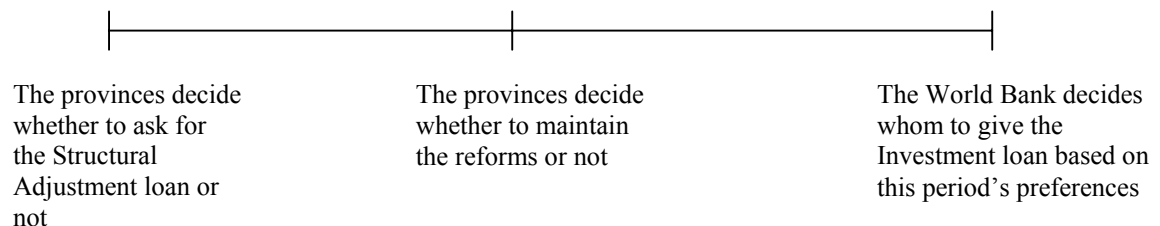
The Game without Commitment nor synergies

The following, is a three period agency game which is played only once. The World Bank, the principal in this game, derives utility from the Structural Adjustment (**S**) and Investment reforms (**I**) implemented by the provinces, the agents of the model. Examples of Investment reforms could be the construction of a bridge or roads, or even the implementation of a system for administrative purposes. In all cases, the money from the loan is used for the implementation of these reforms. It is important to note that, in the case of the Structural Adjustment reforms (**S**), the money that the provinces obtain as part of this loan is of free disposability and can be destined to any purpose. Additionally, the utility that the provinces receive is principally the one they get from the loan, since it is assumed that the benefits that they obtain from the reforms themselves are very little and, will not be considered for the purposes of this model. The provinces have no particular preference for the Structural Adjustment reforms (**S**), but the eligibility criteria for next period's Investment loan depends on their implementation.

The provinces have different preferences over the two types of reforms, which are represented by the parameter λ_i , with $\lambda_i \in [0, \lambda]$ and varying with each agent. The utilities of the agents are separable in the two types of reforms: $U(\mathbf{S}) + \lambda_i U(\mathbf{I})$, where: $U(\mathbf{S}) > 0$, each province derives utility from the money of the loan if she gets it, and $U(\mathbf{I}) > 0$, the provinces have a positive preference for the Investment reforms.

In this case, the World Bank does not precommit to an ex ante rule governing the criteria for the Investment loan's eligibility. On the contrary, the Bank decides in the third period whom to give the Investment loan according to his preferences at that time.

The timing of this game is the following:



The problem will be solved through backward induction. In the last period, the World Bank decides who to give the Investment loan according to his preferences at that moment (we will not internalize this decision problem in this model since it does not contribute to illustrate the point). In the second period, the province decides whether to maintain the Structural Adjustment reforms or not, based on her preference for the Investment loan, the cost of implementing these reforms and the costs of maintaining the Structural Adjustment reforms. If the province maintains the reforms she gets: $q_i [\lambda_i U(I) - C(I)] - C(m)$, with $q_i \in [0, 1]$, where q_i represents the probability of receiving next period's Investment loan, $C(I)$ represents the cost of implementing the Investment loan and $C(m)$ stands for the cost of maintaining the Structural Adjustment reforms. If, on the other hand, she decides to reverse the reforms she gets: $q_i [\lambda_i U(I) - C(I)]$ since, although not maintaining the reforms, there is an exogenous probability q_i of the province receiving the Investment loan (q_i is a random probability and is the same in both cases).

Therefore, the agent will maintain the reforms only if:

$$q_i [\lambda_i U(I) - C(I)] - C(m) > q_i [\lambda_i U(I) - C(I)]$$

Or

$$- C(m) > 0$$

According to this result, under no circumstance will the agent decide to maintain the Structural Adjustment reforms. Since doing so does not increase the probabilities of receiving the Investment loan in the future and maintaining the reforms is costly, the agent always prefers to reverse them.

The next decision that the province has to face is whether to ask for the Structural Adjustment loan or not. He will do this only if:

$$U(S) > C(S)$$

Where $C(S)$ represents the cost of implementing the Structural Adjustment reforms, and $C(S) > 0$.

As a result of this game, only one type of agent is identifiable. Depending on the utility and cost functions, all agents will either enter the game and will not maintain the reforms, or will not enter the game. Assuming that $U(S)$ is always superior to $C(S)$, on the bases that this is what generally happens in reality, the result of this game suggests that all provinces will end up entering the game and reversing the reforms. The only possibility available for the provinces is shown in the following chart, which has four possible actions: enter the game, not enter, maintain the reforms or not maintain them if she were to enter the game.

	m/E	nm/E
E		○
NE		

As was said before in this section, the World Bank is situated in an inefficient, where in each period he chooses the candidate provinces for that period's loan without evaluating their previous performance. It is assumed, that all provinces would prefer to implement the reforms and then reverse them if they had the chance (there are political costs of maintaining the reforms, the provinces only do so if they are punished for deviating or if they perceive future benefits that are conditioned on their present performance). The most likely result, under this scenario, would be that in which the provinces that are given the Structural Adjustment loan end up reversing the reforms, because what they do in this period has no effect in the Bank's decision of who will get the next period's loan.

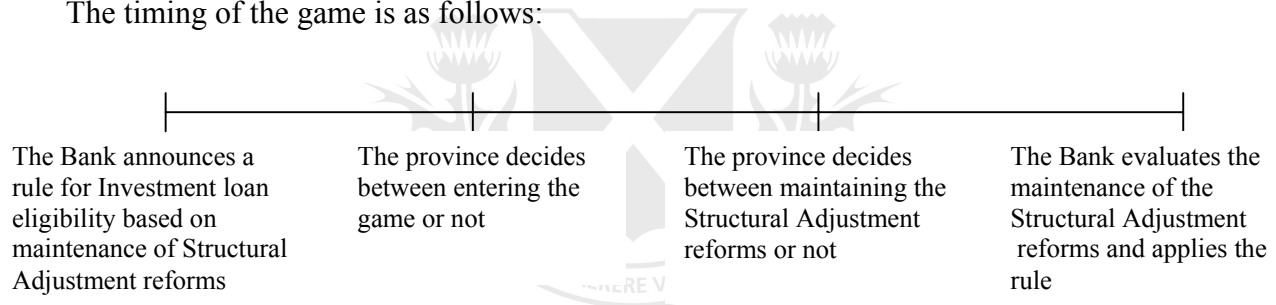
In terms of the model described at the beginning, the situation is comparable to one in which the workers are given the reserve wage, and as a result, make less effort than the one demanded by the firm, since the opportunity cost of being unemployed is exactly this wage (they have nothing to loose if they get fired). What they will end up doing is taking advantage of the utility surplus of making less effort until they are detected shirking and fired, in which case they still receive the reserve wage. The model presented above, is similar to this one in the sense that in both cases the principal agrees to pay the agent a low wage (no surplus above the regular Structural Adjustment loan in the case of the model

described here) and has an imperfect monitoring technology, causing the shirking rate to be high. As a result, an inefficient outcome is achieved since the losses from the increased shirking outweigh the gains from the labor saving. In the model analyzed here, the losses caused by the reversed reforms exceed the benefits derived from not compromising to an ex ante rule governing next period Investment loan's disbursement.

The Game with Commitment

In this model, in contrast to the previous one, the World Bank announces a rule governing next period's eligibility criteria for the Investment loan, based on the maintenance of the Structural Adjustment reforms.

The timing of the game is as follows:



This game will be solved once again by backward induction. In the last period, the World Bank's course of action is automatically determined by the previous agent's behavior, and no further analysis is required at this point. In the third period, each province chooses the best response for each possible rule of the Bank. If he decides to give the Investment Loan randomly, or without baring in mind the previous loans' performance, the situation is similar to that of the previous game, and all the provinces will reverse the reforms. The results are sensitively different if, on the other hand, the Bank designs a rule by which only those provinces that maintained the reforms in the previous period will be eligible for the Investment Loan. This case will be analyzed in what follows. The provinces' best answers will be studied followed by the Bank selection of the rule which maximizes his utility. In this case the Bank's rule will be:

$$BR \begin{cases} I & \text{if } m \text{ in } t = 3 \\ 0 & \text{if } nm \text{ in } t = 3 \end{cases}$$

Where BR: World Bank's Rule

I: investment loan

m: the province maintained the reforms in period 3

nm: the province did not maintain the reforms in period 3

In this stage, the provinces' problem is reduced to comparing the benefits derived from maintaining the reforms versus those obtained from reversing them. If they choose to maintain the reforms they obtain: $\lambda_i U(I) - C(I) - C(m)$, since if they do so they are sure to get the Investment loan. If, on the contrary, they choose to reverse the reforms they get nothing, since following the principal's rule, they do not get the Investment loan.

Therefore, the province will choose to maintain the reforms only if:

$$\lambda_i U(I) - C(I) - C(m) > 0$$

Or

$$\lambda_i U(I) > C(m) + C(I) \text{ with } \lambda_i \neq 0$$

The agent will only maintain the reforms if his preference for the Investment loan, summarized in the parameter λ_i , exceeds the cost of maintaining the Structural Adjustment reforms and that from implementing the reforms. In other words, for those agents whose λ_i is superior to $\underline{\lambda}$ (that of the marginal agent), maintaining the reforms will be the optimal strategy.

Now, the problem of the province is to decide whether to enter the game or not, knowing if she will be able to maintain the Structural Adjustment reforms. At this point, the provinces are divided into two types: those who have a strong preference for the Investment reforms ($\lambda_i > \underline{\lambda}$) and therefore, according to the previous result, will maintain the reforms; and those

who have a low preference for them ($\lambda_i < \underline{\lambda}$) and will reverse them. If the province is of type $\lambda_i > \underline{\lambda}$, she will enter the game if:

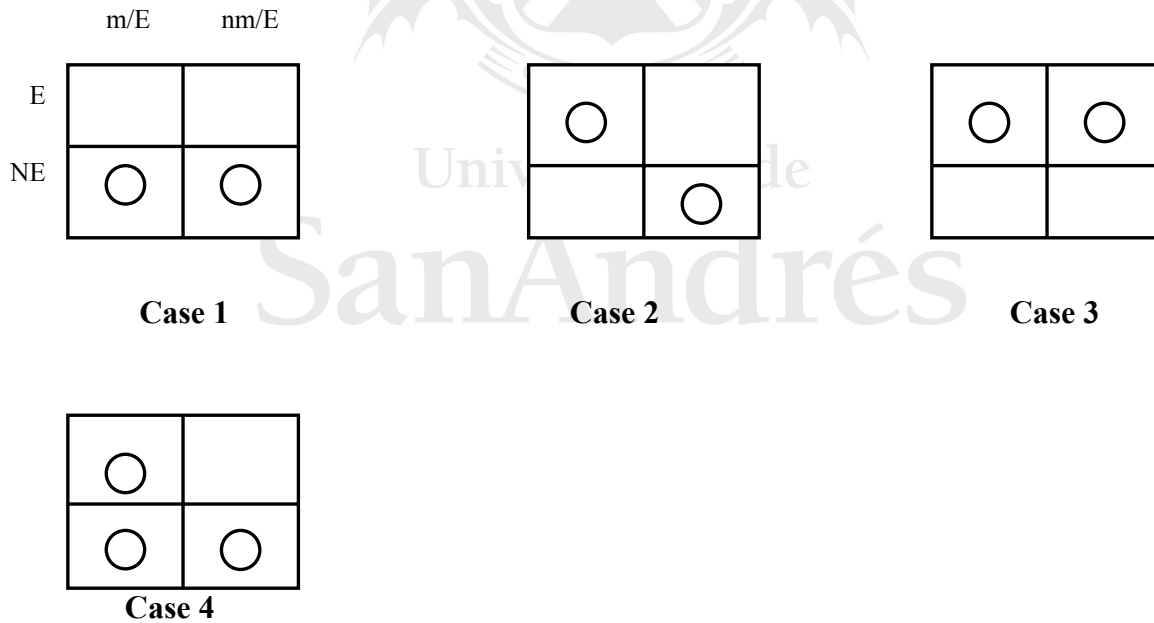
$$U(S) + \lambda_i U(I) > C(S) + C(I) + C(m)$$

On the other hand, if the province is of the type $\lambda_i < \underline{\lambda}$, she will enter the game only if:

$$U(S) > C(S)$$

As a result of the game, three types of agents are recognizable: those who enter the game and maintain the reforms, therefore receiving the Investment loan; those who enter the game and do not maintain the reforms therefore not receiving the Investment loan, and finally those who do not enter the game.

The possibilities available for the three types of agents are the following.



The first case is the situation in which none of the provinces enter the game, because the costs of implementing the reforms (which in the case of the provinces of group $\lambda_i > \underline{\lambda}$ is both the cost of implementing the Structural Adjustment Reforms and the Investment Reforms, while for the group of provinces of type $\lambda_i < \underline{\lambda}$ is the cost of implementing the

first ones), exceed the benefits derived from them. The second case is the one in which, a group of provinces enter the game and maintain the reforms ($\lambda_i > \underline{\lambda}$) and other group of provinces, which would not have maintained the reforms ($\lambda_i < \underline{\lambda}$), does not enter the game because the costs exceed the benefits. In the third case, both groups of provinces enter the game and one of them does not maintain the reforms implemented (those of type $\lambda_i < \underline{\lambda}$). In the fourth case, one group of provinces enters the game and maintains the reforms (those of type $\lambda_i > \underline{\lambda}$), other group, which would have maintained the reforms ($\lambda_i > \underline{\lambda}$) does not enter the game because the costs surpass the utility received and finally, a last group of provinces which would not have maintained the reforms ($\lambda_i < \underline{\lambda}$), does not enter the game because the costs exceed the utility received.

Moreover if we follow the previous exercise and assume that $U(S)$ is always superior to $C(S)$, then we eliminate **Cases 1, 2 and 4**. Ideally, the World Bank would like to prevent those who will not maintain the reforms from entering the game, but since he can not distinguish between agent types, he can not condition the Structural Adjustment loan on this. Due to the fact that the Bank can not identify the agent, some provinces that will not maintain the reforms in the future, manage to enter the game. If he could distinguish between agent types, he would give the Structural Adjustment loan only to those provinces that value the Investment reforms enough, and would give nothing to those that obtain a low benefit from them. In this way, the World Bank makes sure that the only provinces entering the game will maintain the reforms.

Following the analogy with the first models of the example, this situation is comparable to the one in which the worker is given a surplus in the form of a higher wage, making the job more attractive and reducing the shirking rate. The additional cost of contracting the worker at a higher wage is outweighed by the smaller shirking rate. In the present model, the provinces are given a surplus represented by the possibility of being preferred for the Investment loan. As a result, the exit rate is reduced and the probability of provinces reversing the reforms after some time is minimized.

Finally, the World Bank chooses its rule based on the provinces responses. He chooses the rule by which he gives the Investment Loan only to those provinces who maintained the

reforms, since this is the rule which minimizes the probability of having provinces reversing the reforms and therefore maximizes his utility.

Conclusion

The main results of this section suggest that the World Bank can benefit from considering the record of past loans' performance for future disbursements; in that way he generates an incentive on the provinces' side to maintain the reforms, an outcome that would have been impossible to achieve otherwise. As a result, the probability of provinces reversing the reforms once implemented is minimized in comparison to the present scenario where each loan is given independently of the other loans' performance. This is especially relevant for the case of Structural Adjustment operations, where implementation is shorter and the evaluation is done with much looseness than in the case of Investment Loans.

An additional advantage of compromising to an ex ante rule of behavior is that it is not so costly, while the outcomes are sensitively better. In particular, it is less costly than what it is for the firm in the example on efficiency wages, since the Bank only loses in those cases where the provinces reverse the reforms, since he is forced to apply the rule and deny them the Investment loan.

Finally, a possible recommendation to be made could be the appointment of a specific unit in charge of centralizing the different loans, carrying on the projects' long term evaluations, and bearing in mind these results for future loan disbursement. This responsibility could be delegated to the country office of the Bank, or to a central unit in the National Government.

CHAPTER FIVE: *Main Results and Conclusions*

Summary of results

An interesting exercise would have been to show that the process of Structural reform in the Argentinean provinces during the decade of the 90s was not successful, since at first sight, it seems that many of the objectives of reform were not achieved or at least were not maintained. The impression, more than ten years after the first Subnational Adjustment loan was approved for Argentina, is that many of the problems and necessities that justified the Structural Adjustment operations in the provinces during the initial years, are still present today. However, this aim exceeds the ambitions of this study, which had instead, chosen to concentrate the analysis in the particular case of the Provincial Reform Loan.

Section two of this study showed that the Provincial Reform Loan (PRL) was not as successful as the World Bank's evaluations suggested and provided reliable evidence in support of this conclusion. In section three, some problems present in the design of the loan which interfered with its performance, were discussed in detail. Some of these problems were exclusive of the PRL loan, as for example the excessive number of provinces participating, while some others are a common denominator in Structural Adjustment operations. Examples of these were: the excessive number of conditionalities present in most of them, the complexity of their reforms and the absence of clear processing steps for their implementation, the systematic repetition of objectives in different loans, evaluation procedures only based on compliment with conditionality and the lack of long-term sustainability of reforms.

Due of an extension restriction only one of these problems, the last one of those mentioned above, was analyzed in depth in section four of this study. The principal conclusion obtained suggested that there were efficiency gains in considering the synergies of loans when designing a country's lending strategy. The analysis also showed that the World Bank was not taking advantage of these benefits. Finally, a proposal was elaborated to

modify the evaluation and loan disbursement procedures so as to improve Structural Adjustment loans' performance and efficiency.

Implications for the initial hypothesis

This study showed that the Provincial Reform Loan was not as successful as the World Bank's evaluation concluded. Out of eight conditionalities aimed at provincial governments, only two of them were completed successfully: the public enterprises' privatization and the implementation of systems of control of largest taxpayers, although this last one was subject to subjectivity since the only information available was that provided in the interviews. One conditionality was never implemented: the provincial coparticipation laws; another one was not achieved: the provincial fiscal balances, and two of them were reversed: the provincial public employees downsizing, and in some cases, the provincial public banks' privatization. Finally, two conditionalities were only partially completed as the case of the provincial financial administration systems or the Fiscal Pact implementation.

This thesis also demonstrated that design problems were a determinant factor conditioning the Provincial Reform Loan's overall performance. Evidence was given in this study to prove why these design insufficiencies were considered problems affecting the PRL loan, and the corresponding policy recommendations were made in each case.

Additionally, a theoretic analysis was used to demonstrate that the World Bank is operating under an inefficient scenario and that loans' performance (Adjustment and Investment ones) can be improved by changing the actual evaluation and disbursement policy in favor of a more integrated one, that links each loans disbursement to previous loans' performance.

Relevance for today's Subnational Adjustment Lending Policy

Since 1998, a whole new branch of Adjustment Lending has been advocated to the implementation of Structural reforms in Subnational governments. Although the Provincial

Reform Loan was seen, at that time, as a pilot test for these later loans, it had many differences with its successors. The latter ones were aimed at one province in particular, monitoring of the implementation was the unique responsibility of the Bank, and the Ministry of Interior had only a marginal participation in the operation. Similarly, the content of the reforms were slightly different, since education and health were added to the list of areas initially reached by these loans.

However, many of the problems that were analyzed in this paper for the case of the first Provincial Reform Loan were also present in the subsequent ones. For example, there were still too many conditionalities in these last loans although the composition varied; reforms were concentrated mainly in the education and health areas. In a similar manner, the evaluation of these loans is still based on compliment with conditionality, and aspects such as impact and sustainability are only marginally considered. Other elements analyzed, which are also relevant for these loans are, the lack of long term monitoring of the reforms and the repetition of objectives in different loans.

Due to the different design of these later loans, some disadvantages that the PRL had, were overcome. For example, the lack of conditioning power due to the excessive number of provinces participating in the first PRL was no longer a problem for the following SNALs.

Nevertheless, this alternative design had problems of its own, the most important of which was the laxity with which these operations were monitored on the side of the Bank. Before, it was the Ministry of Interior, on behalf of the National Government, the one with real interest in reforming, now that this level of government is practically not involved in this type of operations, this incentive is not as strong for the Bank as it was for the Ministry of Interior. Furthermore, during the time the PRL was conceived, the incentives motivating the different actors involved in Adjustment operations were aligned, nowadays this condition has changed. The National Government has more immediate priorities to attend as does the Ministry of Economy, and the central unit of the Ministry of Interior is practically inexistent.

With this state of things, it is hardly possible to maintain the conditioning power and the results obtained with the PRL, and this could partly explain why two of the four SNALs evaluated for the period 1997-2001 yielded unsatisfactory results.

Areas for future study

Further research could be focused on the experience of Subnational Adjustment Lending in other countries such as Brazil and Mexico. This study could provide additional information for evaluating this type of loans' overall performance, and determine whether or not Argentina's disappointing results were repeated in other countries. Furthermore, an interesting analysis could raise the question of whether these later SNALs were successful in overcoming the difficulties of the first one, or did they bring about problems of their own. Additionally, for this particular case, one could question the role of the World Bank in replacing the Ministry of Interior in the job of monitoring and evaluating the provinces' reform effort. Finally, a comprehensive study of the global impact of Subnational Structural reforms in Argentina is still missing and could be of great use both to national policymakers and to professionals working at the different multilateral credit institutions.

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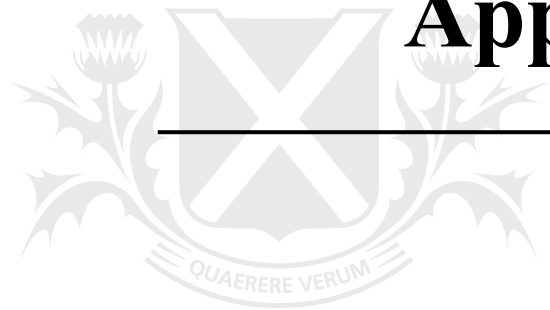
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Appendixes



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Appendix I: Individual Provincial Agreements under the PRL loan

Province	Date of original agreement	Amount agreed initially (in millions of US\$)	Amount effectively disbursed To date 9/30/98 (in millions of US\$)	
			Through initial agreement	Through BOCEP program ¹
Catamarca	5/23/95	35.1	30.7	0.43
Chaco	5/4/95	36.0	19.02	0.27
Chubut	3/2/98	30.0	24.5	
Corrientes	4/26/95	42.0	40.5	
Entre Ríos	3/31/95	54.0	54.0	
Misiones	4/11/95	48.6	47.6	
Salta	6/11/96	30.0	30.0	
Río Negro	11/27/96	40.0	26.0	
San Juan	5/23/95	24.0	18.5	
Santa Cruz	7/2/98	30.0	7.5	
Santiago del Estero	6/28/95	12.0	2.8	3.62
Tucumán	1/9/96	25.8	25.6	
Total		407.5	337.4	4.66

Source: Sucats, Ministry of Interior

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¹ A system of bonds used to encourage private employment in the provinces

Appendix II: World Bank Adjustment Loans

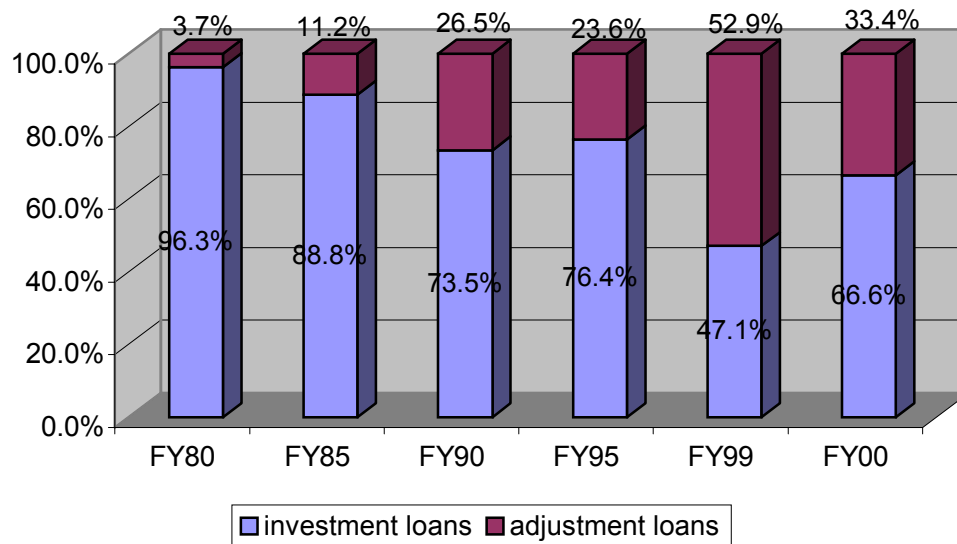
Adjustment vs. Investment Lending

World Bank lending is composed of two types of loans, *Investment loans* and *Adjustment loans*. The first ones are extended for a period of 5 to 10 years. They finance goods, works, and services in support of economic and social development in a broad range of sectors. These type of loans legally represent 75 to 80% of Bank lending, and its main focus are on institutional building, social development and public policy infrastructure needed to facilitate private sector activity. The loans' funds are disbursed against specific foreign or local expenditures related to the Investment project. Examples of Investment Projects are those aimed at urban poverty reduction, rural development, water and sanitation infrastructure, natural resource management, post conflict reconstruction, education and health.

On the other hand, Adjustment Loans are extended for a period of 3 to 5 years. They provide quick disbursing external financing to support policy and institutional reforms in a sector or the economy as a whole. These loans legally account for 20 to 25% of total Bank lending and they have evolved to focus on structural, financial sector, and social policy reform, and on improving public sector reform management. The funds of the loan are disbursed in one or more stages that are released when the borrower complies with the stipulated release conditions. Examples of Adjustment Projects are those which promote competitive market structures, correct distortions in incentive regimes, foster private sector investment, encourage private sector activity, promote good governance and help mitigate the adverse effects of adjustment. During the 80s, the Bank approved 191 adjustment operations in 64 countries for a total of US\$27.1 billion, while during the 90s, this figures increased to US\$71.7 billion and 346 operations in 98 countries.

Adjustment Lending was first used during the aftermath of the second oil shock. The purpose of these loans was to provide balance of payments financing to member countries while stabilization and adjustment measures took place. Later, these loans grew in importance with the onset of the debt crises in the 80s and the need to find a solution to problems such as increases in real interest rates, deterioration in the terms of trade for most developing countries, and recessions and slow growth in the industrial countries.

Figure 1.1: Adjustment vs. Investment Lending



Source: “Adjustment Lending Retrospective Final Report”, Document of the World Bank, June 15, 2001.

Although, in theory at least, the World Bank has a lending restriction on its Adjustment Lending instruments, which can not surpass the 25% limit of total Bank’s lending, this limitation was amply exceeded during years 1999 and 2000, as **Figure 1.1** shows. This growth in Adjustment Lending was directly related to the Asian Crises and the need to finance the countries affected by it. Nowadays, Adjustment Lending share has recovered the pre crises volumes, although the relevance of the 25 percent limit is still questioned (Adjustment Lending Retrospective Final Report, World Bank, 2001:4)

Different types of Adjustment Loans

Adjustment Lending loans are classified according to their characteristics and to the scope of the reform. The different types of Adjustment loans are the following:

STRUCTURAL ADJUSTMENT LOAN (SALs): They generally focus on major macroeconomic and structural issues on a number of different sectors, such as trade policy, resource mobilization, public sector management, private sector development and social sector development.

SECTOR ADJUSTMENT LOAN (SECALs): They support policy changes and institutional reforms in a specific sector. This type of loans focuses mainly on creation of incentives and regulatory frameworks for private sector development, institutional capability and sector expenditure programs.

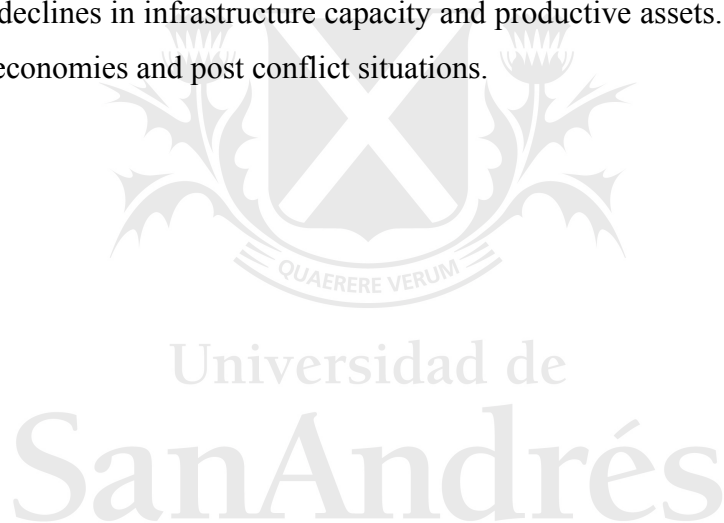
SUBNATIONAL ADJUSTMENT LOANS (SNALs): They support policy changes and institutional reforms at the subnational level (provinces and states) with a focus on the incentive and regulatory framework, institutional capability, subnational expenditure programs and mitigation of social costs. Experience so far suggests that SNALs may carry somewhat greater risks than adjustment loans to national governments, mainly due to the complexity of national-subnational relations.²

PROGRAMMATIC STRUCTURAL ADJUSTMENT LOANS (PSAL): These loans are disbursed in a context of a multiyear framework of phased support for a medium term government program of policy reforms and institutional building. PSALs support the government's program through a series of loans made over three to five years, each building on the preceding loan. Each individual adjustment loan under a PSAL typically supports a one year program, with its tranches spaced regularly throughout the year and tied to specific target measures. The main focus of these loans is the step by step capacity building and reform generally in the public sector, aimed at strengthening public expenditure management and improving governance, resource allocation and public service delivery.

² "Adjustment Lending Retrospective Final Report", Document of the World Bank.

SPECIAL STRUCTURAL ADJUSTMENT LOAN (SSAL): They support structural and social reforms in countries approaching a possible crisis, or already in crises, and with exceptional external financial needs. These loans help countries to prevent a crisis, or to mitigate its adverse economic and social impacts if it occurs. SSALs support structural, social and macroeconomic policy reforms that are typically part of an international support package put together by multilateral donors, bilateral donors, and private lenders and investors. An IMF program must be in place in order to be able to disburse this type of loan.

REHABILITATION LOAN (RIL): This type of loans support government policy reform programs aimed at creating an environment conducive to private sector investment, where foreign investment is required for urgent rehabilitation of key infrastructure capacity and productive facilities. The focus is on key short term macroeconomic and sector policy reforms needed to reverse declines in infrastructure capacity and productive assets. They are generally used in transition economies and post conflict situations.



Appendix III: Municipal Coparticipation Regimes

Only five provinces were studied in detail for this purpose: Chaco, Corrientes, Entre Ríos, Misiones and Tucumán, since they were the ones belonging to the second and third tranches of the loan and the responsible for implementing this conditionality.

The following Appendix studies in detail the different municipal coparticipation systems used in each province up to December 1997 (the last version available at the Ministry of Economy)

The information for this appendix was obtained from the study “Regímenes provinciales de Participación de Recursos a los Municipios” (1997)³

Important abbreviations:

P_i = Population of jurisdiction i

PT= Total population of the province, or sum of jurisdictions’ population (those participating in the corresponding regime).

F_i = amount of \$ to distribute between local administrations. The subscript indicates the fund number, in case there is more than one in that province.

Pm_i = Coefficient indicating coparticipation of resources to the jurisdiction i

IIB = income tax (ingresos brutos)

IA = automobile tax

Province of Chaco

Legal Instruments: Laws N° 3188/86; 3798/92 for the creation of the “Fondo Solidario Municipal (FSM)” and its replacement N°4288/96.

Municipal Coparticipation

The province has two Funds: the Fondo de Coparticipación (FI) and the Fondo Solidario

³ Tomassi, Fernando; “Regímenes Provinciales de Participación de Recursos a los Municipios”, Working Document, Ministry of Interior, December 1997.

Municipal (FSM). The secondary distribution (between municipalities) is done for each of these funds.

Coparticipation Fund: $pm_i = 0.15 (1/M) + 0.25 (Rp_i/RP) + 0.60 (L_i/L)$

Fondo Solidario Municipal: $pm_i = 1/9$

Where: L_i = Estimated number of public employees estimated by the province for each of the municipalities according to their size.

L = Sum of all public employees from all municipalities

M = municipality

RP_i = jurisdiction i 's own resources

RP = total resources of the province

Interpretation:

15% of the coparticipation resources are distributed uniformly between municipalities, **25% according to their own tax collection** and 60% based on the number of employees in each municipality.

Province of Corrientes

Legal Instruments: Laws N° 3598/81, 3599/81, 3753/83, 4054/85, 4752/94, and Decree N° 664/91 of automatic retention of Social Security funds.

Municipal Coparticipation

The province has six Funds: Fondo de Coparticipación (FI), Fondo de Solidaridad Comunal (FSC), Convenio de Descentralización Inmobiliario, Urbano y Subrural (por convenio) (FII), Fondo Especial Municipal (FEM), Convenio de Descentralización Inmobiliario, Urbano y Subrural (municipalities not participating) (FIII), Convenio de Descentralización Impuesto a los automotores y otros rodados (FIV).

Secondary distribution is done for each of these funds.

Fund I: $pm_i = 0.98 (P_i/PT) + 0.02 (P_i^{-1} / \sum_i P_i^{-1})$

FSC: Finance public investment in municipalities or regions

Fund II (Municipalities participating of the IIB agreement) : $pm_i = FII_i / FII$

FEM (participating municipalities): $pm_i = FEM_i / FEM$

Fund III: $pm_i = 0.98 (P_i/PT) + 0.02 (P_i^{-1} / \sum_i P_i^{-1})$

Fund IV (municipalities participating of the IA agreement): $pm_i = FIV_i / FIV$

Where: P_i^{-1} = Inverse of the population of jurisdiction i

Interpretation:

Most of the distribution is based on population indicators and the inverse of this indicator. Though in some cases, this is done according to each municipality's relative collection of the property tax (impuesto inmobiliario y subrural) and the automobile tax.

Province of Entre Ríos

Legal Instruments: Laws N° 8492/91 and its modifications, laws N° 8706/92 and N°8918/95; Law N° 8679 and Decrees N° 3010/90, 3489/90, 4439/90, 2758/91 and Law N° 8465/91.

Municipal Coparticipation

The province has two Funds

FI: $pm_i = 0.33 (1/M) + 0.30 (R_i / Tr_i) + 0.20 (P_i / PTM) + 0.17 (IP_i / IPT)$

FII: $pm_i = FII_i / FII$

Where: R_i = Own resources from jurisdiction i belonging to the fiscal year closed two years before the one where the coparticipation is made.

Tr_i = Total own municipalities' resources

PTM = Total population of the province's municipalities

FII_i = Percentage of the Fund II collected by jurisdiction i.

IP_i = Poverty indicator of municipality i.

IPT = total NBI of the province

Interpretation:

17% of resources are distributed according to the NBI indicator, following a fairness criteria, 20% according to each municipalities' relative population, 33% uniformly between municipalities, and 30% according to the municipality's relative own resources.

Province of Tucumán

Legal Instruments: Laws N° 5360/84, 5684/84, 6097/91, 6246/91, 6316/91, 6650/95, 6651/95.

Municipal Coparticipation

The secondary distribution, in the case of Tucumán, is done through specified fixed coefficients for each municipality with no revealed methodology for their calculation.

In the case of the rural communes, these are separated into three different categories and the resources from coparticipation are distributed uniformly in each category. The criterion for the constitution of these categories was not specified.

The fixed coefficients for the municipalities are shown in the following table:

Table 1: Coparticipation Coefficients

Municipality	Coefficient	Municipality	Coefficient	Municipality	Coefficient
Banda del Río Salí	0.0797	Lules	0.0597	Alderetes	0.0586
Tafi Viejo	0.0797	Bella Vista	0.0537	Burruyacú	0.0316
Concepción	0.0797	Famaillá	0.0496	Tafi del Valle	0.0356
Monteros	0.0707	Simoca	0.0460	Trancas	0.0486
Aguilares	0.0797	Yerba Buena	0.0627	Graneros	0.0296
Las Talitas	0.0506	Juan Bautista Alberdi	0.0516	La Cocha	0.0326

Source: “Regímenes Provinciales de Participación de Recursos a los Municipios”

Coparticipation of resources in the rural communes’ case is shown in what follows:

First Category: 50% of all communes

Second Category: 16.5% of all communes

Third Category: 33.5% of all communes

Distributed evenly: $pm_i = 1/CR_j$

Where: CR_j = Number of rural communes in the province belonging to each category j (where $j = 1, 2, 3$)

Province of Misiones

Legal Instruments: Laws N°2535, N° 3301

Municipal Coparticipation

The secondary distribution of coparticipated resources is done based on fixed percentages for each municipality, in a transitory manner and for an undetermined period of time. The methodology used for determining these coefficients was not revealed. These coefficients are shown in the following table:



Table 2: Coparticipation Coefficients

Municipality	Coef.	Municipality	Coef.	Municipality	Coef.	Municipality	Coef.
Alba Posse	0.563945	Colonia Delicia	0.569397	Gdor.López	0.384345	Profundidad	0.388231
Almafuerte	0.344451	Colonia Polana	0.417453	Gdor.Roca	0.987496	Pto.Esperanza	1.752782
Apóstoles	3.536227	Colonia Victoria	0.458636	Guaraní	0.587245	Puerto Iguazú	3.816666
A.del Valle	1.956589	Colonia Wanda	1.216580	H.Yrigoyen	0.399812	Puerto Leoni	0.523461
Arroyo del Medio	0.357086	Cte.A.Guacurará	0.670207	Itacaruaré	0.431634	Puerto Rico	1.956589
Azara	0.430838	C.de la Sierra	0.581070	Jardín América	1.936957	R.de Montoya	0.486514
B.de Irigoyen	0.731023	Corpus	0.482698	L.N. Alem	3.129740	San Ignacio	0.948080
Bonpland	0.427114	Dos Arroyos	0.492805	Libertad	1.355817	San Javier	1.187078
Caa-Yari	0.427114	Dos de Mayo	0.730694	Loreto	0.352596	San José	0.623421
Campo Grande	1.184310	El Alcázar	0.461964	Los Helechos	0.504976	San Martín	0.401282
Campo Ramón	0.759400	El dorado	5.930809	Mártires	0.344708	San Pedro	1.301685
Campo Viera	1.112792	El Soberbio	0.981689	Mojón Grande	0.395537	Santa Ana	0.591195
Candelaria	0.692935	Fachinal	0.348515	Montecarlo	2.627742	Santa María	0.405770
Capiovy	0.712272	F.Ameghino	0.425783	9 de Julio	0.498936	San Vicente	1.956589
Caragatatay	0.460659	Garupá	1.012874	Oberá	7.192921	S.de Liniers	0.370966
Carro Azul	0.562413	Garuhapé	0.706119	O.V Andrade	0.364861	Santo Pipó	0.850605
Cerro Corá	0.346269	General Alvear	0.360398	Panambí	0.495562	Tres Capones	0.393851
Colonia Alberdi	0.546729	G.M.Belgrano	0.581022	Piray	1.121946	25 de Mayo	1.018611
Colonia Aurora	0.550015	Gral.Urquiza	0.454391	Posadas	25.378508		

Source: “Regímenes Provinciales de Participación de Recursos a los Municipios”

Appendix IV: Provincial Privatization Statistics (1999)

	Privatization and Concessions		
Province	Electric Energy generation and distribution enterprises	Water distribution and drainage enterprises	Provincial Public Banks
Buenos Aires	Privatized (1997)	Privatized (1998)	Not privatized
Catamarca	Privatized (1996)	In process	Not privatized
Chaco	Not privatized	Not privatized	Privatized ⁴
Chubut	Decentralized	Decentralized	Not privatized
Córdoba	Not privatized	Mixed ⁵	Not privatized
Corrientes	Not privatized	Privatized (1991)	Privatized ⁶
Entre Ríos	Privatized (1996)	Decentralized	Privatized (1994)
Formosa	Privatized (1996)	Privatized (1995)	Privatized (1995)
GCBA ⁷			Not privatized
Jujuy	Privatized (1996)	Not privatized	Privatized (1998)
La Pampa	Not privatized	Decentralized	Not privatized
La Rioja	Privatized (1995)	In process	Privatized (1993)
Mendoza	Privatized (1998)	Privatized (1998)	Privatized (1996) ⁸
Misiones	Not Privatized	Not privatized	Privatized (1995)
Neuquén	Privatized	Not privatized	Not privatized
Río Negro	Privatized (1996)	Not privatized	Privatized (1996)
Salta	Privatized (1996)	Privatized (1998)	Privatized (1996)
San Juan	Privatized (1996)	In process	Privatized (1996)
San Luis	Privatized (1993)	Decentralized	Privatized (1996)
Santa Cruz	Not privatized	Not privatized	Privatized (1998)
Santa Fe	Not privatized	Privatized	Privatized (1998)
Santiago del Estero	Privatized (1995)	Privatized (1997)	Privatized (1996)
Tierra del Fuego	Not privatized	Not privatized	Not privatized
Tucumán	Privatized (1995)	Privatized ⁹	Privatized (1996)

Source: Secretaría de Proyección Económica y Regional, Ministerio de Economía, Secretaría de Energía y Minería (Ministerio de Economía), *El Sistema Federal: Diagnóstico y Propuestas*, September 1999.

⁴ The provincial Government was forced to capitalize the Bank recovering its total equity.

⁵ In the city of Cordoba the services mentioned were given in concession for 30 years. –in the rest of the territory they are provided by the municipalities.

⁶ The Bank was privatized in 1992 with the sale of 60% of its total equity. With the Tequila crises the province was forced to acquire the Bank once again..

⁷ The city government does not provide the two services mentioned above

⁸ In 1999 the Bank was closed by the Central Bank.

⁹ The enterprise was given in concession for 30 years, but in august 1997 it resolved to rescind the contract unilaterally.

Appendix V: Provincial Finances during period 1995-1998

Table 1: Provinces Indebtedness for the years 1992-1998 (in thousands of \$)

Province	1992	1993	1994	1995	1996	1997	1998
Corrientes	72539	55655	222174	152798	107690	232576	241799
Tucumán	83111	7727	205521	322844	388200	556603	309969
Entre Ríos	73791	61057	73637	305703	246570	74372	124080
Chaco	42696	52627	97468	213041	110208	142790	263562
Catamarca	23730	75981	107657	82805	117032	50383	503010
Río Negro	55335	38848	178573	406616	335809	1941003	278984
Salta	118519	24782	81095	198287	201149	87958	103020
Santiago del Estero	35974	120964	121403	149116	65776	102967	114174
San Juan	13903	72748	149303	329252	116633	85565	41323
Misiones	45492	35579	41995	214277	19085	107620	161437

Source: Dirección Nacional de Coordinación Fiscal con las Provincias, Ministry of Economy

Table 2: Own tax resources/ Total tax Resources for the years 1995-1998 (in percentage)

Province	1995	1996	1997	1998
Corrientes	12.9%	11.7%	10.9%	11.3%
Tucumán	17.8%	18.7%	19.1%	19.4%
Entre Ríos	30.7%	29.7%	28.8%	28.1%
Chaco	14.7%	15%	13.8%	12.5%
Catamarca	6.3%	9.1%	8.6%	8.8%
Río Negro	23.8%	25.5%	24.3%	26.2%
Salta	17.03%	18.2%	18.1%	17.94%
Santiago del Estero	10.4%	11%	11.6%	12.8%
San Juan	12.2%	15.3%	15.2%	15.93%
Misiones	16.3%	19.9%	18.6%	17.2%

Source: Dirección Nacional de Coordinación Fiscal con las Provincias, Ministry of Economy

Appendix VI: Fiscal Pact Implementation Results (March 1999)

Subject	C.F.	B.A.	Cat.	Cord.	Corr	Cha.	Chu.	E.R.	For.	Juj.	L.P.	L.R.	Men.	Mis.	Neu.	R.N.	Sal.	S.J.	S.L.	S.C.	S.F.	S.E.	Tuc.	T.F.
1. Stamp Tax																								
1.1. Immediate Agreements																								
1.2. Medium term Agreements																								
2. Specific Taxes																								
2.1. Fuel transfers																								
2.2. Gas Transfers																								
2.3. Energy transfers																								
2.4. Sanitary Services																								
3. Bank debits and Payroll																								
3.1. Bank debits																								
3.2. Payroll tax																								
4. Gross receipt tax																								
4.1. Primary Production																								
4.2. Financial Services																								
4.3. FCI, AFJP and Insurance																								
4.4. Currency trading																								
4.5. Goods Production (Industry)																								
4.6. Electricity, Gas, Water																								
4.7. Real Estate construction																								
4.8. Tourism																								
4.9. Technological and Scientific Investigation																								
5. Property Tax																								
5.1. Valuations																								

