Comisión Económica para América Latina y El Caribe

XII SEMINARIO REGIONAL DE POLITICA FISCAL

Organizado por CEPAL
Con el copatrocinio del FMI, Banco Mundial y BID
y el auspicio del Ministerio de Hacienda de Chile

Santiago de Chile, 24 al 26 de enero del 2000

NACIONES UNIDAS

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COMPENDIO DE DOCUMENTOS

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El programa del XII Seminario Regional de Política Fiscal refleja los criterios que tradicionalmente han presidido la selección y tratamiento de temas en anteriores ediciones de este foro anual:

i) propiciar una visión conceptual amplia respecto al contenido y gama de problemas por considerar en la formulación, diseño e implementación de la política fiscal, como también en la coordinación y armonización de esta última con las demás políticas macroeconómicas, en particular con la política monetaria y de administración de la deuda pública

ii) focalizar en el examen de problemas, diagnósticos y soluciones referidas al campo fiscal de las economías de América Latina y el Caribe, comparando experiencias internacionales, identificando mejores prácticas y destacando los límites que las especificidades propias de cada realidad imponen a la transferencia de enseñanzas de terceros países

iii) promover el uso de diferentes perspectivas de análisis --macroeconómico, microeconómico o institucional de manera flexible, según el caso-- a fin de orientar el proceso de diagnóstico, análisis y toma de decisiones gubernamentales respecto a las funciones de asignación de recursos, estabilización, distribución y crecimiento económico

Tal amplitud de miras necesariamente exige que el Programa del Seminario abrigue una amplia gama de tópicos, como, también, que estos puedan ser tratados mediante enfoques teóricos diversos y por capacidades tecnico-profesionales no menos variadas. De la libre competencia de ideas en todos los planos se espera surjan las luces que mejor podrán orientar la toma de decisiones gubernamentales en el plano fiscal de cada país de nuestra región respecto a las convencionales funciones de asignación de recursos, estabilización, distribución y crecimiento económico que son responsabilidad del sector gobierno.

Sesión 1
A la luz de recientes experiencias de acceso a los Mercados Financieros por parte de Gobiernos Sub-Nacionales: ¿Qué diseño de Marco Regulatorio sería más apropiado para evitar sobre-endeudamiento? Comando central? Compatible con incentivos? Combinación de ambos?

Antecedentes

Existe una comprensible tensión entre la responsabilidad de las autoridades económicas de los gobiernos centrales por asegurar equilibrios macroeconómicos (especialmente, ante la relativa falta de incentivos para asegurar disciplina fiscal en los gobiernos sub-nacionales) y las aspiraciones de autonomía en los demás niveles de gobierno (en especial, para decidir autónomamente sobre las formas de financiar sus compromisos de gasto público).- Esto genera un conflicto entre oferta de regulación (originada en el gobierno central y destinada a minimizar riesgos de sobre-endeudamiento subnacional) y demanda por regulación (vista como *lobby* para legitimar el acceso de los gobiernos sub-nacionales a los mercados financiero y, en la medida de lo posible, para asegurar el beneficio de garantias públicas).

La orientación regulatoria hoy vigente en muchos países de la región tiene características propias de una estructura de comando central.- Sin embargo, la creciente importancia política de los procesos de descentralización fiscal y el hecho de que numerosos gobiernos subnacionales de la región y de Europa, ya se encuentran operando activa y exitosamente en los mercados de deuda, sugiere la conveniencia de repensar dicho enfoque. Esto se ve reforzado por el hecho de que: (i) la discusión en curso acerca de una nueva arquitectura del sistema financiero internacional, destaca que el sector privado deberá tener una mayor y creciente responsabilidad para prevenir y resolver eventuales crisis futuras; (ii) el enfoque de comando central que informa el marco regulatorio hoy vigente en muchos países de la región, sufre importantes y conocidas debilidades (básicamente, asimetrías de información, experiencia y motivación, entre las autoridades reguladoras y reguladas).-

Propósito

Revisar la experiencia reciente de acceso de gobiernos subnacionales a los mercados financieros y discutir las condiciones bajo las que el referido enfoque de comando central podría ser complementado por diseños regulatorios capaces de alinear los incentivos de los gobiernos subnacionales (para acceder a los mercados financieros locales y externos), con los objetivos perseguidos por las autoridades regulatorias del gobierno central (esto es, limitar el 'riesgo moral' y evitar sesgos hacia el sobre-endeudamiento provincial, estadual y/o municipal).-

Sesión 2
Incentivos Tributarios para atraer Inversión Extranjera Directa: Experiencias Recientes y Evaluación de Diseños Alternativos

Antecedentes

La IED hacia América Latina y el Caribe viene experimentando aumentos sin precedentes durante los 90's (de poco menos de 10.000 millones de dólares en 1990 pasó a poco mas de 67.000 millones en 1998).- Entre las explicaciones de tal auge destaca un sensible cambio de actitud en los países respecto al rol de la IED.- En un notable ejemplo de cambio de paradigma, respecto al que prevalecía durante las primeras tres décadas posteriores a la II Guerra Mundial, la IED es hoy percibida como una manera superior de dinamizar el comercio internacional e impulsar el crecimiento económico.- En principio ella permite que la economía receptora acceda a nuevos y privilegiados mercados (de insumos y productos), a tecnologías y asistencia técnica más avanzadas, así como a nuevas formas de conocimiento (en materia de producción, administración, comercialización, transporte, etc.), y por cierto, a la generación de nuevos empleos con productividad y remuneraciones superiores a la media .- Ello explica en parte por qué las autoridades económicas de la región están dispuestas a --y de hecho se esfuerzan por-- promover la radicación de la IED dentro de sus respectivas jurisdicciones, mendiante la oferta de diversos tipos de incentivos.- Entre estos últimos destacan diversas modalidades de incentivos tributarios horizontales y/o selectivos (por sectores, industrias o empresas).

De hecho, los gobiernos llegan a competir entre sí --de maneras a veces predatoria-- para asegurar la localización del mayor volumen posible de IED dentro de sus respectivas fronteras (para lo cual conceden exenciones o vacaciones impositivas por diferentes horizontes temporales, deducciones especiales por cuenta de depreciaciones aceleradas, tasas preferenciales, zonas libres de impuestos, etc.), descuidando hasta cierto punto su composición .- Este último punto viene generando abundante reflexión en algunos países, donde los incentivos tributarios están siendo diseñados no apenas para atraer IED, sino para asegurar que ésta se canalice hacia actividades y/o sectores prioritarios.- Además, estos temas vienen despertando fuerte interés en las llamadas 'economías pequeñas', que para competir exitosamente con las de mayor tamaño relativo son impulsadas a atender demandas de las empresas responsables por la IE, con pesadas consecuencias en materia de 'renuncias' tributarias para el Tesoro Nacional.- Esto último también puede llegar a tener un significativo impacto sobre las finanzas públicas de los gobiernos subnacionales (y por carácter transitivo, sobre el Tesoro Nacional) en economías grandes y de tradición política federal, donde la 'guerra' de incentivos entre niveles de gobierno subnacionales ha venido ganando espacio hasta transformarse en un grave problema fiscal.-

Propósito

Promover el análisis y discusión entorno a diversas modalidades de incentivos tributarios para atraer IED en uso en la región, desde una perspectiva comparativa en cuanto al diseño de tales instrumentos, al costo fiscal de su utilización y los resultados que vienen siendo alcanzados.-

Sesión 3
Administración de Riesgos y manejo de Pasivos Contingentes del Sector Público: ¿Cómo incorporar el tema de las Garantias Gubernamentales --explícitas e implícitas-- a la programación presupuestaria anual y plurianual?

Antecedentes

El sector gobierno, como cualquier agente económico, debe hacer frente a muchos tipos de imprevistos con claras consecuencias financieras.- Así cabe mencionar los pagos que el Tesoro público debe efectuar en cada ejercicio fiscal como consecuencia de fallos judiciales adversos, o por reconocimiento de deudas *inadecuadamente contabilizadas* en el pasado (ej. reconocimiento de 'esqueletos' fiscales), o por indemnizaciones (ej. por despidos de trabajadores), compensaciones (ej. por expropiación de propiedades) y/o reparaciones (ej. por daños privados causados por agentes públicos).- De igual modo, el Estado debe hacerse cargo del pago de diversos seguros implícitos [ej. por quiebres de cosechas, inundaciones, terremotos u otras catástrofes naturales, a los que debe adicionarse el 'rescate' de organizaciones financieras -estatales y privadas- insolventes, agencias de gobiernos subnacionales técnicamente en bancarrota, o en general, de 'proyectos' que por diversos motivos cuentan con garantias gubernamentales implícitas (ej. la seguridad social de grupos especialmente vulnerables)].- A lo anterior debe adicionarse los compromisos financieros derivados de la oferta de avales u otros tipos de garantias públicas explícitas (ej. volúmenes mínimos de ventas o tasas mínimas de rentabilidad a concesionarios privados de servicios de utilidad pública).- Elementales principios de administración de riesgos y normas contables de aceptación universal, sugieren la necesidad de que los pasivos contingentes del sector público reciban un tratamiento técnico especial, de manera análoga a lo que el sector privado hace con los suyos.- Ello incluye la oportuna y transparente identificación, estimación y presupuestación de los pasivos latentes, así como el continuo monitoreo y evaluación de su 'calidad' (a fin de recalcular el valor esperado de los compromisos financieros a medida que las circunstancias hagan variar la probabilidad de su efectivación).

Aun reconociendo que en algunos países se viene dedicando atención al tema (ej. a través de la creación de fondos de estabilización, formación de reservas técnicas, provisiones por pérdidas derivadas de garantias otorgadas, normas para el oportuno reconocimiento público de pérdidas, etc.), parece evidente que: (i) falta mucho por avanzar en materia de administración de riesgos en el campo fiscal (especialmente si se lo compara con las iniciativas y avances ya logrados en el campo financiero); (ii) se conoce poco sobre lo que los países de la región vienen haciendo al respecto (en principio, no parece constituir práctica corriente el mantener adecuado registro de los compromisos contingentes por niveles de gobierno, según los tipos o modalidades que adoptan, el perfil temporal de los valores involucrados y el valor estimado de la probabilidad de que se hagan efectivos, etc.).-

Propósito

Promover un intercambio de ideas y experiencias sobre administración de riesgos asociados con pasivos contingentes del sector público. Además, se busca conocer lo que constituirian 'mejores prácticas' para identificar, estimar, supervisar e incorporar tales pasivos a los presupuestos públicos --anual y plurianual-- de diferentes niveles de gobierno.-

Sesión 4
Papel, alcance y costos fiscales de las Redes de Protección Social.

Antecedentes

Durante la era de Bretton Woods --y bajo supuestos convencionales *a la Krugman*-- una crisis de balanza de pagos generalmente conducía a un ajuste fiscal contraccionario sin que las autoridades gubernamentales hicieran mayores esfuerzos por neutralizar, o al menos compensar, las consecuencias sociales negativas que de aquel se derivaban.- En aquellos tiempos, los problemas económico-financieros de un país eran vistos como eventos básicamente aislados, producto de la implementación de malas políticas domésticas que intentaban 'hacer vivir a la sociedad, más allá de sus medios'.- En dicha era, los organismos de cooperación financiera internacional --cuando convocados a colaborar en la corrección de un desequilibrio en las cuentas externas-- usualmente recomendaban comprimir el gasto público (como un medio de reducir la absorción global de recursos), dejando a cargp de las autoridades domésticas decidir la composición de los cortes.- En los años 90 el escenario es bastante diferente al anterior.

En primer lugar, los déficit públicos dejaron de ser abiertamente elevados, frecuentes y generalizados como en décadas precedentes. En segundo lugar, la combinación de flexibilidad cambiaria (propiciada por el quiebre del modelo de Bretton Woods) y movilidad del capital financiero internacional (promovida por las políticas de liberalización y desregulación financiera iniciada en los años 80), tuvieron como resultante una fuerte y generalizada volatilidad cambiaria que posibilitó crisis bancarias y financieras cuyos efectos reales adversos son hoy bien conocidos.- La gravedad y escala internacional de las recesiones ocurridas en Asia y América Latina a partir de 1997 se expresa en notables aumentos no transitorios de los niveles de desempleo abierto (en el sector formal) y de subempleo (en el sector informal) de numerosos países.- En un corto periodo de tiempo y en diferentes partes del mundo, muchos millones de personas volvieran a caer debajo de los niveles de pobreza de los que habían conseguido escapar en décadas anteriores y de manera especial, durante fase de rápido crecimiento registrada a comienzos de los 90's.

La simultaneidad y escala internacional con que se sintió el impacto social adverso de las crisis financieras recientes: contribuyó a minar el paradigma de que los problemas económicos nacionales pueden ser vistos como fenómenos básicamente aislados, fortaleció la preocupación de la comunidad internacional con las posibles repercusiones sistémicas de problemas inicialmente puntuales, y llevó aquella a percibir con mayor claridad que la sostenibilidad política de los programas económicos depende de la minimización de sus costos sociales.- Todo ello ha venido contribuyendo para gestar un nuevo consenso (del que participan las economías del G-7, las agencias de Naciones Unidas, las instituciones de Bretton Woods, y por cierto, los propios países afectados por dichas crisis), respecto a la necesidad de priorizar la protección de los grupos más vulnerables en futuros programas de estabilización, ajuste y de reformas estructurales.-

<u>Propósito</u>

Examinar opciones teóricas alternativas para el diseño de 'redes de protección' de corto plazo para grupos socio-económicos más vulnerables, analizar los resultados de experiencias recientes en economías de América Latina y Asia, como también, evaluar el costo fiscal correspondiente a tales intervenciones. Además, se tratará de clarificar en qué sentido y medida las propuestas más recientes para integrar 'redes de seguridad' al diseño de una nueva arquitectura financiera internacional, constituyen una nueva doctrina para el manejo del gasto público en épocas de crisis (respecto a las recomendaciones de la ortodoxia convencional). Más específicamente: ¿De qué manera dichas 'redes' se vinculan a la fijación de metas fiscales en Programas de Estabilización y Ajuste del FMI?, y ¿Cuál es el papel de los bancos de asistencia multilateral en esta materia?.-

Sesión 5
El nuevo Manual de Estadísticas de Finanzas Gubernamentales del FMI: Presentación y Discusión

<u>Antecedentes</u>

El Departamento de Estadística del FMI se encuentra revisando la edición de 1986 del ***Manual*** que entrega los conceptos, definiciones, clasificaciones y reglas contables básicas para la generación e interpretación del sistema de estadísticas gubernamentales de mayor uso internacional.- Para esta nueva edición se vienen considerando importantes cambios que esta sesión permitirá conocer en primera mano, creando al mismo tiempo un espacio para que especialistas en finanzas públicas y política fiscal de AL&C entreguen sus reacciones , sugerencias y recomendaciones.- Los capítulos ya disponibles del ***Manual*** se encuentran en la página *web* del Fondo (http://www.imf.org), donde es posible apreciar las principales novedades.- Entre éstas destaca el propósito de compatibilizar el marco analítico del ***Manual*** con el Sistema de Cuentas Nacionales de Naciones Unidas de 1993.

Como consecuencia, cambia la caracterización del sector gobierno (desde la óptica de funciones a la de agrupación de unidades), el criterio para registrar transacciones (de caja a devengado), y aumenta el grado de integración entre flujos y estoques (la noción de riqueza neta y hoja de balance del sector gobierno adquieren gran importancia).- Estos últimos y otros importantes avances conceptuales propuestos en el ***Manual,*** contrastan con la sensación de que los indicadores fiscales más utilizados (digamos, sobre déficit y deuda pública) están afectados de una cierta dosis de opacidad que convendría disipar pues perjudica las posibilidades de evaluación y análisis de las propias autoridades económicas nacionales y, por cierto, la comparabilidad internacional de las finanzas públicas y de la política fiscal.- Por este motivo, la CEPAL y el Banco Nacional de Desarrollo Económico y Social (BNDES) de Brasil vienen trabajando en una iniciativa conjunta para mejorar la transparencia y comparabilidad de los indicadores fiscales de los países de AL&C, tema este que será objeto de discusión en un Taller *ad-hoc* a realizarse el día posterior a esta sesión.-

Propósito

Crear un espacio para que los especialistas en finanzas públicas y política fiscal de la región, quiera sean de gobierno, instituciones académicas especializadas u organismos internacionales, puedan tomar conocimiento detallado y en primera mano, sobre los cambios que vienen siendo propuestos para esta nueva edición del Manual y para que tengan la oportunidad de expresar sus observaciones, sugerencias y recomendaciones. Establecer un puente con el Taller sobre Metodologías para Estimación y Cálculo de Indicadores Fiscales organizado por CEPAL-BNDES

Juan Carlos Lerda
Coordinador
XII Seminario Regional de Política Fiscal

INDICE

DISERTACION INAUGURAL

Disertación Inaugural - 2

"What is the best government? That which teaches us to govern ourselves"
--Johann Wolfgang von Goethe

THE ROLE OF THE STATE AND THE QUALITY OF THE PUBLIC SECTOR *

by
Vito Tanzi

January 5, 2000

* This paper's objective is to contribute to the literature on second generation reforms. An earlier version was presented at the Fund "Conference on Second Generation Reforms" (November 8-9, 1999) and at a conference on "Controlling Public Activities" organized by the Bank of Italy, in Perugia (December 2-3, 1999). Specific comments on the earlier draft received from Era Dable-Norris, Barry Potter and Howell Zee were much appreciated. I would also like to thank Patricio Castro, Jerome Fournel, Eduardo Ley, Istvan Székely and various participants in an internal FAD seminar. The views expressed are strictly personal and not official Fund views.

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I. The Role of the State

Human beings are social animals, as a consequence they tend to aggregate in groups. Aggregation generates markets and the need for social institutions. Markets and economic activities are characterized by specialization on the part of the participants. Specialization leads to exchanges, and exchanges involve contracts. Contracts may be implicit or explicit. Implicit contracts prevail in primitive societies and are often enforced by existing moral and social codes. As societies develop, they tend to need more explicit or formal contracts which in turn require institutions to register them, when registration is required, and to enforce them. Individuals also accumulate assets and this leads to the need for property protection. Furthermore, they need personal protection against criminal elements within their groups or protection against outsiders. Thus any aggregation of individuals requires the existence of at least rudimentary institutions that perform these functions and that can be considered a minimal state. This is the essential role of the state in a primitive society or the minimal role in any society.[1]

As societies become more complex, and, perhaps, as the groups that constitute them become larger and less homogeneous, the state must assume additional responsibilities if it wishes to promote fully the welfare of the individuals that comprise it. For example, markets are not efficient when they are distorted by monopolies or when essential information is not available to the participants, or is too costly for them to obtain. This leads to the need for the state to regulate markets and to provide at least some essential information. Thus, institutions must be created to satisfy these needs. See World Bank (1997).

There are some goods (defense, city streets, etc.) that only the state can provide because private individuals would not find in their interest to provide them. An important reason is that once these goods are provided, the provider will not be able to exclude from their use individuals who do not wish to contribute to the cost of providing them. Another reason is that once they are produced they can be consumed jointly by everyone so that it would be inefficient to exclude some individuals from their use. Thus, if these goods are essential, they must be provided (but not necessarily produced) by the state. These are the public goods of the public economics literature. Also, the production or consumption of some goods or activities generate positive or negative externalities which are not captured by those who consume or produce them. Thus, if the state does not intervene, the market is likely to underproduce or overproduce these goods or activities. Once again, there may be a need for the public sector to intervene.[2]

All the above are examples of a general role of the state that in the public economics literature goes under the name of <u>allocation</u>. See Musgrave (1959). Although some problems of allocation can be dealt with by the use of regulations, often, if the state must perform this role, it will need resources. In principle the state could directly appropriate these resources by forcing individuals to contribute their time or their wealth for the production of the required goods--as it does, for example, with compulsory military service or with some forms of expropriation. In medieval times roads were often built in this way. However, a more efficient alternative is to use resources raised through taxation. Thus, there is a need for a tax system and for institutions that collect taxes. And, of course, there is a need for institutions that spend the money and keep track of that spending. In all these activities, in a market economy the state is

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1 There is now an extensive literature that argues that even gangs or criminal associations of individuals require within themselves some organization that is a rudimentary form of government. See Skaperdas and Syropoulos (1995), Charap and Harm (forthcoming), and various papers in Fiorentini and Zamagni, editors (1999). For the concept of a minimal, or even of an ultraminimal, state see Robert Nozick (1974).

2 The traditional state intervention is to tax those who generate negative externalities and to subsidize those who generate positive externalities.

expected to minimize the cost that its activities impose on the market and on society at large. Thus, a public sector of high quality requires an efficient tax system and an expenditure system that minimizes inefficient and unproductive spending. It also requires a budget large enough to allow the state to perform its role in a satisfactory way. See Tanzi and Zee (1998).

In addition to the essential or fundamental role of the state associated with the allocation of resources, a role that has been explicitly recognized and described by economists at least since Adam Smith's *The Wealth of Nations*, in this century two or, perhaps, three additional economic roles have been assigned to the state. These are (a) redistribution of income, (b) stabilization of economic activity, and (c) promotion of growth and employment. These latter tasks are less firmly based in economic theory than the allocation role but they have been important in the practical implementation of policies in the second haft of the 20th century.[3]

Markets produce goods and services and provide incomes to those who participate in them. Depending on the initial positions of the individuals as to ownership of real assets, of financial resources, and of human capital and talent in general, and depending on effort, propensity to save, luck and risk taking, a given pattern of income (and wealth) distribution is determined. This distribution may or may not match the prevailing societal perception of the degree of inequality that is considered acceptable. Furthermore, because of physical or mental handicaps, or because of other characteristics or situations, such as old age, unemployment, number of dependents in the family and so on some individuals may not be able to generate an income sufficient to sustain themselves or their families. In these cases, in this century, and in some countries, the state has been expected to provide them with transfers aimed at raising their consumption over an essential minimum.[4]

The assignment of a redistributive role for the state has dramatically changed the character of its intervention in the economy because it has introduced in its actions purely political considerations or objectives. In fact, while, at least in principle, the state's role in allocation can be derived from technical and objective analysis, the proper redistributive role cannot be established objectively. For example, there is no objective way to determine the ideal Gini coefficient or the ideal ratio of the top quintile to the bottom quintile of the income distribution of a country. Thus, these decisions are unavoidably influenced by the biases of the individuals constituting the government in power.

Programs aimed at redistributing income often require a lot of resources and the presence of institutions charged with administrating these programs. For this reason, they tend to lead to large increases in public spending and in the level of taxation as they have in the so called welfare states.[5] At times, the redistribution objective has been pursued through progressive taxation. But more often it has required large bureaucracies and much public spending. In many countries a large proportion of the public employees is now engaged in the provision of education and health services and a large share of the total public spending of industrial countries goes for social programs including pensions. And in some cases public employment has had the specific objective of redistributing income. See Alesina, et al (1999).

Markets do not operate smoothly but are characterized by fluctuations that at times become recessions or even depressions. These recessions lead to growing unemployment and a loss of output and, in the second part of the 20th century, they created another major justification for state intervention namely, the maintainment of full or at least high employment and the stabilization of output. The

[3] These roles had not affected much the behavior of governments in market economies until this century.

[4] In previous centuries religious groups played a similar role in helping the poorest.

[5] The World Bank, op.cit., has argued that the process of taking over these new functions has distracted the state from its more fundamental role.

promotion of this Keynesian objective is carried out by government officials and requires some relevant institutions. These officials must have the capacity to change tax revenue and/or public spending in order to influence aggregate demand in desirable directions and must have the information and the technical knowledge and wisdom to make the right decisions.

Finally, in recent decades, governments have also promoted policies aimed at raising the rate of growth or at creating employment. Import substitution and industrial policies have been examples of attempts at raising the growth rate. Manipulation of the work week and public investments in particular activities or regions are examples of attempts at raising employment. Regardless of the wisdom of these policies, particular institutions must be responsible for executing them.

We can summarize the role of the state in a market economy in the following way:

1. It must establish and enforce formal rules in the economy, including the enforcement of contracts and the protection of property rights, as well as rules governing the extraction and the use of public revenue;

2. It must provide a legal and regulatory framework that reduces transaction costs--that is the cost of dealing with other individuals in economic matters--and promotes market efficiency--through strategic market intervention in cases of market failure or through the production of some essential information;

3. It must provide public goods and deal with obvious cases of externalities which cannot be resolved by negotiations between the involved private parties;

4. It must promote macroeconomic stabilization; and

5. It must promote a distribution of income that is consistent with the prevailing view of society.

For all of these functions the state needs some rules and institutions:

The role of the state in the economy has changed over time and varies across countries because it is influenced by the changing views of society and by changing technologies. Therefore, the quality of the public sector should be assessed in light of the objectives and priorities of the government at any given point in time. These objectives may vary depending on the current needs of a particular country. At times these objectives may even be in conflict with one another. The state plays its role through the set of rules, laws, and institutions that make up the public sector. The higher is the quality of the public sector, the easier it will be for the state to promote its role.

<u>The quality of the public sector is defined here as the characteristic that allows the state to pursue its objectives in the most efficient way</u>. Although it is difficult to separate the two, the quality of the public sector is not necessarily the same thing as the quality of economic policy. Thus, the quality of the public sector is distinguished from the quality of the policies that a given government may be pursuing at a given moment. A high quality public sector is simply the instrument that facilitates the formulation and the implementation of the government's policies. A good public sector makes it easier to pursue good policies. But, even a high quality public sector cannot guarantee consistently good economic policies because it cannot prevent policymakers from occasionally pursuing poor policies. However, one would have some hesitation to call a public sector of high quality if poor policies were <u>frequently</u> pursued and one would expect to find a high relation between the quality of the public sector as defined here and the quality of economic policy. In other words, a high quality public sector is likely to promote good policies and over time a low quality public sector is likely to promote poor policies.

The definition of high quality public sector used in this paper differs from that of "good government" used by other writers. For example, La Porta et al (1998) define good government as one that is "good for capitalist development." They do not distinguish between quality of public sector and quality of public policy. A poor public sector will, of course, render the pursuit of good policy more difficult because it will not provide the government with the needed information and it will not guarantee that the policy decisions will not be distorted in the implementation stage. See on this, Tanzi (forthcoming).

II. The Importance of Rules

In the previous section I described the broad categories of state intervention in the economy. Each of these categories requires specific programs. In democracies with market economies the mandate for intervention in the economy given to the state is often specified, first, by a constitution and then by many laws and regulations that give a specific content to the normally general principles enunciated by the constitution. Thus, the constitution and the laws and regulations establish the rules of the game that guide the actions of individuals and enterprises on one hand and public institutions on the other. But, as North and Weingast have pointed out, "[a] critical political factor is the degree to which the regime or sovereign is committed to or bound by these rules"[6] (1994, p.312).

A. The role of constitutions

The principles expressed by the constitution may be clear but are often not very specific. The constitution must be a living document that guides action but it cannot be one that addresses specific situations or that anticipates activities or situations that do not exist at the time the constitution is written. It has been reported that Napoleon rejected the draft of the constitution that the best legal minds of his time had prepared at his request because he felt that the document was too specific and, thus, potentially too restrictive and likely to become obsolete with the passing of time. He preferred a statement of general principles that could be interpreted with some flexibility over time. To a large extent the American constitution is a good example of such a statement. Only rarely it has required amendments.

Examples of constitutional principles that are not too clear abound. A well known example is Article 81 of the Italian Constitution that seems to restrict deficit financing but that, over the years, was interpreted in ways that did not prevent the occurrence of large fiscal deficits. Examples of too restrictive constitutional limits are also not uncommon. An important example is the 1988 Brazilian Constitution. In recent years that document has prevented the national government from making important and badly needed reforms in fiscal federalism and in the pension system. Other examples are, the Indian Constitution that has prevented the introduction of a national sales tax, or the Pakistani Constitution that has limited the scope of any sales tax imposed by the national government to goods only and has prevented the taxation of agricultural incomes.

A problem with constitutions is that they tend to reflect the preoccupations and the political forces of the time they were written. A good example of this characteristic is the Italian Constitution. Its first article sets the tone by stating that "Italy is a democratic Republic founded on labor." It subsequently states that all citizens have the right to labor. See Article 4. The third chapter (Title III) of the

[6] In authoritarian governments or in dictatorships the constitution may play a marginal role. Stalin's constitution for the Soviet Union was a very good one but it did not prevent him from doing whatever he wanted. He was obviously not bound by the constitutional limitations.

Constitution, which specifically deals with "economic relations," lists many rights of workers and only limitations to property rights. It specifies that the state can put limits to the use of property and can expropriate it for the national interest. It also states that the state can impose various limits to the use of property in order to "establish equitable social relations." If the proper economic role of the state in a market economy requires the protection of property rights, this document is surely reluctant to assign that role to the state. It should, thus, not be surprising if economic policies and institutions in Italy have developed to conform to this constitution and have allowed policies (rent controls, expropriation of land with very low compensation, etc.) that are contrary to the protection of property.

In conclusion, the role that constitutions play in determining the quality of the public sector cannot be exaggerated.[7] It is the constitution that allows or disallows certain actions on the part of the governing body and on the part of the citizens. Thus, at least in principle, the laws and the regulations that govern a country must be consistent with the constitutional principles as interpreted by a Supreme Court or by an equivalent body. In recent years, there has been a trend in many countries to try to modernize their constitutions. However, the results have not been always very good. At times the revised constitutions have been poorly formulated, complex and confusing.

Some economists, including James Buchanan and Francesco Forte have argued that the economic or fiscal role of the constitution should be one of establishing limits to governmental action as for example done by the Swiss Constitution. See Forte (1998). The constitution should stress what the state cannot do rather than what it should do. Thus, these authors might favor limitations to tax rates, to levels of public spending or to fiscal deficits. The Maastricht Stability and Growth Pact might be seen as an example of such a constitution even though it is silent about the size of public spending.

In some circumstances, and again Brazil comes to mind, a change in the constitution that removed obstacles to desirable and important reforms may be a necessary condition for raising the quality of the public sector and of public policy.

B. Laws

While the constitution sets, or at least should set, the general principles that guide the country's policies, the latter are permitted and directed by specific laws. It is possible to generalize that the quality of the public sector is enhanced when the laws are relatively few, are clearly written--and thus not subject to conflicting interpretation--are comprehensive, and are not in conflict among themselves. Difficulties have arisen when the laws are too many, are not clear, do not cover all relevant areas of economic activities, or provide conflicting signals.

Among European countries it has been reported that while some of them have only few thousands active laws others may have tens of thousands. See for example, Ferro et al (1999). It may thus be difficult to find one's way in this legal jungle. The legal system may reflect a problem conceptually similar to that associated with Y2K. It occurs because at each time that a new law is enacted, all the existing laws should be scrutinized and, if necessary, revised to make sure that all the elements of these laws are consistent with the new law. When the existing laws are many, and especially when they are not clear, it is almost impossible to ascertain this. Thus, occasionally elements imbedded in laws enacted in the past, but still on the books, conflict with the new laws. When this happens the directives to the citizens as well as to the institutions charged with implementing the programs contemplated by the laws get confused. This problem could be referred to as one of legal inconsistency. It often characterizes the relations between

[7] This of course assumes that the rule of law is well established in the country so that the constitution is taken seriously.

national and subnational governments, or between, say, pension and health programs on one hand and annual budget laws on the other.[8] Zoning laws and laws dealing with the environment have also suffered from this problem. At times, a law and, thus, a given institution authorizes a certain land use but another law and another institution prohibits its. These conflicts may lead to costly mistakes.

Thus, to repeat, the quality of the public sector is enhanced when the laws are written clearly and cover all the necessary areas, when they do not lead either the public or the public officials to conflicting interpretations, when their number is as small as feasible, and when they are not in conflict among themselves. Over the years there have been attempts on the part of some countries either to codify the existing laws or to simplify them. However, these actions, which would give benefits only over the long run, do not get much political support. Thus, the attempts are often abandoned before they produce the necessary results. See, for examples, Guy (1996), Braibant (1996), Mattarella (1994), Smith and Richardson (1999) and Tan and Tower (1992).

C. Regulations

Laws are often accompanied by specific regulations.[9] These can be classified in three groups: economic regulations, safety regulations, and information regulations. Regulations explain procedures or elaborate on the content of the laws or simply impose rules on individuals and enterprises. In some cases the laws are so complex as requiring a very large regulatory body. For example, the regulations covering the U.S. Internal Revenue Code cover 35,000 pages. The Internal Revenue Code itself is some 1500 pages long. Regulations issued by an executive authority or by a regulatory agency can themselves be very complex, may not be easily accessible by the public, and may overlap with other regulations. In some countries they may not even be published.[10]

Because many forms of regulations do not require budgetary appropriations or formal approval by the legislature, they tend to be less scrutinized. The interpretation of regulations is often left to the bureaucrats who administer them. Therefore, the possibility of confusion or even abuse is very high. Regulations have been identified by the relevant literature as one of the major causes of corruption because the bureaucrats in charge may abuse them to derive personal advantage. See Tanzi (1998b). They have also been shown to impose very large welfare costs on the economy.[11]

Because of the dynamic character of economies, and because of fast technological change, it is common to find countries with too many anachronistic, useless, or even damaging regulations and too few necessary regulations related to new economic activities.[12] This is an area where excess and scarcity often coexist. Many countries are now struggling to create needed regulations for the financial and banking sectors, for the use of the information superhighway (internet), for genetic research, for the use of some drugs, and for other similar, important, new areas.

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[8] For example, the budget law may assign a given budgetary allocation for the health sector but the laws that determine the performance of the health sector may imply a much higher spending level. See Reviglio (1999) for a specific example from Italy.

[9] Regulations may be legislated and thus be laws themselves or they may be issued by public agencies.

[10] In a country in which I worked many years ago tax incentives regulations were not publicly available in any form. Thus, the bureaucrats making the decisions had all the knowledge and their decisions could not be challenged by the taxpayers.

[11] See 1984 Report of the U.S. Grace Commission. See also Dixit (1996) and Laffont and Tirole (1993).

[12] A couple years ago, it was reported in the American press that in California, bread had to be sold only in pieces of an exactly well specified weight. This regulation, which was still on the book, had been introduced at the beginning of the century when most buyers did not have scales so that they could be easily cheated by unscrupulous bakers. In Italy and Germany discounts on sales by shops must be approved by the municipality and must be limited in time.

In conclusion, a high quality public sector must have enough clear rules to guide economic (and other) activities but not rules that are so many or so vague as to give excessive power to the bureaucrats or to create uncertainty among those who make economic decisions. In general, the rules should specify what is not allowed rather than authorize what is allowed. Discretion by bureaucrats should be kept to a minimum. It has been reported that, in some countries, particular activities--say, a request for a tax incentive or an application to open a small enterprise--may need 30 or 40 authorizations signed by public employees in as many agencies or offices. See, inter alias, De Soto, 1989.

An important step would be to make a periodic inventory, say, every ten years, of all the existing regulations, so that a regulatory budget could be established and could be pruned of redundant and anachronistic regulations while complementing it with new required ones and while clarifying the confusing ones. Such an attempt was made by a few countries including Hungary and Argentina. Such a process, while costly, would raise the overall quality of the public sector. Another useful step is the creation of a one-stop, or a "single window," center where individuals can obtain all the permits and authorizations they need. Such centers have been created in a few places and are reported to have led to the elimination of many existing regulations.[13]

In addition to the formal, constitutional rules and the rules specified in the laws and in the regulations, the quality of the public sector may be affected by informal norms or arrangements that influence the economic behavior and the behavior of the public sector. Such norms (a) influence the choice of presidents, ministers, and other high level officials; (b) characterize appointments in the civil service; and (c) influence contacts between the state and the private sector.[14] These informal norms may be based on religious, social, or political considerations. Being of an informal nature and being based on cultural characteristics, these norms are difficult to change. Still the application of arm's length relationships and the rule of law to all aspects of public sector behavior should be a goal in the search for a higher quality public sector. See Tanzi (1995).

III. Political and Procedural Rules

The constitution, the laws, and the regulations establish the broad legal powers of the public sector, or, putting it differently, they set the rules of the game that should determine the behavior of the public sector and the regulation of the market. The importance of these rules cannot be underestimated. Several authors including Buchanan, Alesina, von Hagen, Poterba, Tabellini, and Persson have argued that political arrangements such as fiscal federalism and fiscal decentralization, proportional or nonproportional representation in parliaments, the frequency of elections, the choice of presidential versus nonpresidential types of governments, the role of the ministry of finance as a super ministry, the rules that apply to the budgetary process--for example, whether it starts with a macroeconomic constraints which reflects a collective view on priorities or whether it allows pressures for spending to be determined through the political influence of each minister--whether parliament can modify the content of budgetary proposals, or whether it must vote on the whole budget, whether the central bank is independent and so on have a significant impact on fiscal and macroeconomic outcomes.[15] These situations have been modeled

[13] Examples of these centers now exist in Bologna (Italy) and in Salvador de Bahia (Brazil). In Bologna an attempt is being made to allow access to this one-stop center through the internet.

[14] In some countries high public positions are almost inherited. Some jobs in particular institutions are passed from one to another member of the same family. In others, party affiliation facilitates access to government jobs and a change in government creates a large number of vacancies because many jobs are considered as political.

[15] Ricardo Hausmann has argued in support of a politically independent Fiscal Council that would restrict annual public debt accumulation to agreed levels. The analogy to a central bank independence is obvious.

using sophisticated game theories and have been subjected to some empirical testing. See inter alias, Tabellini and Persson (forthcoming) and Poterba and von Hagan (1998). The guiding assumption is that economic policy is much influenced by these arrangements.

I will not review this literature which is still evolving and which, at times, has given conflicting results. While recognizing its importance and its potential contribution to economic policy, in this paper the focus is on other aspects and, specifically, on the quality of the public institutions. Political and procedural rules are more likely to affect policies than the quality of the public sector or of public institutions. It is the institutions that confront the citizens and that implement the policies. But, of course, by changing the incentives under which policy makers and institutions operate, the political and procedural rules may affect the behavior and, thus, the quality of the institutions and vice versa. The rules are just a set of instructions. They are not yet the policies. Until the game is played, these rules remain just pieces of papers; and the game is played by the institutions charged with carrying out these instructions.[16] They may or may not carry the instructions in a faithful and efficient way.[17] The public sector is composed of many institutions, some more important than the others. It is the performance and the efficiency of these institutions that, to a large extent determine the quality of the public sector.

IV. The Quality of Public Institutions

The quality of the public sector may be affected by the absence of some essential institutions or by the poor performance of the existing institutions. For example, in many countries, there are no institutions responsible for enforcing competition or for forcing full disclosure on the part of financial institutions or for publishing good accounts on the part of enterprises whose shares are traded in the stock market. As a consequence the market may function less well because of cronyism and monopoly powers or because of lack of essential information. The performance of public institutions depends on many factors including (a) tradition and reputation, (b) the resources they have available and the discretion over their use (c) the clarity of their mandate, (d) their organizations, (e) the incentives that they face, (f) the quality of their leadership and staff, and (g) the freedom they have over reorganizational matters.

Take one of the most fundamental institutions as an example, namely the tax administration. Its performance will depend, in part, on its tradition and its reputation. A tax administration that has been efficient, honest, and proud in the past is likely to continue to be so in the future unless it faces truly fundamental shocks. By the same token it is very difficult in the short run to change a corrupt and inefficient administration.[18] Its performance will also depend on the resources that it has available to hire capable employees and to pay good salaries, to invest in new computer technology, to carry necessary audits and so on. The clarity of its mandate--for example to enforce fairly and objectively the tax laws--is important. Its day-to-day independence from political pressures is essential. When the mandate becomes unclear, either because the laws are not transparent or because the institution is subjected to political interference that forces it to accommodate the special circumstances of some taxpayers, problems develop. This, for example, has been the case in some transition economies and in some developing countries.[19] In these countries, political interference has reduced the quality of the tax administration. The organization of the tax administration is also important and so is the set of incentives that it faces. If an institution is

[16] It can be argued that there are two sets of games taking place. The first is the one that sets the rules and the second is the one that implements them.

[17] In a recent paper I have argued that public policy is often distorted by the prevalence of principal-agents problems. See Tanzi (forthcoming).

[18] Occasionally countries have closed corrupt administrations and have opened new ones, thus starting from scratch.

[19] See for example, Tanzi (1998a).

poorly organized, or if good or bad performances are equally compensated, the contribution of this institution to the quality of the public sector will be low.[20]

There are current attempts at strengthening incentives either by making tax administration politically independent like central banks, [21] or by negotiating explicit contracts between the government and the tax administration that require quantitatively specified performances. In Australia, for example, the government guarantees to the tax administration a given level of resources over a three-year-period. In exchange the tax administration commits itself to deliver some outcomes and some quantified outputs.[22]

This brings into the picture two other important and related aspects of public institutions namely (a) the synergy among public institutions and (b) the enforcement mechanisms. These are treated as two separate aspects although, to a large extent, they are two faces of the same coin.

A. Synergy

Like different elements of an ecological system, public institutions work together and support one another so that it may not be possible to have, say, a first-class tax administration in an environment where other institutions, such as the treasury or important ministries or the judiciary, or even the post office, do not function well.[23] Often the same weaknesses affect different institutions. This implies that attempting to improve just one institution, when the others need equal attention, is not likely to generate the desired results in the long run. This has been the experience in transition economies where, for example, the establishment of a good treasury system has not improved much the quality of public expenditure management when the budgetary process has continued to generate budgets that were so unrealistic that no treasury could finance or manage them. In some of these cases the result has been the accumulation of arrears on the part of government and, as a counterpart, the accumulation of tax arrears by the taxpayers. See Potter and Diamond (1999).

Inter-institutional externalities (either positive or negative) are very important and must be recognized and dealt with in any attempt at improving the quality of the public sector. Unfortunately, to my knowledge this aspects has not been addressed in the literature. For example, when the judiciary does not work well, many other institutions suffer. A holistic approach that addresses problems in different institutions at the same time is likely to be necessary. However, such an approach, which is inevitably difficult to follow, must be guided by a clear strategy and by the proper sequencing of the changes required and made. If this approach requires more time to implement than the political horizon of the government that introduces it, it is less likely to be fully implemented. This is the reason why the quality of the public sector changes only slowly over time.

B. Enforcement mechanisms

The quality of the public sector will depend to a considerable extent on the existence of controls and enforcement mechanisms. Some of these mechanisms must operate within the institutions themselves. For example, efficient internal auditors' offices can improve the functioning of the institutions and can

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[20] Rules that apply to hiring, promotions, firing and similar issues for public servants obviously play an important role in the determination of the quality of the public sector.

[21] In exchange the tax administration receives more discretion over the use of resources.

[22] The cost of collection ratio may play some role in this context. See, for example, Highfield (1999).

[23] For example, in countries in which tax evaders are not punished by the courts, it will be more difficult for a tax administration to fight tax evasion.

provide some guarantees that the latter will not stray away from their basic mandate. But these mechanisms may not be sufficient. In other cases the enforcement mechanisms must cut across institutions. This happens when supreme audit institutions specialized in controls and in enforcement have the responsibility of controlling spending and revenue collection. These institutions often receive their mandate from the constitution and act as independent bodies.

Examples of these supreme audit institutions are the General Accounting Office (GAO) in the United States, the Cour des Comptes in France and La Corte dei Conti in Italy, the General Auditor's Offices in Latin American Countries and so on. Historically, these audit institutions have focused too much on whether the institutions have complied with the letter of the law rather than with the spirit of it. Thus, in many cases, the performance of the institutions in terms of outputs and outcomes has attracted less attention than whether they have complied with legalistic requirements. This kind of auditing is of limited value except, perhaps, for insuring accountability because it does not promote the quality of the public sector in its fundamental objective of delivering services to the public. It does not guarantee that the public is getting value for the money spent by the public sector.

In recent years a movement to focus on performance and on output, rather than on formalities and on input, has started. This movement tries to assess public spending in terms of its economy, efficiency and effectiveness. It requires quantitative indicators of public performance and of the cost of public sector activities. It has had its strongest expression in New Zealand and Australia and, in some form, it is spreading to other countries.[24] It has brought with it many changes in contractual arrangements and in organizations in public institutions. For example, in the countries that have adopted it, tenure on civil service jobs has gone and many constraints on the actions of those who run departments have been removed. The government, as the principal, now makes contracts with a public agency on what it must deliver and the head of that agency becomes personally responsible for the outcome. If the agreed goals are not met, the contracts of the heads of the agencies are not renewed or their salaries are reduced. Thus strong economic incentives have been linked to performance. The final impact of this change on cultures different from those prevailing in New Zealand and Australia remains to be assessed.[25] For example, in societies where it is difficult to fire workers, almost regardless of their performance, it would be difficult to implement these changes. It is easy to see a conflict between this approach and the spirit of the Italian Constitution.

This discussion of enforcement mechanisms and controls would not be complete if two fundamental points were not made.[26] The first is the weakness of the cash accounting approach that has characterized the measurement of the operation of the government in providing support for good efficiency controls. The second is the developing field of measuring consumer reactions and preferences with respect to the services rendered by the public agencies. However, before discussing these two points, it is important to mention that any concept of quality of government services must be related to the cost of those services and the resources available to generate them. The higher are the resources available, the better one should expect the public services to be. However, given the level of resources available, the higher is the quality of the public sector, the higher will be the quality of the services.

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[24] While the Australian system initially focused on the outcome from public spending, the New Zealand system has always concentrated on measurable output. It should be clear that outputs and outcomes are not the same thing. Outcomes may be more difficult to measure and may be affected by public spending only with long lags. For example, educational spending may be assessed in terms of students in school (an output) or in terms of growth in human capital (an outcome). Health spending may be assessed in terms of operations performed or in terms of impact on the length and the quality of life.

[25] For a skeptical assessment of this change see Schick (1998).

[26] I am grateful to Barry Potter for calling my attention to these two points.

The first question, then, is how to measure the level of resources used. Traditionally, the fiscal accounts (and thus the budget) have relied on cash accounting or cash transactions. Thus, the cost of, say, agency X is measured by the cash transfer that agency X receives from the budget. However, cash transactions have many weaknesses now widely recognized by accountants and economists. The need for accrual accounting is now well established, at least, in principle, although many practical difficulties with its use are likely to delay for some time the transition from cash accounting.[27] Of course, accrual accounting measures much better the true costs of public sector activities. It would, thus, allow audits that are more meaningful in comparing outcomes to true costs. For example, cash accounting ignores the opportunity cost of using public sector assets if this use does not result in cash transfers. See Tanzi and Prakash (forthcoming). Thus, an activity that receives little cash transfers but uses very valuable land or buildings is now assessed to have low costs. This is obviously wrong.

The second question relates to the role of citizens, as taxpayers and consumers of public services, in evaluating the latter. Most of the reforms to date, particularly those agency-based reforms that pursue the split between principal (the government) and agent (the public agencies), represent actual or implicit contracts between two producer interests. A reasonable parallel from the private sector might be that between a regulator in the private sector and the monopoly industry that it regulates. The regulator is trying to represent the consumer in some sense: but his direct role is really concerned with the producers surplus (avoiding any super-normal profits) rather than consumer interests. What is missing in the Australia/New Zealand arrangements is the voice of the consumer. Unlike the private sector where the consumer can state his preference in a very obvious way (providing there is some adequate degree of competition within the market), this role is denied in public services. Some reforms in the 1990s have been directed at trying to find a surrogate measure for consumer preferences. There are perhaps three approaches that are worth mentioning.

- First, some evaluation work has deliberately sought to canvas the views of particular consumers, not so much in terms of an organized consumer survey, but as part of a wider exercise that tries to understand what, for example, parents make of the education that is given to their children. However, such exercises have tended to be very partial and confined to individual sectors.

- A second approach has been that of consumer surveys on a more organized basis that may cover a number of different services. The World Bank and individual countries have launched some initiatives in this area.[28] While an advance on the past, the limitations of the approach are also well understood. First, it is essentially opinion-related rather than measuring some actions or providing specific responses by the consumer to quality concerns. Second, it is subject to the usual problem that a well crafted survey can produce more positive views of public sector provision, than might be justified.

- These weaknesses in both evaluation and consumer survey-type approaches led the United Kingdom in the early 1990s to seek some third surrogate approach. From this emerged the "Citizens' Charter," which tried to involve the citizens' voice in the setting of standards. This has been done in a number of ways. Citizens' representatives or other consumer interests are involved in the setting of standards and performance contracts between government and agencies, rather than just the ministry of finance. Moreover, having set standards, consumers

[27] The Department of statistics of the IMF is in the process of producing a new manual of government finance statistics based on accrual accounting.

[28] For example, users of public hospitals have been asked to assess the quality of the services. Or taxpayers have been asked their opinions of the tax administrations.

are also given a right and the means to complain through the provision of telephone hot lines, etc. The consumer response is taken into account when assessing the overall performance of an agency manager. The compulsory use of name badges for officials so that consumers, through their response, can both reward good and punish bad service is a small but significant element. This is still another example of how incentives are slowly being introduced in the public sector. Most important, in certain cases, consumers are entitled to some form of compensation, if the public service provider fails to meet the required standard. The simplest example is that season ticket holders on particular rail services were entitled to refunds, if delays in the running of trains exceeded a certain minimum.

None of the approaches is wholly satisfactory. But the injection of a consumer voice in the setting of standards, in commenting upon the observations or otherwise of standards and, thus, in influencing the future allocation of public sector resources, is likely to be a major theme over the next few years. It is also likely that incentives and penalties will play an increasing role in promoting a higher quality public sector.

In addition to the internal controls and those performed by auditing institutions such as the GAO or the Court des Compts there are some other institutions whose working and efficiency are an essential ingredient in the quality of the public sector. Among these the system of justice is of the greatest importance. The role of the justice system in all its manifestations in enforcing contracts, in protecting property, in ensuring the safety of individuals, in keeping corruption under control, and in improving the efficiency of other institutions is fundamental. Thus, it is not an exaggeration to state that the quality of the public sector of a country and the functioning of its market depend significantly on the quality of its justice system. It is for this reason that the system of justice is receiving a lot of attention in many countries including European countries, such as, France, Italy, and Portugal, and the majority of Latin American countries.

In many countries the justice system has been in crisis in recent years. Individuals and property are not protected, contracts are not enforced, processes take years or even decades to be concluded, and so on. In many cases individuals who break the law are not punished, are punished lightly, or are not punished until much later when the deterrent effect of the punishment is lost. In some countries, the slow moving or even corrupt system of justice has provided an implicit incentive to tax evasion, to corruption and to other crimes because those caught committing these crimes could count on the inefficiency or the corruptibility of the justice system to escape punishment. In some countries it takes ten years for the government to determine whether someone accused of tax evasion ought to pay the unpaid taxes. And, often, the penalties imposed are insignificant. This is a good example of the cross-institutional externality mentioned earlier. The same may happen with those who do not live up with the terms of contracts. For example, the proliferation of bad loans and of financial crises is in part a direct consequence of the low and much delayed penalties on those who do not live up to their financial contracts.[29] In some countries apartments are left empty rather than being rented out because of the difficulty that the owners would have in reclaiming them when needed.

When justice is corrupt or inefficient, it becomes unjust because some people are more adroit at taking advantage of its weak points. The poor and the more law abiding citizens are the ones who end up paying the higher price and economic activity suffers. Equal access to justice, and to a justice that is administered in a timely fashion must remain one of the fundamental goals of the state. If this goal is not met the quality of the public sector will remain poor. See Guigou (1999).

[29] In many countries bankruptcy has become almost a trivial matter with little consequences.

V. Measuring the General Quality of the Public Sector

Although knowledgeable individuals have some a priori notions of the quality of the public sector of countries, it would be difficult or even impossible to get objective measures of that quality. In principle one could conduct surveys of perceptions of such quality using the same techniques adopted, for example, in the surveys of corruption. However, the informational requirements on the part of the respondents to give acceptable results would be extremely high; thus, the quality of the responses would be low. It might be easier to evaluate the quality of the major institutions that make up the public sector and somehow weigh their importance to the general quality of the public sector. However, given the number of such institutions and the knowledge required to assess them, such an enterprise would also be extraordinarily costly and not necessarily successful in achieving the desired results. An alternative way would simply measure the economic and social performance of a country. This alternative would focus on the output or better the outcome and attribute the results to the quality of the public sector. However, this approach would also have its limitations.

In recent years some institutions and some scholars have begun to focus on particular features that capture some significant aspects of the quality of public sectors. The IMF, for example has been focusing on data that countries could produce and make available to the public. Some of these data relate to the public sector. The assumption would be that countries that are willing and able to generate good public sector data, and are willing to make them available to the public, have a higher quality public sector.[30] The Fund has also started to assess the transparency of fiscal policy and fiscal institutions. This evaluation is done against a set of principles of fiscal transparency. The assumption is that lack of transparency is an indication of a lower quality of the public sector and that this lack of transparency promotes inefficiency, poor policies, and various problems of governance. In time there might be transparency reports for most countries. These would provide proxies for informal assessments of the quality of the public sector.

In recent years, there has been a lot of attention paid to issues of governance and corruption in public institutions. These issues also bear on the quality of the public sector. It has been recognized that lack of transparency in the way institutions operate promotes inefficiency and corruption. There is now a large literature on transparency and on corruption. Australia and New Zealand, have once again led the way in promoting techniques aimed at increasing transparency. The new "architecture" of the international financial system has recommended that countries become more transparent in their policymaking. More transparency would probably mean less corruption and generally a higher quality and better performing public sector. However, much needs to be learned about these relationships. It must also be recognized that tests of transparency may be superficial or deep. Superficial tests would not be very useful in understanding what is going on in a public sector and deep test may require a lot of highly specialized resources.

Corruption is a sign of a public sector's lower quality. Various groups have been generating corruption indexes for a large number of countries. See Tanzi (1998b). These indexes purport to measure "perceptions" of corruption. It is likely that to some extent, and assuming that the perceptions reflect reality, these indexes of corruption can also be taken as proxies for the quality of the public sector. However, caution is needed because, quite apart from the quality of the corruption indexes, a country could have a totally honest bureaucracy or even political leadership and very inefficient policies and institutions. While important, corruption is only one aspect of poor public sector quality.

Some authors, such as Rauch and Evans (forthcoming) have provided estimates of bureaucratic performance for many developing countries thus providing measures for yet another variable that has a

[30] The data themselves might tell more about the quality of public policy than the quality of the public sector.

bearing on the quality of the public sector. On the other hand, Keefer and Knack (1997), after defining institutional quality as "objective evaluations...of the institutions that protect property and contractual rights" attempt a measurement based on various indicators. It is questionable whether what they measure is the quality of public sector institutions.

There are other variables that may provide information on the quality of the public sector. Some would relate to its efficiency, some to the policies followed. For example, the relationship between spending in a given category--say health and education--and the outcome of that spending--such as lives saved, successful operations, reduction in the incidence of certain diseases, educational achievements--would be an indication of efficiency. See Gupta et al (1997). On the other hand, measurements of fiscal sustainability might be indications of poor policy rather than of poor quality of the public sector.

VI. Concluding Remarks

The quality of the public sector can be assessed only against the role of the state. If the public sector allows the state to promote its goals in an efficient and successful way, it can be argued that the public sector is of high quality. However, the goals must be realistic because even a very efficient public sector will be unable to cope with unrealistic goals. Thus, in general the quality of the public sector cannot be measured by the quality of the policy outcome although the two are obviously closely linked.

In general, an efficient public sector should be able to achieve the state's objectives with the minimum degree of distortion of the market, with the lowest burden of taxation on the taxpayers, with the smallest number of public employees and with the lowest absorption of economic resources by the public sector. The public sector must be transparent in its processes and in its outcome. Corruption should play no role in the decisions made by the bureaucrats and the political leaders. And the resources in the hand of the public sector should be put to a use that maximizes their social rate of return. Such a public sector would be clearly "market augmenting."

The equity aspects of the public sector are also important because the pursuit of equity, as distinguished from efficiency, is now one of the fundamental goals of the public sector. Given its impact on the use of resources and on growth, a public sector that, through all its aspects, promotes equity must be deemed to be of higher quality than one that doesn't. However, as argued earlier, it is difficult to determine the optimal role of the public sector in this area and it is easy to identify disincentive effects that may be created by some policies that redistribute income. See, for example, Alesina, et al (1999).

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SESION 1

¿ QUE DISEÑO DE MARCO REGULATORIO ES MAS ADECUADO PARA EVITAR EL SOBRE-ENDEUDAMIENTO SUBNACIONAL ?

RESPONSABILIDAD FISCAL A NIVEL SUBNACIONAL: ARGENTINA Y BRASIL *

George Kopits, Juan Pablo Jiménez y Alvaro Manoel
Fondo Monetario Internacional

Versión Preliminar

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Indice

La evolución en las finanzas públicas en Argentina y Brasil en las ultimas décadas se ha caracterizado por dos tendencias importantes. Por un lado, ambos países han sufrido recurrentes déficits fiscales en un contexto de desequilibrios macroeconómicos. Por el otro, como en muchos otros países con sistemas federales, tanto en Argentina como en Brasil se han observado presiones centrífugas hacia la descentralización fiscal[1]. La descentralización del gasto público no siempre estuvo acompañada por el consiguiente aumento de recursos a nivel subnacional, con lo cual las tendencias mencionadas se alimentaron mutuamente.

A principios de los años noventa en la Argentina, y hacia mediados de la década en el Brasil, se han lanzado iniciativas de ajuste en el sector público. Más recientemente, ante la necesidad de respaldar los programas de estabilización—en el marco de la Ley de Convertibilidad en Argentina y el Plan Real en Brasil—y con el fin de eludir el efecto contagioso de futuras crisis cambiarias (tipo Tequila) en mercados emergentes, ambos países decidieron adoptar reglas macro-fiscales de manera de alcanzar el necesario equilibrio fiscal. La legislación de responsabilidad fiscal o convertibilidad fiscal, que se lanzó este último año, brinda una oportunidad para promover la disciplina fiscal no solamente en el ámbito nacional, sino también a nivel subnacional. En efecto, la premisa de base de este estudio es que para que la responsabilidad fiscal se haga realidad, se la debe ejercer en todas las jurisdicciones donde tenga lugar la toma de decisiones de política fiscal, sea cual fuere el grado de descentralización.

Con estas consideraciones en mente, el presente trabajo propone explorar esquemas alternativos que puedan asegurar una conducta prudente de política fiscal por gobiernos subnacionales en estos países. En otras palabras, se trata de encontrar soluciones que sean eficaces y al mismo tiempo respondan a la realidad institucional de cada país, para resolver la problemática de las tendencias mencionadas. Con tal propósito, la primera sección de este trabajo consiste en una breve reseña de la experiencia internacional con instrumentos de responsabilidad fiscal bajo sistemas federales. En las secciones que siguen se examinan el desempeño fiscal y el proceso de endeudamiento público en las provincias argentinas y los estados brasileños durante los últimos años. Finalmente, con este telón de fondo, se evalúan diversos esquemas que emergen en estos países y futuras perspectivas para consolidar la disciplina fiscal a nivel subnacional.

I. Modelos de responsabilidad fiscal [2]

En principio, la responsabilidad fiscal es un concepto amplio que se puede aplicar por medio de reglas o de una política discrecional[3]. En la práctica, es un sinónimo de reglas fiscales, es decir, restricciones permanentes sobre el déficit fiscal, sobre el stock de deuda pública, o sobre algún otro indicador global de conducta fiscal. Por lo general, tales reglas—que se pueden implantar en diferentes grados de formalidad institucional—están acompañadas por criterios de transparencia y de un marco

[1] La tendencia hacia la autonomía subnacional se ha documentado en Tanzi (1995) y Ter-Minassian (1997a). Las presiones centrífugas más violentas se han manifestado en los países integrantes de la antigua Unión Soviética y la antigua Yugoslavia; véase Kopits y Mihajlek (1993).

[2] El término modelo se usa en este trabajo en el sentido genérico institucional; de ninguna manera se le atribuye un significado analítico como de modelo económico teórico o econométrico.

[3] La ley de Honestidad Presupuestaria de 1998 promulgada en Australia, con fuerte énfasis sobre transparencia por medio de informes frecuentes y confiables de performance e intenciones en las finanzas públicas, es un buen ejemplo de responsabilidad fiscal sin reglas. Pero el término se originó con la ley de Responsabilidad Fiscal de 1994 en Nueva Zelanda, que además de normas de transparencia establece reglas de política fiscal.

presupuestario plurianual consistente con previsiones macroeconómicas[4]. Es en este sentido que usamos el concepto en nuestra reseña.

Más allá de esta aclaración, un aspecto fundamental en la implementación de un programa de ajuste fiscal o de una regla fiscal tiene que ver con el nivel de gobierno que deba llevarlo a cabo. En un sistema unitario la responsabilidad obviamente se concentra en el gobierno nacional, por lo cual la política fiscal suele ser más eficaz, especialmente en lo que se refiere a la estabilización, que en un sistema descentralizado. En cambio, en un sistema federal la responsabilidad fiscal es difusa ya que reside a cada nivel de gobierno. De ahí que se necesite establecer un esquema para que la responsabilidad sea en efecto asumida por el gobierno nacional (federal, central) y a su vez por cada gobierno subnacional (provincial, estatal, local, municipal, etc.). En caso contrario puede que ocurra una falta de responsabilidad con externalidades sobre otros gobiernos que a la larga se refleja en un alza en el costo de financiamiento y un déficit mayor para el gobierno general.

Por lo general, en sistemas federales, la tendencia hacia la descentralización fiscal por intermedio de la devolución de funciones de gasto y de recursos tributarios a entes subnacionales ha sido acompañada por el establecimiento de límites o la prohibición al financiamiento de déficits de gobiernos subnacionales por parte del banco central y por fuentes extranjeras[5]. Pero más allá de estos límites se pueden identificar dos modelos básicos para promover la responsabilidad fiscal a nivel subnacional: el modelo autónomo y el modelo de coordinación.

En el *modelo de autonomía* el gobierno subnacional se impone a sí mismo una restricción al endeudamiento y/o al saldo presupuestario (Cuadro 1). El ejemplo quizá más conocido es el de EE.UU., donde ya antes de la Guerra Civil algunos estados habían introducido la llamada regla de oro (que requiere equilibrio entre los ingresos y gastos corrientes). Actualmente esta regla está en vigencia en casi todos los estados (con la excepción de Vermont) con diferentes grados de severidad[6]. A principios de los años noventa, en Canadá, varias provincias adoptaron diversas reglas que requieren un saldo presupuestario global equilibrado o limitan el déficit en proporción al nivel de ingresos, mientras otros siguen la regla de oro[7]. En Suiza, la mayoría de los cantones ha seguido de facto o de jure diferentes versiones de la regla de oro[8].

Además de su carácter completamente voluntario, estos esquemas tienen varios aspectos en común. Primero, las reglas fueron introducidas por gobiernos subnacionales que desean ganar credibilidad ante los mercados financieros; de hecho, en ninguno de estos países existe una regla macro-fiscal a nivel federal[9]. Segundo, las relaciones intergubernamentales (es decir, la distribución subnacional de recursos, transferencias, responsabilidad por gastos) generalmente están bien definidas y son estables. Tercero, las sanciones por no cumplimiento de estas reglas generalmente consisten en pérdida de prestigio político por parte de los gobernantes y su partido político y, más concretamente, por un aumento en el costo de interés del gobierno en el mercado financiero; con menor frecuencia, en algunas provincias canadienses, la falta de cumplimiento involucra la dimisión o la imposición de una multa al funcionario responsable.

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[4] Kopits y Symansky (1998) contiene un análisis detallado de reglas macro-fiscales. Véanse las reseñas en Kopits (1999a) desde el punto de vista argentino, y en Tavares, Manoel, Afonso y Nunes (1999) con una óptica brasileña.

[5] Véase Ter-Minassian y Craig (1997).

[6] Por ejemplo, mientras que en algunos estados la regla solo se debe observar ex ante, en otros la obligación es también ex post. También en algunos estados se han creado fondos de contingencia o se permite el traspaso de gastos no utilizados de un año a otro. Suits y Fisher (1985) describen abusos cometidos bajo esta regla en los estados de Michigan y Nueva York.

[7] Véase Millar (1997).

[8] Por ejemplo, Basilea, Friburgo y St. Gallen están obligados a cumplir ex ante y ex post con la regla, bajo una definición estricta de lo que constituye gasto de capital.

[9] En el caso de Suiza se acaba de votar en un referéndum una regla de equilibrio presupuestario a nivel federal, que todavía no ha entrado en vigencia.

Cuadro 1
Reglas fiscales a nivel subnacional

	Fecha de introducción	Restricción	Estatuto	Sanción por no cumplimiento
Modelo de autonomía				
Canadá	varios	equilibrio corriente	ley	judicial
Estados Unidos	varios	equilibrio corriente	constitución, ley	judicial
Suiza	varios	equilibrio corriente	ley	judicial
Modelo de coordinación				
Alemania	1949	equilibrio corriente	constitución	judicial
Australia	1927 1/	límite al endeudamiento	acuerdo informal	reputacional
Colombia	1997	límite al endeudamiento	ley	judicial
CFA (zona del franco)	1973	límite al crédito de banco central	tratado internacional	financiero
UE (bajo UEM)	1997	equilibrio global	tratado internacional	financiero

1/ Abandonado en 1992.

El *modelo de coordinación* entre los gobiernos subnacionales generalmente cae bajo la tutela del gobierno nacional, o supranacional en el caso de una unión cambiaria entre países. En Australia, desde los años veinte, guiados por el gobierno central, los estados estuvieron sujetos a un acuerdo informal ("gentlemen's agreement") sobre la asignación de límites de financiamiento del déficit subnacional. Con el tiempo este acuerdo se convirtió en un mecanismo más formal bajo la autoridad del Consejo de Préstamos, antes de ser abandonado por su ineficacia dada la evolución de varios canales de evasión por parte de los estados[10]. El caso de Alemania, donde en la constitución de posguerra se adoptó la regla de oro a nivel federal y en los Länder para asegurar la estabilización económica, pertenece al modelo de coordinación—a pesar de que a primera vista se asemeja al modelo autónomo[11]. Mas recientemente, en Colombia se estableció un límite al endeudamiento de gobiernos territoriales. Las entidades territoriales no pueden contraer nuevos créditos si su deuda supera 80% del ingreso corriente y sus pagos de interés superan 40% del superávit corriente[12]. Además en muchos países, como se ha mencionado, se le prohibe a los gobiernos subnacionales, al igual que al gobierno general, financiar su déficit con créditos del banco central.

[10] Véase la descripción del sistema en Scott (1983) y una evaluación crítica de su funcionamiento en Craig (1997).

[11] Spahn y Föttinger (1997) demuestran la falta de transparencia en la contabilidad y en el financiamiento de déficits en los Länder, no obstante la utilidad de la regla como instrumento de coordinación.

[12] Según la ley 358 de 1997, el incumplimiento de estas restricciones implica suspención de nuevo endeudamiento, salvo que la entidad territorial prescriba a un plan de aporte con el Ministerio de Hacienda; la Superintendencia de Bancos podrá imponer multas financieras a entidades que otorguen créditos a estos gobiernos. Pero estos incentivos y recursos no han sido suficientes para que todos los gobiernos subnacionales cumplan con la regla.

Otro ejemplo que también tiene características de coordinación es el de la Unión Europea, si se considera cada estado miembro como un gobierno subnacional que funciona dentro de una federación o confederación. En este caso, los valores de referencia del déficit global (límite de 3% del PBI) y la deuda pública (límite de 60% del PBI) se imponen en virtud del Tratado de Maastricht que estableció la Unión Económica y Monetaria (UEM). También bajo el tratado, los estados miembros del CFA zona franca están sujetos a un límite de endeudamiento con el banco central equivalente a 20% de sus ingresos tributarios—una restricción que incentiva la evasión.

A diferencia del modelo autónomo, el modelo de coordinación debe abarcar a todos los gobiernos subnacionales—no solamente aquellos que asumen la obligación unilateralmente. Adicionalmente, estas reglas uniformes se imponen desde arriba, habitualmente según un acuerdo entre los entes subnacionales y bajo la tutela nacional (o supranacional en el caso de la Unión Europea). Por consiguiente, existe una autoridad nacional (o supranacional) encargada de velar por el cumplimiento de la regla y autorizada a imponer sanciones (inclusive multas financieras) por no cumplimiento. Además, la experiencia comprueba que la credibilidad del modelo se apoya fielmente en la transparencia de las relaciones financieras entre la autoridad nacional y las autoridades subnacionales, y en los criterios de contabilidad. La falta de transparencia perjudica la eficacia de la regla. Aun así, en general, las reglas bajo el modelo de coordinación han sido menos eficaces, con excepción de la UEM que entró en vigencia hace poco.

Otra diferencia clave es que mientras en el modelo de coordinación la razón de ser de la regla fiscal es en parte la de reducir el riesgo moral que puede surgir por la existencia de una garantía de rescate ("bailout clause") implícita o explícita, en el modelo de autonomía los gobiernos subnacionales no tienen acceso al rescate financiero por parte del gobierno nacional en caso de insolvencia o incapacidad de pago. En otras palabras, en el modelo de coordinación, la regla sirve para evitar la externalidad negativa de la falta de disciplina fiscal de un gobierno subnacional altamente endeudado sobre el costo de financiamiento de otros gobiernos del mismo nivel pero menos endeudado dentro del mismo espacio económico[13].

Por consiguiente, desde el punto de vista de un país altamente endeudado con un sesgo al déficit presupuestario, se puede argüir a favor del modelo de coordinación. Volviendo a la premisa de base, en estas circunstancias, es difícil implementar un ajuste fiscal o mantener la prudencia fiscal a nivel nacional sin restricciones que se apliquen de manera uniforme y transparente por todos los gobiernos subnacionales.

II. Desempeño fiscal en las provincias argentinas

Los noventa han sido una década de significativos cambios en la economía argentina. Numerosas reformas estructurales sumadas a un contexto internacional favorable permitieron lograr un crecimiento sostenido, sin precedentes en las últimas décadas. Aun así, la situación fiscal no pudo dejar de lado la tendencia que la caracterizó en los últimos años; solo obtuvo superávit en el año 1994. En lo que se refiere a las provincias, la evolución de la situación fiscal ha sido extremadamente volátil en los últimos años (Cuadro 2). El déficit consolidado de las provincias subió desde un 0,7% del PBI en 1993 a 1,32% del PBI en 1995, para luego acercarse al equilibrio y volver a subir a 0,6% del PBI en 1998. Así pues, el año 1995 divide este período en dos subperiodos. Esta evolución de la situación fiscal provincial es producto de diferentes cambios que se produjeron en las finanzas provinciales durante estos años, entre los cuales

[13] Véanse los argumentos basados en la presencia o ausencia de cláusulas de rescate con referencia a la Unión Europea, en Eichengreen y von Haguen (1995) y McKinnon (1996).

sobresalen importantes modificaciones en la relación entre el gobierno central y las provincias. Por supuesto que este resultado global observa comportamientos diferenciados cuando se observa provincia por provincia[14].

El favorable contexto macroeconómico determinó un importante crecimiento de los recursos tributarios, ya sean de origen nacional (transferidos a las provincias vía el régimen de coparticipación de impuestos) como de origen provincial. Los recursos coparticipables observaron un fuerte aumento en esos años, no sólo por el importante aumento en el nivel de actividad sino también por cambios en la estructura impositiva[15]. Este fuerte crecimiento de los recursos a transferir resultó clave, permitiendo al gobierno central reformular los montos de transferencias hacia las provincias. Los fondos detraídos al sistema de coparticipación fueron canalizados fundamentalmente para financiar el creciente déficit del sistema de seguridad social[16]. Por el lado del gasto, a fines del año 1991 se dispuso la transferencia de los servicios educacionales[17]. Este proceso de descentralización (fortalecido por presiones políticas), que se realizó sin la correspondiente transferencia de recursos[18], explica en parte el crecimiento de los gastos de personal observados en las jurisdicciones provinciales.

La estabilidad de precios y el fuerte auge en actividad, en el periodo 1992-94, permitió al gobierno central reformular de manera significativa la relación financiera entre la administración central y las provincias y avanzar en el proceso de descentralización. Pero a principios de 1995 la crisis financiera impacta en forma abrupta sobre las finanzas provinciales. La crisis repercute en las cuentas provinciales de dos maneras: por un lado, la pérdida de depósitos en los bancos provinciales determinó la necesidad de

[14] La particular configuración del ordenamiento fiscal en Argentina, con una fuerte asimetría entre las responsabilidades de gasto y de recaudación tributaria, hace que los cambios en los recursos de origen nacional determinen en forma significativa la situación fiscal de las provincias. Para mas detalle acerca de las características del sistema federal argentino, inclusive un análisis en forma desagregada, véase Banco Mundial (1996).

[15] La nueva estructura se caracterizó por un fuerte aumento de las tasas del IVA y ganancias, en ese momento totalmente coparticipables, y una considerable pérdida de importancia de los recursos de comercio exterior, que no se transfieren a los niveles subnacionales. Adicionalmente las provincias recibieron recursos extraordinarios provenientes de la cancelación de obligaciones entre la Nación y las provincias (Ley 24133 y 24154) y el pago de deudas del gobierno federal por regalías hidrocarburíferas.

[16] Las transferencias a las provincias sufrieron sucesivas modificaciones desde 1991. Los cambios afectaron, principalmente el sistema de coparticipación regulado por la ley 23548 (BO: 26/1/88), configurando un esquema crecientemente complejo. Entre las modificaciones realizadas sobresalen aquellas que recayeron sobre el IVA y el impuesto a las ganancias (afectando una parte de lo producido a diversas asignaciones específicas), y los dos "pactos fiscales" que determinaron, en esencia, la afectación del 15% de la recaudación coparticipada al financiamiento del Sistema Nacional de Previsión Social.Estas modificaciones, además de cambiar la distribución efectiva de los recursos entre el gobierno central y las provincias, generaron distintas transferencias con asignación específica – hacia la finalidad Cultura y Educación en el caso de activos, hacia el sistema de seguridad social, el Fondo del Conurbano Bonaerense, las transferencias según el índice de Necesidades Básicas Insatisfechas (NBI) y el Fondo de Aportes del Tesoro Nacional en el caso del impuesto a las ganancias, hacia el sistema de seguridad social nacional y provincial en el caso del IVA- las cuales hicieron mucho más complejas las relaciones entre el gobierno central y los gobiernos provinciales. Para un análisis pormenorizado del tema, véase Cetrángolo y Jimenez (1995).

[17] Se descentralizaron aquellos que aun quedaban en manos del Ministerio de Cultura y Educación de la Nación (fundamentalmente secundarios) y el Consejo Nacional de Educación Técnica (CONET), algunos hospitales y programas sociales a los gobiernos provinciales y Municipalidad de la Ciudad de Buenos Aires Vale recordar que el proceso de descentralización de servicios sociales se había iniciado con la transferencia en 1978, cuando se transfirieron varios de los hospitales que aun dependían de la Nación según ley 21883 (BO: 2/11/78). En cuanto a servicios educacionales, léase Ley 24049 (BO: 7/1/92). Para más detalle sobre el proceso de descentralización véase Bisang y Cetrángolo (1997) y Carciofi, Cetrángolo y Larrañaga (1996).

[18] En el mensaje del Poder Ejecutivo Nacional que acompaño el proyecto de la Ley 24049 se justifica el proceso de descentralización afirmando que el mismo "ha tenido principio de ejecución a partir de la mayor dotación de recursos financieros que se originan como efecto de la ley 23548, por la que se dio un nuevo régimen de coparticipación federal y que significó un sacrificio en la participación del Gobierno Nacional". En realidad, la forma en que se financió esta transferencia consistió en la retención, por parte de la Secretaria de Hacienda de la Nación, de la participación de cada provincia en la distribución secundaria de los montos coparticipados de una suma equivalente al costo de esos servicios. A medida que las provincias se hicieron cargo de los servicios fueron recibiendo los montos allí establecidos.

un importante flujo de aportes desde los tesoros provinciales; por el otro lado, la caída en el nivel de actividad significó un menor ingreso por impuestos provinciales y por transferencias de origen nacional, vía el régimen de coparticipación. Ante esta situación, el gobierno central asumió un papel activo y utilizó las diversas herramientas con las que contaba para el rescate financiero de las provincias más golpeadas por la crisis[19], ya sea utilizando los Aportes del Tesoro Nacional, los anticipos de coparticipación, o los préstamos en títulos públicos.

Cuadro 2
Argentina: Ejecución presupuestaria consolidada de las provincias,1993-98
(en porcentaje del PBI)

	1993	1994	1995	1996	1997	1998
Ingresos	**10,8**	**10,6**	**10,4**	**10,7**	**11,1**	**11,4**
Tributarios	9,3	9,1	8,8	8,9	9,3	9,5
De origen provincial	3,7	3,8	3,6	3,6	3,7	3,9
De origen nacional	5,6	5,4	5,2	5,3	5,6	5,6
Ingresos corrientes	1,2	1,3	1,3	1,4	1,2	1,2
Ingresos de capital	0,3	0,2	0,3	0,4	0,6	0,4
Gastos	**11,5**	**11,5**	**11,6**	**11,1**	**11,2**	**11,8**
Gastos corrientes	9,9	9,7	9,8	9,4	9,4	10,0
Gastos de consumo	7,2	7,1	7,1	6,6	6,6	6,9
Pagos de interés	0,2	0,2	0,3	0,4	0,4	0,4
Transferencias corrientes	2,6	2,4	2,4	2,5	2,5	2,7
Gastos de capital	1,6	1,8	1,8	1,7	1,8	1,8
Saldo primario (-déficit)	**-0,5**	**-0,7**	**-0,9**	**-0,1**	**0,3**	**-0,3**
Saldo global (-déficit)	**-0,7**	**-0,9**	**-1,2**	**-0,4**	**-0,1**	**-0,7**

Fuente: Dirección Nacional de Coordinación Fiscal con las Provincias

En el plano fiscal, el gobierno central tomó diversas medidas de emergencia para enfrentar la crisis[20]. Estas medidas no fueron compartidas con las provincias, lo que permitió al gobierno central mejorar su posición fiscal relativa. El déficit fiscal en las provincias alcanzó su pico en la serie bajo análisis, y a diferencia de crisis anteriores, las condiciones de acceso al crédito bancario se tornaron particularmente difíciles para las provincias. Los gobiernos provinciales tuvieron que endeudarse a elevadas tasas y comprometer porcentajes crecientes de su coparticipación como garantía de los préstamos. La pérdida de depósitos de los bancos provinciales, producto de la crisis financiera, agravó la crisis fiscal de las provincias. Los gobiernos provinciales financiaron la banca oficial, en un primer momento para evitar su caída y, luego con el objetivo de capitalizarla para su privatización[21].

[19] Las provincias más afectadas fueron Río Negro, Mendoza y Córdoba; véase Banco Mundial (1996) y Damill (1997)

[20] Entre ellas una sobretasa al IVA del 3% y un aumento de los aranceles sobre el comercio exterior

[21] Producto de la crisis, durante ese periodo las provincias avanzaron a un ritmo mayor en el proceso de privatizaciones En los últimos años se produjo la privatización de catorce bancos provinciales (además uno licitado y cuatro en proceso de privatización), 14 empresas de energía eléctrica (adicionalmente 2 en proceso de privatización) y 7 empresas de agua potable (además 2 en proceso de privatización y 4 licitadas). Como resultado de este proceso puede observarse que salvo los bancos de

(continued...)

El proceso de ajuste realizado por las provincias se reflejó en una notable reducción del déficit en 1996. En ese sentido, las partidas que observaron un mayor ajuste fueron las transferencias a las empresas públicas provinciales (producto de las privatizaciones) y a los organismos de seguridad social[22]. Como efecto de estas medidas, el déficit provincial consolidado se redujo significativamente hasta 1997. Pero ya nuevamente en 1998 las provincias experimentaron un deterioro de la situación fiscal, producto de la acción combinada de un empeoramiento del contexto macroeconómico y de decisiones de gasto tomadas por las provincias. En efecto, el empeoramiento en la situación fiscal de las provincias se explica por causas de tipo endógeno y exógeno. Por el lado endógeno pueden nombrarse: la caducidad de las normas de emergencia que se aplicaron en 1995 y 1996 para superar la crisis; la implementación de políticas específicas, sobretodo en educación; y cierta laxitud en lo referente al control del gasto debido a la mejora en el acceso al mercado financiero. Mas tarde, como causa exógena puede señalarse la crisis financiera internacional a mediados de 1998 que produjo una caída en el nivel de actividad y consecuentemente en la recaudación tributaria.

En lo referente al endeudamiento provincial, en 1992 la reforma de la Carta Orgánica del Banco Central introduce dos modificaciones que tuvieron un fuerte impacto en la evolución de las deudas provinciales. Primero, el Banco Central no puede tomar ningún nuevo activo interno, lo que significa que las provincias no podían contar mas con el Banco Central para descontar préstamos de los bancos provinciales a los gobiernos nacionales. Segundo, se prohibe al Banco Central garantizar depósitos bancarios, con lo cual los bancos provinciales tienen que apoyarse en la confianza de los depositantes para mantener liquidez. Ambas medidas endurecen la restricción financiera de las provincias, limitando su habilidad para pedir prestado a los bancos oficiales.

A su vez, cambios en la situación de los mercados de crédito permitieron que las provincias tengan un acceso mas fluido a fuentes financieras internas y externas. Durante los inicios de la década este proceso se desenvolvió sin mayores inconvenientes. Pero como se observó antes, la crisis de 1995 tuvo un efecto significativo en las finanzas provinciales. La crisis significó una fuerte fuga de depósitos y el agravamiento de la situación de los bancos provinciales, lo cual se reflejó también en un notable aumento del endeudamiento provincial. La subida de las tasas de interés sumado al difícil acceso a los mercados financieros significó una pesada carga fiscal, motivando a la mayoría de las provincias a avanzar en un masivo proceso de privatización de bancos y empresas estatales[23]. Con el acceso al Banco Central cerrado por la reforma de la Carta Orgánica, las provincias tuvieron que utilizar sus propios recursos para recapitalizar los bancos, preparándolos para su privatización.

Como resultado de la crisis de 1995, el stock de la deuda del conjunto de provincias se incrementó significativamente, en 18% comparado al año anterior. Luego, durante el periodo 1996-99, el nivel de endeudamiento muestra pequeñas variaciones, aunque, analizado en forma individual, se observa que el comportamiento de las provincias no ha sido uniforme[24]. Algunas provincias se encuentran sumamente comprometidas cuando se compara su endeudamiento con sus ingresos (Cuadro 3). Se destaca en este grupo la delicada situación de Corrientes, Formosa y Río Negro con un stock de deuda que supera los

las provincias de Buenos Aires, Córdoba, La Pampa, Neuquen, Tierra del Fuego y el Gobierno de la Ciudad de Buenos Aires, los restantes bancos provinciales han sido privatizados o están en proceso de privatización.

[22] El Pacto Federal (Ley 24130) incluye una cláusula por la cual el gobierno central acepta el traspaso de los sistemas previsionales provinciales al Sistema Integrado de Jubilaciones y Pensiones. A fines de 1999 se habían transferido las cajas previsionales de Catamarca, Santiago del Estero, Ciudad de Buenos Aires, Salta, San Juan, Mendoza, La Rioja, Río Negro, Jujuy, Tucumán y San Luis. Este proceso significó para las provincias un importante ahorro fiscal, ya que los déficit de estas cajas fueron absorbidos por el gobierno central.

[23] En ese año se creó el Fondo Fiduciario para el Desarrollo Provincial (Decreto 266/95), que tuvo como objetivo ayudar a las provincias en este proceso.

[24] Para un análisis detallado de la evolución de la deuda provincial, ya sea en lo que se refiere a su nivel como su composición, véase Secretaría de Programación Económica y Regional (1999).

ingresos provinciales. Mientras tanto, en Buenos Aires, la Pampa, San Luis y Santa Cruz el endeudamiento no alcanza ni un quinto del nivel anual de ingresos.

Cuadro 3
Argentina: Deuda de las provincias, 1996-98
(en porcentaje de ingreso provincial)

	1996	1997	1998
Total	**47,9**	**40,8**	**44,1**
G.C.B.A.	78,1	77,6	67,8
Buenos Aires	36,9	11,8	14,1
Catamarca	65,4	62,2	69,2
Córdoba	40,6	39,8	35,8
Corrientes	95,6	96,7	116,7
Chaco	67,6	79,0	92,9
Chubut	55,1	63,3	75,2
Entre Ríos	43,1	39,6	44,5
Formosa	101,7	107,0	111,5
Jujuy	54,7	62,6	86,0
La Pampa	18,6	16,5	15,4
La Rioja	58,7	40,0	49,1
Mendoza	73,5	86,0	54,8
Misiones	67,4	79,1	83,8
Neuquen	21,2	18,4	28,6
Río Negro	78,1	101,2	123,1
Salta	55,7	58,6	57,2
San Juan	44,2	49,6	53,3
San Luis	12,4	11,2	10,6
Santa Cruz	9,2	4,1	18,2
Santa Fe	14,1	14,1	20,0
Santiago de Estero	42,6	39,1	38,9
Tucumán	78,1	83,1	85,0
Tierra del Fuego	18,1	36,8	32,1

Fuente: Dirección Nacional de Coordinación Fiscal con las Provincias

La evolución del endeudamiento obedece en gran parte a la reglamentación de los gobiernos provinciales. Algunas normas se encuentran en la órbita del gobierno central y otras en jurisdicción de las provincias. Por su lado, dentro del gobierno central la competencia sobre coordinación y control se divide entre diversas entidades: Banco Central, Ministerio de Economía, y Jefatura de Gabinete.

En este sentido, en el caso argentino se observa una idiosincrática forma de control del gobierno subnacional, en que se combinan los modelos de autonomía y de coordinación.

La Constitución Nacional otorga amplias facultades a las provincias para el financiamiento de fuentes extranjeras[25]. Dentro de este marco, el acceso de las provincias al uso del crédito se encuentra regulado por diferentes mecanismos. En la órbita provincial, en forma autónoma, las constituciones provinciales establecen límites al endeudamiento provincial, la autorización necesaria para hacer uso del crédito y la manera de utilización[26]. Estos límites no siempre han sido respetados por las jurisdicciones provinciales. En lo que se refiere a los créditos en moneda extranjera, estos caen bajo la tutela del gobierno central[27].

Las operaciones de crédito de las provincias o municipios generalmente resultan garantizadas mediante la cesión de los recursos que perciben diariamente las provincias de acuerdo con el Régimen de Coparticipación[28]. Este mecanismo produjo que en los últimos años la afectación de la Coparticipación Federal haya sido en promedio del 30%, destacándose los casos Corrientes, Formosa, Río Negro y Tucumán, que superan el 50% (Cuadro 4). Este tipo de afectación de los recursos a coparticipar, que para las entidades bancarias resulta un acceso privilegiado al colateral, distorsiona la necesaria evaluación crediticia. Este mecanismo incentiva a los bancos a prestar sin evaluar la situación de solvencia de los presupuestos provinciales. Por otro lado, al ser la transferencia afectada en el origen distorsiona el normal proceso presupuestario en cuanto a las decisiones de gasto.

Cuando se evalúa el proceso de endeudamiento de los subniveles provinciales y su relación con el gobierno central, deben mencionarse los mecanismos de financiamiento de emergencia con los que cuenta el gobierno central, los cuales impactan en la performance fiscal y en la evolución del endeudamiento[29]. La Constitución Nacional autoriza al Congreso otorgar subsidios para cubrir el déficit en las operaciones ordinarias de las provincias.[30]

Con este propósito, se estableció el Fondo de Aportes del Tesoro Nacional (ATN), financiado por el 1% del total a coparticipar[31], para ser distribuido por el Ministerio del Interior[32]. De acuerdo con una evaluación de las transferencias hechas por este Fondo en el período 1988-96 en relación a los principios

[25] El articulo 125 establece que entre las diversas atribuciones que tienen las provincias figura la posibilidad de importar capitales extranjeros. Mas detalladamente, el artículo 124 establece: "Las provincias podrán crear regiones para el desarrollo económico y social y establecer órganos con facultades para el cumplimiento de sus fines y podrán también celebrar convenios internacionales en tanto no sean incompatibles con la política exterior de la Nación y no afecten las facultades delegadas al Gobierno Federal o el crédito público de la Nación, con conocimiento del Congreso Nacional."

[26] En el Anexo 1 se resumen las exigencias incluidas en las Constituciones Provinciales de las 24 jurisdicciones para poder acceder al crédito público.

[27] Las provincias están sujetas a la "...supervisión, coordinación y aprobación del Ministerio de Economía y Obras y Servicios Públicos, respecto de todo acto, contrato, gestión o negociación de créditos por los que se originen obligaciones de pago en moneda extranjera" bajo la Resolución 1075 (BO: 23/9/93). La autoridad de aplicación en el Ministerio de Economía es la Secretaria de Programación Económica y Regional (Resolución 1090 (BO: 31/8/98)).

[28] Estas operaciones están sujetas a la autorización bajo la Resolución 1075. El Banco de la Nación Argentina funciona como agente de recaudación y retención de las transferencias tributarias.

[29] Existe numerosa bibliografía sobre la posibilidad de rescate de los gobiernos provinciales y su impacto en el comportamiento fiscal provincial; para el caso argentino, véase Nicolini, Posadas, Sanguinetti y Tommasi (1999).

[30] El Artículo 75, inciso 9 establece que corresponde al Congreso "acordar subsidios del Tesoro Nacional a las provincias cuyas rentas no alcancen, según sus presupuestos a cubrir sus gastos ordinarios" Para más detalle sobre el funcionamiento de los Aportes del Tesoro Nacional, véase Cetrángolo y Jiménez (1997).

[31] Este Fondo sufrió posteriormente algunas modificaciones: a partir del año 1992, de acuerdo al Decreto 879/92 (BO: 9/6/92), se incorporó al Fondo de ATN el 2% del impuesto a las ganancias; la Ley 24621 (BO: 9/1/96) dispuso que a partir de 1996, el Fondo sufre una detracción anual de 6 millones de pesos; de acuerdo con la Ley 24699 (27/9/96) el impuesto a las ganancias sufre una detracción (previa a su distribución) de 580 millones anuales, de estos, 20 millones se destinan al Fondo de ATN.

[32] De acuerdo con la Ley 23548 (BO: 26/1/88), el Fondo de ATN "...se destinará a atender situaciones de emergencia y desequilibrios financieros de los gobiernos provinciales y será previsto presupuestariamente en jurisdicción del Ministerio del Interior, quien será el encargado de su asignación."

expresados en la ley de creación de este Fondo[33], se ha constatado que las provincias favorecidas con mayor proporción de los ATN no son las que presentaban problemas fiscales más graves. Los desequilibrios fiscales parecen explicar poco acerca de las justificaciones utilizadas en la distribución de los ATN. En ese sentido, este mecanismo de financiamiento de emergencia no parece cumplir con el fin con que fue creado. Un avance importante ha sido el recorte en los recursos con lo que cuenta este fondo, por parte de las nuevas autoridades nacionales, poniéndole un límite a este mecanismo de rescate discrecional.

Cuadro 4
Argentina: Retención de ingresos provinciales provenientes de la Coparticipación Federal, 1998
(en porcentaje de ingreso por coparticipación)

	Afectaciones Bancarias	Total Afectaciones
Total	**17,3**	**27,9**
Buenos Aires	0,3	0,8
Catamarca	22,4	52,4
Córdoba	14,3	14,8
Corrientes	47,7	48,3
Chaco	19,6	20,1
Chubut	13,6	14,2
Entre Ríos	18,1	18,6
Formosa	24,0	24,6
Jujuy	40,3	71,2
La Pampa	1,4	2,0
La Rioja	41,6	77,1
Mendoza	6,8	44,9
Misiones	21,7	22,2
Neuquen	1,4	2,0
Río Negro	63,2	96,5
Salta	22,5	53,9
San Juan	3,4	33,1
San Luis	1,7	22,4
Santa Cruz	1,5	2,0
Santa Fe	1,8	2,4
Santiago del Estero	45,4	67,3
Tucumán	58,7	95,8
Tierra del Fuego	32,2	32,8

Fuente: Dirección Nacional de Coordinación Fiscal con las Provincias

[33] En Cetrángolo y Jiménez (1997) se encuentran diversas medidas para evaluar la situación fiscal de cada provincia. Ya sea considerando la proporción del déficit (antes de recibir ATN) cubierto en cada provincia por ATN; ya sea utilizando la relación porcentual entre el déficit y el gasto total en cada jurisdicción; ya sea considerando la relación entre el déficit y el total de recursos de la provincia restadas las transferencias del Fondo de ATN; en todos los casos, aquellas provincias favorecidas con mayor proporción de ATN no se corresponden con las que presentaban problemas fiscales más graves. Las cinco provincias con peor desempeño fiscal en el período 1988-96 son Chubut, Catamarca, Jujuy, San Juan y Formosa. En cambio las más favorecidas por los ATN durante ese período fueron La Rioja, Tucumán, Salta y Mendoza. La Rioja recibió, en promedio, en el período 1988-96, el 33.5% de estos recursos.

La falta de un mecanismo claro y transparente de distribución de recursos entre el gobierno central y las provincias ha influido en la evolución fiscal desfavorable de las provincias. Además, durante la ultima década, se desaprovechó un contexto macroeconómico en general sumamente favorable, que hubiese facilitado la discusión, diseño e implementación de un nuevo esquema de relaciones fiscales entre el nivel federal y las provincias. También faltaron medidas para incentivar y transparentar el funcionamiento de los mecanismos de acceso al crédito por parte de las jurisdicciones provinciales. La tarea pendiente en este sentido es introducir instrumentos que conduzcan a que los mercados financieros internalicen de manera adecuada el riesgo crediticio. Por supuesto que estas medidas deben ser acompañadas por políticas que incentiven un comportamiento fiscal responsable por parte de las propias provincias.

III. Desempeño fiscal en los estados brasileños

El sistema federal brasileño se ha desarrollado en ciclos claramente definidos, tanto de centralización como de descentralización. Desde 1987 se experimenta un ciclo claro de descentralización fiscal. En tanto la apertura política disminuía el poder del gobierno central, la Constitución de1988[34] acentuaba la tendencia hacia la desconcentración de los ingresos tributarios; ya en 1987 la porción federal correspondía a poco menos del 60% del total.

La crisis económica y la hiperinflación también pusieron de manifiesto la falta de adecuación del sistema tributario y abrieron un espacio político para introducir cambios sustanciales en el sistema federal. Probablemente el hecho de que la carga tributaria haya disminuido de 25% del PBI a principios de los años setenta a 20% a los fines de los ochenta promovió las propuestas con miras a la descentralización. Una de las consecuencias de esa descentralización fue un mayor peso de los gobiernos estatales sobre el déficit y sobre la deuda pública, lo que constituye el principal problema de la relación federativa actual.

Actualmente los estados y municipios recaudan directamente el 32% del total de impuestos que se cobran en el país y, tras efectuar las distribuciones constitucionales de los impuestos recaudados, pasan a disponer del 43% de la recaudación tributaria nacional. Esta división entre las esferas de gobierno se ha mantenido prácticamente estable desde el gran cambio acaecido en el periodo 1989-93[35]. Se destaca en este contexto el papel de las transferencias constitucionales de ingresos recaudados por el gobierno federal. En efecto, aproximadamente el 27% de los ingresos de la Unión se destinan a sufragar gastos de los estados y municipios[36].

La importancia de los gobiernos subnacionales en el gasto público también se pone de manifiesto en las principales categorías del gasto (Cuadro 5). El componente mas dinámico consiste en salarios (inclusive pensiones a los jubilados) pagados que fueron creciendo como proporción del PBI hasta alcanzar el 7,3% en 1998. Se verifica, en cambio, un estancamiento e incluso una reducción relativa de los gastos de capital.

[34]La Constitución de 1988 desconcentró significativamente el sistema: transfirió autoridad tributaria a los estados y municipios; les devolvió responsabilidades de gasto, aunque no bien definidas; consolidó la independencia del endeudamiento de los estados y municipios, quedando sujetos nominalmente a límites impuestos por el Senado; y posibilitó la ampliación del número de municipios.

[35]Los principales beneficiarios de la descentralización han sido los municipios cuando se consideran los recursos tributarios *disponibles* para el gasto público. También se registraron cambios en la división *horizontal* a lo largo del tiempo después de que fueron transferidos más recursos a las regiones más pobres. Véase al respecto Serra y Afonso (1999).

[36]Véase Mendes (1999). El análisis de las transferencias puede encontrarse además en Ter-Minassian (1997b).

Cuadro 5
Brasil: Ejecución presupuestaria de los estados y municipios, 1994-98
(en porcentaje del PBI)

	1994	1995	1996	1997	1998
Ingresos	**13,6**	**13,6**	**12,0**	**12,9**	**13,2**
Tributarios	8,5	9,0	9,3	9,2	9,3
ICMS (IVA)	6,8	7,2	7,5	7,4	7,5
Otros	1,7	1,8	1,8	1,8	1,8
No tributarios	1,7	1,4	0,5	0,5	0,5
Transferencias	3,4	3,2	3,3	3,3	3,5
Gastos	**14,5**	**15,9**	**14,9**	**15,1**	**15,0**
Gastos corrientes	12,9	13,5	13,4	13,4	13,6
Salarios Brutos	5,9	7,0	7,4	7,3	7,3
Materiales y suministros	2,3	2,1	2,3	2,2	2,3
Pagos de interés real 1/	1,4	2,1	1,3	1,5	1,6
Otros gastos corrientes	3,4	2,3	2,4	2,4	2,4
Gastos de capital	1,9	1,9	1,6	1,8	1,5
Efectos en cobro y ajustes	-0,3	0,6	--	--	--
Saldo primario (-déficit)	**0,5**	**-0,2**	**-0,6**	**-0,7**	**-0,2**
Saldo global operacional (-déficit)	**-1,0**	**-2,3**	**-1,9**	**-2,2**	**-1,8**
Saldo global nominal (-déficit)	**-19,0**	**-3,5**	**-2,7**	**-3,0**	**-2,0**

Fuente: Banco Central de Brasil y Ministerio de Hacienda.
1/ Los pagos de interés real líquidos representan pagos de interés sobre la deuda externa más el componente real de los pagos de interés sobre la deuda interna.

Como resultado, los gobiernos subnacionales contribuyeron de manera importante al déficit y a las necesidades de financiamiento del sector público. Se esperaba que la descentralización de la recaudación tributaria Xsobre todo del ingreso disponible que queda bajo el control de los gobiernos subnacionalesX ocurrida después de iniciada la década de los años noventa, diera lugar a un alivio de las cuentas públicas y se comenzara a producir un equilibrio, al menos, en esas esferas de gobierno. Lamentablemente, se ha constatado que los estados y municipios siguen teniendo un importante impacto negativo. Mientras que el gobierno central rindió, en cifras acumuladas, un superávit primario del 4,4% del PBI durante el periodo 1994-98, los estados y municipios produjeron un déficit primario acumulado del 1,2% del PBI (Cuadro 5).

El efecto de los desequilibrios fiscales, asociados a la ausencia de mecanismos efectivos para controlar el endeudamiento de los estados y municipios y la generación de déficit primarios y de operaciones en esos niveles de gobierno provocaron, a lo largo de los años, problemas con respecto al flujo y al monto de la deuda pública de los gobiernos subnacionales. Una consecuencia grave es que esa situación dio lugar a una serie de rescates y mecanismos de asistencia ad hoc de parte del gobierno central para los estados y municipios[37].

[37]Rangel (1999) y Mendes (1999) presentan los análisis más recientes de estos rescates y mecanismos de asistencia.

El desglose de la deuda pública de los estados y municipios brasileños[38] permite constatar en primer lugar el nivel reducido del componente externo, de menos de 5% del total. Ese resultado obedece a los efectos de las negociaciones de la deuda externa con los acreedores internacionales de principios de los años noventa y a la emisión de los bonos Brady y su concentración en el gobierno federal—deudor soberano de los títulos externos en función del esquema de renegociación utilizado. La porción mas importante, que supera el 80% del total, se debe al Tesoro Nacional, además de las obligaciones que también fue incluida en las renegociaciones[39]. El resto, de mas del 10%, corresponde a la deuda contraída con la red bancaria nacional (Cuadro 6).

El mayor aumento de la deuda pública de los estados tuvo lugar en los años setenta y ochenta, con los conocidos resultados problemáticos de los años noventa. Esta evolución se puede caracterizar por tres fenómenos: *internalización* mediante la sustitución de deuda externa frente a bancos internacionales, denominada en dólares, por deuda interna frente al Tesoro Nacional, en su mayor parte denominada en moneda nacional; *crecimiento acelerado* de la deuda en obligaciones, debido al deficiente control ejercido por el gobierno federal y por el Senado; y *federalización* debido a las varias asunciones, reescalonamientos y rescates realizados por el gobierno federal [40]. En las dos últimas décadas, la Unión negoció en condiciones favorables deudas de los estados, contraídas originalmente con el sector financiero público y privado (equivalentes a 34% del PBI), en tanto que las compensaciones y los pagos por privatización, redujeron significativamente el total[41].

En la comparación de gobiernos subnacionales se observa que, en general, los estados más ricos, pero con una tradición arraigada de endeudamiento público (especialmente en obligaciones emitidas recientemente) como São Paulo, Minas Gerais, Rio de Janeiro, Rio Grande do Sul, presentan niveles de endeudamiento que no llegan al 30% del PBI. Por otra parte, muchos de los estados más pobres, entre los cuales de encuentran Acre, Alagoas, Goiás, Maranhão, Mato Grosso, Roraima, alcanzan niveles por encima del 40% del PBI (Cuadro 6).

[38]La deuda pública brasileña, y en particular la de los estados, se desarrolló recién a partir de los años sesenta. La deuda de los estados aumentó bastante en los años setenta (deuda externa). Las Constituciones de 1967 y 1988 atribuyeron al Senado la fijación de límites globales al endeudamiento de los estados, y correspondía al Banco Central establecer normas para ponerlos en práctica. No obstante, siempre hubo resquicios en la legislación, lo que hizo que los órganos de control fiscalizaran básicamente la utilización de los recursos (la inversión, por ejemplo) y no el monto ni la sostenibilidad de la deuda. A partir de 1975 hubo algunas innovaciones en esos controles vinculándose la capacidad de pago a los ingresos líquidos de los estados (Resoluciones del Senado Federal 62/1975 y 93/1976. Véase a ese respecto Almeida (1996).

[39]Es importante destacar que del total de la deuda en obligaciones que figura en el Cuadro 6 (R$24.600 millones), casi la mitad de esa cantidad correspondía a la deuda del estado de Rio de Janeiro (R$11.300 millones), cuyo contrato de renegociación con el gobierno federal quedó formalizado a fin de 1999. Por lo tanto, en los datos que serán proporcionados en el año 2000, seguramente ese monto de deuda en obligaciones deberá trasladarse a la columna "Deuda contractual frente al Tesoro Nacional". Por otro lado, la otra mitad aproximada de la deuda en obligaciones (R$10.400 millones) de São Paulo no corresponde a la deuda del estado sino a la del municipio de São Paulo y probablemente será renegociada con el gobierno federal en el programa de reprogramación de la deuda existente.

[40]Véase Almeida (1996).

[41] Véase Mendes (1999).

Cuadro 6
Brasil: Deuda consolidada de los estados y municipios, septiembre de 1999
(en porcentaje del PBI estatal)

	Deuda en Obligaciones 1/	Deuda Contractual Interna			Deuda Externa 3/	Deuda Total
		Tesoro Nacional	Bancaria	Otras 2/ 3/		
Total	**2,5**	**17,1**	**2,8**	**0,5**	**1,1**	**24,0**
Acre	-	41,6	2,3	4,6	-	48,5
Alagoas	12,1	28,9	1,7	1,7	0,5	44,9
Amapá	-	1,9	5,7	-	0,4	8,1
Amazonas	-	12,7	0,2	0,0	0,0	12,9
Bahia	-	16,5	3,1	0,2	1,9	21,7
Ceará	-	14,8	3,0	0,0	4,4	22,2
Distrito Federal	-	0,0	5,5	0,0	0,7	6,3
Espírito Santo	-	9,0	2,0	1,1	1,5	13,6
Goiás	-	40,7	1,9	3,8	0,3	46,7
Maranhão	-	45,6	1,5	0,6	0,1	47,8
Mato Grosso	-	38,9	1,0	1,2	1,0	42,1
Mato Grosso do Sul	-	29,0	1,9	0,1	0,4	31,3
Minas Gerais	-	21,8	1,0	1,0	1,3	25,1
Pará	-	8,3	0,7	0,1	1,2	10,4
Paraíba	-	25,4	1,8	0,9	0,3	28,4
Paraná	-	9,1	3,0	0,9	2,3	15,3
Pernambuco	3,1	12,9	1,2	0,4	0,9	18,6
Piauí	-	29,7	11,4	0,1	0,9	42,1
Rio de Janeiro	10,3	6,0	11,5	0,1	1,4	29,3
Rio Grande do Norte	-	12,3	2,9	0,4	0,2	15,9
Rio Grande do Sul	0,1	19,5	0,8	0,8	0,9	21,9
Rondônia	-	19,3	5,4	4,9	-	29,6
Roraima	-	16,2	27,3	1,0	-	44,5
Santa Catarina	3,4	9,2	1,2	1,3	1,1	16,2
São Paulo	3,0	20,1	1,4	0,0	0,7	25,2
Sergipe	-	20,9	2,4	0,5	1,7	25,5
Tocantins	-	5,0	6,7	0,1	13,9	25,7

Fuentes: BACEN/DEDIP, BACEN/DEMAB, CETIP, IBGE, gobiernos estatales del Distrito Federal y de los municipios capitalinos. El valor del PBI (diciembre de 1997) se ha recalculado a septiembre de 1999.
1/ No incluye los pagarés que no están bajo custodia de CETIP, ni las obligaciones de empresas estatales registradas en Bovespa.
2/ Incluye las deudas frente a INSS, FGTS, PASEP y otras entidades.
3/ Proyección con base en los últimos datos de los que disponen los estados, el Distrito Federal y los municipios capitalinos. No incluye deudas de administración indirecta (todos los niveles) ni de administración directa de los municipios no capitalinos.

Si se compara la deuda en proporción de los ingresos líquidos de los estados Xla suma de recursos tributarios mas transferencias constitucionales que quedan a disponibilidad de los estadosX, ciertamente un indicador apropiado para determinar la responsabilidad y la sostenibilidad fiscal, es evidente una vez mas el alto porcentaje registrado por los estados con una tradición arraigada de endeudamiento, pese a que son los de economías más ricas. En este sentido, se destacan São Paulo, Minas Gerais, Rio de Janeiro y Rio Grande do Sul, con un nivel superior a 320% de su ingreso liquido, muy por encima de la una media del 274% para el conjunto de los estados (Cuadro 7). Aunque no del todo comparable, es interesante observar que el valor de este indicador en los estados brasileños es muy superior al valor medio de 44% en las provincias argentinas (Cuadro 3).

Cuadro 7
Brasil: Deuda consolidada de los estados, septiembre de 1999
(en porcentaje del ingreso estatal líquido real) 4/

	Deuda en Obligaciones 1/	Deuda Contractual Interna			Deuda Externa 3/	Deuda Total
		Tesoro Nacional	Bancaria	Otras 2/ 3/		
Total	**19,9**	**208,2**	**27,0**	**5,8**	**13,0**	**273,9**
Acre	-	129,1	6,7	14,7	-	150,5
Alagoas	96,9	221,4	2,8	9,8	4,4	335,3
Amapá	-	6,7	15,7	-	1,4	23,8
Amazonas	-	152,7	2,0	0,1	0,0	154,9
Bahia	-	177,9	27,1	1,7	22,8	229,6
Ceará	-	125,6	21,8	0,4	38,2	186,0
Distrito Federal	-	0,1	30,3	0,1	4,1	34,5
Espírito Santo	-	100,3	17,7	11,5	17,3	146,8
Goiás	-	440,1	17,5	40,9	3,4	502,0
Maranhão	-	287,7	6,0	2,7	0,9	297,2
Mato Grosso	-	297,6	4,4	8,8	7,9	318,6
Mato Grosso do Sul	-	365,9	20,5	-	4,9	391,3
Minas Gerais	-	308,3	4,7	15,0	18,5	346,4
Pará	-	70,0	3,8	1,1	10,4	85,3
Paraíba	-	163,2	6,5	4,5	1,6	175,9
Paraná	-	126,5	14,3	13,0	29,8	183,5
Pernambuco	36,9	143,5	11,3	3,9	11,0	206,6
Piauí	-	176,2	61,5	0,6	5,1	243,4
Rio de Janeiro	184,3	47,8	195,1	1,3	16,8	445,2
Rio Grande do Norte	-	71,6	13,8	2,4	1,4	89,2
Rio Grande do Sul	1,2	311,8	7,5	12,4	13,8	346,7
Rondônia	-	119,1	33,6	31,1	-	183,8
Roraima	-	30,3	48,7	1,9	-	80,8
Santa Catarina	61,7	169,3	13,8	23,9	20,4	289,0
São Paulo	3,8	298,5	6,6	0,1	8,8	317,8
Sergipe	-	141,8	16,1	-	12,2	170,1
Tocantins	-	15,1	17,1	-	41,6	73,8

Fuentes: BACEN/DEDIP, BACEN/DEMAB, CETIP, gobiernos estatales del Distrito Federal y de los municipios capitalinos.
1/ No incluye los pagarés que no están bajo custodia de CETIP ni las obligaciones de empresas estatales registradas en Bovespa.
2/ Incluye las deudas frente a INSS, FGTS, PASEP y otras entidades.
3/ Proyección con base en los últimos datos de los que disponen los estados, el Distrito Federal y los municipios capitalinos. No incluye deudas de administración indirecta (todos los niveles) ni de administración directa de los municipios no capitalinos.
4/ Ingreso líquido real (Orden No. 491 de STN/MF, del 29-II-99) anualizado, que incluyen el ingreso tributario propio más las transferencias gubernamentales.

La evolución del sistema federal brasileño en la última década se ha caracterizado por una serie de déficits y un alto endeudamiento público a nivel subnacional, que fue aliviado por numerosos rescates por parte del gobierno federal. Esta situación que aún subsiste emana de tres causas especificas[42]. Primero, los estados y municipios tienen un gran peso dentro del sector público en lo que se refiere a los ingresos, gastos y la deuda pública, en función de descentralización fiscal; al mismo tiempo existe una asimetría en la distribución de los derechos y deberes entre los tres niveles de gobierno, con un sesgo a favor los gobiernos subnacionales, en cuanto la división de responsabilidades de gasto no están bien definidas. Segundo, los bancos estatales financiaban a los estados, y algunos todavía mantienen el potencial de financiamiento[43]. Tercero, los gobernadores tienen una fuerte influencia política en el Senado, que por mandato constitucional debería controlar el endeudamiento de los estados y municipios. Como regla general, el Senado siempre aprobó incrementos a los límites de endeudamiento—por lo menos mediante la capitalización de intereses—de los estados y municipios[44].

Una consecuencia negativa de este cuadro institucional ha sido la enorme dificultad de realizar ajustes fiscales en los niveles inferiores de gobierno, necesarios para la estabilización macroeconómica, recurriendo en vez el aumento de la deuda pública y a repetidas operaciones de rescate y otorgase asistencia a los gobiernos subnacionales a fin de hacer viables la continuidad y el funcionamiento del sector público. Se presentaron también otros impedimentos importantes al ajuste fiscal que también emanan de la reciente evolución del sistema federal brasileño reciente. En primer lugar, hubo una interferencia de los estados en el comercio exterior (variable típica de control nacional) mediante la tributación de las exportaciones de productos primarios y semielaborados por medio del ICMS (Impuesto a la Circulación de Mercancías y Servicios). Esta cuestión fue resuelta mediante el compromiso del gobierno federal de compensar posibles pérdidas líquidas de recaudación de ese impuesto por parte de los estados. Pese al acuerdo logrado y a las compensaciones realizadas por el gobierno federal, a éste se le acusa repetidamente de disminuir los ingresos de los estados en función de esta medida tributaria que tiene un gran impacto sobre el comercio internacional y sobre la eficiencia del sistema productivo[45].

En segundo lugar, la estructura tributaria provocó asimismo una guerra entre los estados mediante la manipulación de las alícuotas del ICMS y la concesión de beneficios ocultos tras empréstitos subsidiados e inclusive participaciones de capital en acciones de empresas privadas. A raíz de la guerra tributaria, ha disminuido el ingreso tributario estatal disponible lo cual termina por involucrar al gobierno federal, ya sea desempeñando su función de intermediario entre los estados o bien compasando algunos gobiernos subnacionales afectados.

En tercer lugar, dada la magnitud de la devolución de la autoridad tributaria a los estados y municipios bajo mandato constitucional, la Unión se vio obligada a dejar de hacer uso de los impuestos tradicionales para el ajuste fiscal, induciendo de esa manera la creación de nuevos impuestos, como por

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[42] Véase el análisis más detallado que presentan Serra y Afonso (1999).

[43] Pese al significativo reordenamiento del sistema financiero de los estados que tuvo lugar en los últimos años con el cierre de un gran número de bancos y la transformación de varias instituciones financieras estatales en simples agencias de desarrollo (sin derecho a la captación de recursos frente al público), siguen sobrando algunos bancos de algunos estados importantes (São Paulo, con el Nossa Caixa Nosso Banco) que pueden, en ciertas situaciones políticas de debilitamiento del gobierno federal, volver a realizar operaciones bancarias en favor de su accionista mayoritario.

[44] En el futuro los estados podrían tener derecho a emitir obligaciones provocando la desestabilización del mercado de títulos de deuda pública, aun si en los recientes contratos de renegociación los estados se han comprometido a no emitir deuda en obligaciones durante un cierto período. Esta regla se vuelve más plausible cuando así lo determina una ley superior o una resolución del Senado, ya que este ultimo tiene la prerrogativa de aprobar, en ciertas circunstancias, el incremento de los límites del endeudamiento público.

[45] El problema se resolvió con la Ley Complementaria 87 de 1996. Nótese que el sistema de compensación delineado y aprobado abre la posibilidad de revisiones en función de las opciones existentes y lleva, inexorablemente, a incrementos en los montos retransferidos a los estados.

ejemplo la contribución social sobre las utilidades de las empresas y el impuesto sobre las transacciones financieras. Se trata, en realidad, de impuestos en cascada, de baja eficiencia económica, pero el gobierno federal ha basado en ellos el aumento de su recaudación tributaria dado que, en función del esquema de transferencias, cualquier aumento en los impuestos más eficientes (impuesto sobre la renta de las personas jurídicas y físicas, impuesto sobre los productos industrializados) están preasignados automáticamente a los estados y municipios los cuales, a su vez, no sienten compromiso alguno con el ajuste fiscal a nivel nacional.

Cabe destacar otras dos consecuencias negativas de la estructura actual de transferencia de impuestos de la Unión a los estados y municipios. Por un lado, este mecanismo termina por desincentivar el esfuerzo local de tributación de fuentes propias, sobre todo en lo que respecta a los municipios[46]. Por otro lado, los significativos aumentos de las transferencias de ingresos a los estados y municipios a partir de la Constitución de 1988 han tenido un efecto multiplicador de los gastos de los gobiernos subnacionales sin mejoras en su desempeño fiscal—es decir, reducción del déficit y de la deuda a niveles prudentes. Además, podría aducirse que los gobiernos subnacionales maximizan el gasto debido a que parte de su cobertura queda o quedará a cargo del gobierno federal[47].

Por último, cabe señalar el riesgo moral como consecuencia del papel financiero desempeñado por el gobierno central hacia los estados y municipios—además del mecanismo normal de transferencia de recursos vía el presupuesto federal, con una mayor concentración en las regiones más pobres—mediante operaciones sucesivas de rescate y renegociación de las deudas de los estados y municipios, y de rescates de los bancos estatales con activos incobrables frente a los gobiernos estatales, especialmente a través del Banco Central. Es decir, el procedimiento repetitivo de transferencia constitucional y no constitucional de recursos tributarios, vinculados a asistencia en la intermediación entre los estados, así como la implementación de programas de rescate de deudas de los gobiernos subnacionales y de sus instituciones financieras, han fomentado un comportamiento fiscal deficiente a nivel subnacional[48].

Es evidente, por lo tanto, la necesidad de mejoras sustanciales en la imposición de responsabilidad fiscal, ya sea con respecto al control de gastos, al esfuerzo de recaudación de fuentes propias, y a la limitación del déficit, como del endeudamiento al nivel de estados y municipios. Puede ser criticable el hecho de que hasta la fecha no se hayan dado pasos hacia estas mejoras en tanto que los gobiernos subnacionales han tenido un amplio espacio de maniobra con respecto a sus operaciones de crédito y, al mismo tiempo, el gobierno federal ha sido susceptible a las presiones políticas para implementar programas de rescate y asistencia a los gobiernos subnacionales[49].

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[46]Pese a que la Constitución de 1988 definió claramente los impuestos a nivel municipal (impuesto sobre los bienes inmuebles, impuesto sobre los servicios, tasas de servicios públicos, etc.) no hay grandes incentivos para aumentar y ni siquiera para aplicar estos tributos (en los casos en que no existan). En general, los municipios más pobres del nordeste, por el hecho de que reciben un gran volumen de recursos a través del gobierno federal, tienden a disminuir sus esfuerzos de recaudar impuestos locales. Lo mismo ocurre, por ejemplo, con los municipios más ricos de São Paulo, que reciben cuantiosas transferencias estatales por su porción alícuota del ICMS.

[47]Werneck (1995) y Rangel (1999) proponen esta explicación.

[48]Rangel (1999) trata esta hipótesis formalmente para el caso brasileño.

[49]Véase Rangel (1999, cap. II) al respecto.

IV. Perspectivas para el futuro

Una manera de resumir la evaluación del desempeño del sector público a nivel subnacional en Argentina y Brasil es con un *fuerte sesgo al desequilibrio vertical*, que se puede atribuir en general al proceso de descentralización y al mecanismo de relaciones intergubernamentales. La devolución de funciones de gasto en las últimas décadas ha sido algo ambigua—aunque siguiendo más o menos el principio de subsidiariedad—[50] y no siempre fue acompañada de suficientes incentivos a la recaudación de ingresos tributarios al nivel subnacional. De ahí que los gobiernos subnacionales en lo posible hayan tratado de interpretar de manera limitada su responsabilidad de gasto, hayan otorgado diversas exenciones tributarias —que en el caso brasileño se degeneraron en guerras tributarias entre algunos estados —y se hayan apoyado en la coparticipación de ingresos y transferencias financieras del gobierno central. Todo esto ha conllevado a que, en varias ocasiones, las autoridades federales se hayan visto obligadas a rescatar de manera ad hoc—mediante medidas mas sutiles y menos voluminosos en la Argentina— provinciales o estatales. En resumen, este comportamiento ha contribuido directa o indirectamente a los déficits y al endeudamiento del sector público.

Para remediar esta situación, ambos países han emprendido programas globales de ajuste fiscal con un horizonte a mediano plazo. Dentro del marco de este esfuerzo, el reordenamiento del mecanismo de reparto de los ingresos tributarios entre varios niveles de gobierno, en combinación con una reforma del sistema tributario indirecto, ocupa un rol central. Al respecto, en Argentina, la aprobación de la pendiente ley de coparticipación nacional resultaría en una excelente posibilidad para hacer más transparente, sólida y permanente las relaciones fiscales entre el gobierno central y las provincias. Pero quizá el paso mas importante hacia la responsabilidad fiscal es la legislación inminente sobre reglas fiscales a todos los niveles de gobierno en Brasil y la reciente promulgación de reglas al nivel federal en Argentina.

Con los antecedentes de rescate financiero por el gobierno central, falta de incentivos para la recaudación de impuestos y renuencia al control de gasto a nivel subnacional, la experiencia internacional provee una lección clara para ambos países. Esencialmente, tomando en cuenta el peligro del desequilibrio macroeconómico que enfrentan, no obstante el obvio atractivo del modelo autónomo en una genuina estructura federal, el modelo de coordinación parece ser más apropiado para asegurar los beneficios del ajuste fiscal[51].

En Brasil, el proyecto de Ley de Responsabilidad Fiscal que se está debatiendo en el Congreso representa un reconocimiento de esta lección en cuanto reúne ciertas características de los enfoques australiano y alemán. Además de procurar asegurar la adopción de la regla de oro a cada nivel de gobierno (en vigencia comenzando en el año 2001)[52], la Ley incorpora metas para la deuda pública en proporción a los ingresos propios más transferencias constitucionales. Esta meta se deberá fijar para cada nivel de gobierno—bajo la recomendación del Presidente y autorización del Senado—en base del ratio

[50] En la UE este criterio directriz significa que aquellas funciones (educación primaria y secundaria, servicios básicos de atención médica, servicios públicos, etc.) que se pueden desempeñar más eficazmente a nivel subnacional, se deban ejercer a ese nivel, dejando un mínimo de funciones (defensa, relaciones exteriores, etc.) al gobierno nacional.

[51] CEPAL (1998, p. 221) parece estar de acuerdo con este punto de vista, con énfasis en el papel de la coordinación política mas allá de los aspectos técnicos.

[52] La regla de oro, aunque presente en la Constitución, nunca fue reglamentado y por lo tanto no se ha usado para contener el endeudamiento publico. El proyecto de Ley de Responsabilidad Fiscal que fue enviado al Congreso contiene la reglamentación necesaria la aplicación de la regla.

consolidado a ese nivel de gobierno[53]. En relación a las principales categorías de gasto, la Ley también impone límites sobre salarios y pensiones a servidores públicos (la mayor categoría en los gastos corrientes). Además, la Ley exige equilibrio financiero y actuarial en los regímenes de seguro social (ya con cuentas separadas de los respectivos tesoros estatales) y de que nuevos beneficios solo podrán ser aprobados previo un aumento equivalente de ingresos o corte equivalente de gastos.

Un aspecto crucial de la Ley es la prohibición estricta de nuevas renegociaciones (inclusive refinanciamiento o postergación) de deudas de gobiernos estatales por parte del gobierno federal. Además, la Ley da lugar a la utilización de transferencias voluntarias como instrumentos importantes da responsabilidad fiscal, y asimismo exige cumplimiento con los límites al endeudamiento y a los gastos de personal para la realización de tales transferencias.

Otras dos innovaciones de procedimiento presupuestario que también afectan a los gobiernos subacionales en Brasil merecen ser mencionadas. Por un lado, la introducción de un mecanismo de compensación presupuestaria en caso de renuncia de ingresos tributarios y en caso de creación de gastos con carácter continuado, para evitar gastos de larga duración sin recursos para financiarlos que pueden poner en peligro la sostenibilidad fiscal. Por otro lado, la introducción de cortes automáticos bimensuales si son necesarias durante la ejecución del presupuesto para el cumplimiento de metas aprobadas para el año.

En Argentina, en cambio, la Ley 25125, de Administración de los Recursos Públicos (también conocida como Ley de Convertibilidad Fiscal), aprobada en setiembre de 1999, sigue esencialmente el modelo autónomo, en concordancia con las características institucionales del país. Mientras que establece una regla de saldo presupuestario equilibrado a nivel federal (con vigencia desde 2003), la Ley solamente propone invitar a los gobiernos provinciales a adoptar una regla similar[54]. Bajo la necesidad de un ajuste fiscal global, inclusive a nivel provincial, en los últimos meses se han lanzado iniciativas que se aproximan al modelo de coordinación. En efecto, en el Compromiso Federal (firmado a fines de 1999 por los gobernadores de las provincias) se expresa la intención de tomar medidas legislativas a nivel subnacional con el fin de adoptar reglas similares a las que contiene la Ley de Convertibilidad Fiscal[55]. En las provincias de Salta, San Luis y Tucumán ya hay leyes vigentes que cumplen con el Compromiso[56].

Aunque el enfoque argentino está menos definido en el trato de gobiernos subnacionales, quedan numerosos interrogantes también en la implementación de la Ley de Responsabilidad Fiscal en Brasil. En especial, esta ley impone un desafío a la capacidad de gestión de los estados y los municipios brasileños no solamente en los aspectos operacionales de las reglas sino también en cuanto al diseño y ejecución de reformas—sobre todo en cuanto al sistema de pensiones para empleados públicos y al mecanismo de impuestos indirectos—que son indispensables para su cumplimiento. Sin embargo, las provincias

[53] Es decir, si el ratio de la deuda de un determinado estado se encuentra por encima del ratio fijado para todos los estados, entonces este estado debe apuntar a un superávit primario que permita reducir su deuda a ese nivel. En cambio, si su ratio está por debajo del ratio que se ha designado como meta para todos los estados, entonces debe seguir simplemente la regla de oro. Lamentablemente, existe el riesgo de que este mecanismo en el proyecto de ley original se modifique en la versión del Relator en la Cámara de Diputados permitiendo que el ratio de la deuda fijado como meta podría ser alteradas durante el ejercicio.

[54] Según la Ley 25125, "El Poder Ejecutivo nacional invitará a los gobiernos provinciales y al Gobierno Autónomo de la Ciudad de Buenos Aires al dictado de normas legales en concordancia con lo dispuesto en la presente ley" (Art. 10).

[55] El Compromiso Federal (Art. 5) establece que "las provincias y el Gobierno de la Ciudad Autónoma de Buenos Aires se comprometen a impulsar en sus respectivas jurisdicciones, durante el año 2000, el dictado de una legislación que de acuerdo a sus propias normas constitucionales adopte principios o parámetros similares a los establecidos para la Nación por la ley 25152 de Administración de los Recursos Públicos o Solvencia Fiscal, con el objeto de disminuir el déficit fiscal, contener el gasto público y asegurar la transparencia fiscal."

[56] Véase Anexo 2. En el mes de enero de 2000 se aprobaron leyes de este tipo en Catamarca y Formosa, que no se pudieron incluir en el anexo.

argentinas enfrentan un desafío aun más fundamental: el diseño de reglas con suficiente flexibilidad institucional como para que mantengan el grado deseado de autonomía y que al mismo tiempo ofrezcan de manera uniforme suficientes incentivos para el ejercicio de disciplina fiscal.

En la Argentina queda pendiente el diseño de las reglas fiscales por parte de los gobiernos provinciales (que según el Compromiso Federal debería llevarse a cabo en el transcurso del año) y su posterior cumplimiento. Algo que será necesario comprobar en la práctica también en Brasil. Al respecto, dada la magnitud de ambos países y la diversidad regional de su estructura económica, sería conveniente diseñar un mecanismo automático de compensación o suspensión de las reglas para amortiguar el efecto de choques exógenos asimétricos a nivel subnacional. El Pacto de Estabilización y Crecimiento, bajo la UEM en la Unión Europea, ofrece un ejemplo de limitada utilidad para los casos argentino y brasileño[57].

En el futuro más lejano, también será necesario modificar las reglas fiscales en el contexto de una política macroeconómica coordinada dentro del Mercosur—un tema que últimamente ha recibido creciente atención de parte de las autoridades en ambos países—quizá siguiendo los criterios de la UEM. Idealmente, esto requiere unificación de la política monetaria e introducción de reglas fiscales uniformes en todos los países miembros del Mercosur a todos niveles de gobierno[58], dentro de un espacio económico integrado. A su vez, este último involucraría la armonización concertada de impuestos indirectos entre los países miembros[59].

[57] Para análisis y simulaciones con respecto a los países G7, véase Kopits y Symansky (1998).

[58] Vale la pena destacar que los valores de referencia de la UEM se aplican solamente al nivel nacional, lo que transfiere a países miembros la tarea de distribuir el ajuste fiscal entre diferentes niveles de gobierno. Este es un problema potencial para algunos países con una estructura federal. Por ejemplo, en Alemania el problema esta resuelto en cierto grado mediante regla de oro a nivel subnacional. En Italia, hasta ahora los gobiernos regionales no han cumplido con el pacto de estabilidad interno en vigencia durante el periodo 1999-2001, que los obliga a un ajuste marginal en su deficit. En el futuro las tensiones internas se van a agudizar, como lo ilustra Reviglio (1999) en referencia a los gastos por servicios de salud, en parte por presiones demográficas.

[59] Esto significa el establecimiento de bases impositivas y tasas mínimas uniformes. Véase Kopits (1999b).

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Anexo 1
Argentina: Reglamentos sobre el crédito público en las provincias

El siguiente cuadro ofrece un resumen de las exigencias más importantes de las constituciones provinciales para la aprobación y el uso del crédito público[60].

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
Bs. Aires	Ley sancionada por 2/3 miembros presentes de cada Cámara.	Los recursos se aplicarán a objetos determinados. Especificar recursos especiales con que se hará el servicio de la deuda y su amortización. Debe especificarlos la ley que los autoriza. Responsabilidad de la autoridad que los invierta o destine a otros objetos.	
C.A.B.A.	Mayoría absoluta del total de los miembros de la Legislatura. Crédito público interno o externo. Autorizada por ley. Determinación concreta de su objetivo.		
Catamarca	La legislatura autoriza al Poder Ejecutivo con el voto de 2/3 miembros presentes de cada cámara.	Prohibido cubrir los gastos ordinarios de la administración. No pueden aplicar los recursos a otro objeto.	Servicio de la deuda y su amortización no podrán exceder el 20% de las rentas efectivas de la provincia en el quinquenio anterior.
Córdoba	Autoriza al Poder Ejecutivo con los 2/3 de los miembros presentes en cada cámara.	Para el financiamiento de obras públicas, promoción del crecimiento económico y social, modernización del Estado y otras necesidades excepcionales o de extrema urgencia.	Amortización e intereses: no pueden superar el 20% de la renta provincial. Base de cálculo: el menor de los ingresos anuales ordinarios de los tres últimos ejercicios, considerados a valores constantes.
Corrientes	Ley sancionada por 2/3 de votos del total de miembros de cada cámara. El Poder Ejecutivo debe ser facultado por el Poder Legislativo.	Se deben aplicar a los objetos determinados en la ley de su creación.	En ningún caso se podrá comprometer más del 25% de la renta anual de la Provincia.

[60] Elaboración propia de acuerdo con información recopilada por Zapata (1999) de constituciones provinciales.

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
Chaco	Ley sancionada con el voto de los dos tercios de los miembros que componen la Legislatura. Corresponde a la Cámara de Diputados autorizar al Poder Ejecutivo a contraer empréstitos, emitir fondos públicos y celebrar cualquiera otra operación de crédito.	Determinación concreta del objetivo de la operación y de los recursos afectados para su servicio.	No excederán anualmente del veinticinco por ciento de las rentas de la provincia.
Chubut	Facultar al Poder Ejecutivo, con la mitad más uno de sus miembros.	Bases y objetos determinados. No pudiendo ser autorizados para *equilibrar los gastos ordinarios de* la administración.	
Entre Ríos	Facultar al Poder Ejecutivo con la mitad más uno de los miembros de cada Cámara.	Bases y objetos determinados. No pueden ser autorizados para equilibrar los gastos ordinarios de la administración. Ni el numerario obtenido de los mismos, ni los fondos públicos que se emitan, podrán ser aplicados a otros objetos que los determinados por la ley de su creación.	En ningún caso la totalidad de los servicios de los empréstitos comprometerán más de la cuarta parte de las rentas de la provincia .
Formosa	Corresponde al Poder Legislativo las siguientes *atribuciones:...* Autorizar al Poder Ejecutivo a contraer empréstitos basados en el crédito de la Provincia. Dos tercios de votos bajo pena de nulidad.	Financiamiento de obras públicas, reformas agrarias, crecimiento económico y social o para atender gastos originados por catástrofes y otras necesidades excepcionales o de extrema urgencia.	El servicio de la totalidad de las deudas autorizadas y que hubieren de autorizarse, podrá ???comprometer más de la cuarta parte del promedio de los cálculos de recursos ordinarios anuales.
Jujuy	La Legislatura podrá autorizar mediante ley especial por el voto de los dos tercios de la totalidad de sus miembros. Corresponde a la Legislatura aprobar o rechazar el arreglo de pago de la deuda interna y externa de la Provincia.	Con fines de promoción económica la Provincia podrá contraer empréstitos destinados a financiar obras productivas específicamente planificadas y cuyos servicios financieros deberán ser cubiertos por los rendimientos de la obra.	

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
La Pampa	Deberá sancionársela ley con dos tercios de votos de los miembros que componen la Cámara de Diputados.	Especificar el objeto al que los fondos se destinan y los recursos asignados para su servicio. Podrá autorizarse únicamente cuando su producido sea destinado a la ejecución de obras públicas, para hacer efectivos planes de colonización agraria o para atender gastos originados por catástrofes, calamidades públicas u otras necesidades excepcionales o impostergables del Estado, calificadas por ley. En ningún caso podrá aplicarse a enjugar déficit de administración.	No podrán exceder del veinticinco por ciento de la renta ordinaria anual de la Provincia.
La Rioja	Con el voto de los dos tercios de los miembros en funciones de la Cámara de Diputados. Corresponde a la Cámara de Diputados:... Autorizar al gobernador a contraer empréstitos, emitir títulos públicos y celebrar cualquier otra operación de crédito con arreglo a lo dispuesto por esta Constitución.	Ningún compromiso de esta clase podrá contraerse sino para obras públicas. Los recursos provenientes de ese tipo de operaciones no podrán ser distraídos ni interinamente de su objeto, bajo la responsabilidad de la autoridad que los invierta o destine a otros objetos.	El servicio de la totalidad de las deudas autorizadas, no podrá comprometer más del veinticinco por ciento de la renta provincial, a cuyo efecto se tomará como base el cálculo de recursos menor de los tres últimos años.
Mendoza	Ley sancionada por 2/3 de los miembros presentes de cada cámara. Corresponde al Poder Legislativo: Reglamentar la administración del Crédito Público. Facultar al Poder Ejecutivo para contratar empréstitos o emitir fondos públicos como lo determina la Constitución.	Deberá especificar los recursos especiales con que no deba hacerse el servicio de la deuda y su amortización. No podrán aplicarse los recursos que se obtengan por empréstito, sino a los objetos determinados, que debe especificar la ley que lo autorice, bajo responsabilidad de la autoridad que los invierta o destine a otros objetos.	
Misiones	Corresponde a la Cámara de Representantes: Autorizar al Poder Ejecutivo, con los dos tercios de votos de los miembros presentes.	Bases y objetos determinados, no pudiendo ser autorizados para equilibrar los gastos ordinarios de la administración. Ni el numerario obtenido de los mismos ni los fondos públicos que se emitan, podrán ser aplicados a otros objetos.	En ningún caso la totalidad de los servicios de los empréstitos comprometerán más de la cuarta parte de las rentas de la provincia.

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
Neuquén	Corresponde al Poder Legislativo: Facultar al Poder Ejecutivo, con el voto favorable de la mayoría absoluta de todos sus miembros, a contraer empréstitos. Las leyes que autoricen la contratación de empréstitos serán dictadas en sesión *especial de la Cámara*, convocada al efecto con tres días de anticipación. Dictar la ley orgánica del crédito público. Por ley especial de la Legislatura podrá autorizarse la emisión de empréstitos o emitir fondos públicos con base y objeto determinado, no pudiendo ser autorizados para equilibrar los gastos ordinarios de la administración. Con fines de promoción económica la provincia con el acuerdo de la mayoría absoluta de todos los miembros de la Cámara de Diputados podrá suscribir empréstitos destinados a financiar obras productivas específicamente determinadas por el Consejo de Planificación cuyos servicios financieros *quedarán cubiertos por los* rendimientos de la obra.		En ningún caso la totalidad de los servicios del empréstito comprometerán más de la cuarta parte de las rentas generales de la provincia. El numerario obtenido de los mismos podrá ser aplicado a otros destinos que ios establecidos en la ley de su creación.
Río Negro	Ley sancionada con los dos tercios de votos de los miembros de la Legislatura. La Legislatura tiene las siguientes facultades y deberes: Considera el pago de la deuda interna y externa de la Provincia.	No pueden aplicarse los recursos sino los fines determinados, que debe especificarse en la ley que los autoriza, bajo responsabilidad de la autoridad que los invierta o destine a otros objetos. Pueden autorizarse únicamente cuando sea destinado a la ejecución de obras publicas, para hacer efectiva la reforma agraria o para atender gastos originados por catástrofes, calamidades públicas y otras necesidades excepcionales e impostergables del estado calificadas por ley, sin poder aplicarse en ningún caso a enjugar déficit de administración.	Deben especificar los recursos con que debe afrontar los servicios de la deuda y su amortización, los que en ningún caso podrán exceder el 25% de la renta ordinaria anual.

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
Salta	La Legislatura puede autorizar empréstitos sobre el crédito general de la Provincia o emisión de fondos públicos. Sancionada por los dos tercios de votos de los miembros presentes de cada Cámara, actuando como originaria la de Diputados.	Toda ley que sancione empréstitos especifica los recursos especiales con que deben atenderse los servicios de la deuda y su amortización, así como los objetos a que se destina el monto del empréstito.	La totalidad de los servicios de intereses y amortización no puede exceder la cuarta parte de los recursos ordinarios del tesoro provincial.
San Juan	Son atribuciones de la Cámara de Diputados: Autorizar al Poder Ejecutivo a contraer empréstitos, determinando sus intereses y las bases y condiciones para su amortización; emitir títulos públicos y cualquier otra operación de crédito con arreglo a lo dispuesto por la Constitución.		
San Luis	Ley sancionada con el voto de los dos tercios de los miembros de la Legislatura. Corresponde a la Legislatura: Autorizar la celebración de contratos sobre empréstitos de dinero basados en el crédito de la Provincia u otros de utilidad pública..	Los recursos no pueden ser distraídos ni provisoriamente de sus fines. La ley que provea a otros compromisos extraordinarios, debe establecer los recursos especiales con que deben atenderse los servicios de la deuda y su amortización.	En ningún caso el servicio de la totalidad de las deudas autorizadas, puede comprometer más del 25% de la renta provincial, a cuyo efecto se toma como base al cálculo de recurso menor de los últimos tres años.
Santa Cruz	Corresponde al Poder Legislativo:... Autorizar al Poder Ejecutivo, con dos tercios de votos de los miembros presentes, para contraer empréstitos. Reglamentar la administración del crédito público.		
Santa Fe	Corresponde a la Legislatura: Autorizar al Poder Ejecutivo para celebrar contratos y aprobar o desechar los concluidos "ad-referendum" de la Legislatura.		El servicio de la totalidad de las deudas provenientes de empréstitos no puede comprometer más de la cuarta parte de la renta provincial.

Jurisdicción	Autorización Necesaria.	Utilización Endeudamiento	Limite en el crédito público
Sgo. Del Estero	La Cámara de Diputados puede autorizar empréstitos sobre el crédito general de la provincia o emisión de fondos públicos. La ley que lo autorice debe ser sancionada por los 2/3 de votos de la totalidad de los miembros. Corresponde al Poder Legislativo: Autorizar al Poder Ejecutivo a la emisión de fondos públicos o de empréstitos sobre el crédito general de la Provincia. Debe tener dos tercios de votos de la totalidad de los miembros, debiendo prever recursos especiales con que haya de hacerse efectivo el servicio de la deuda.	Debe especificar los recursos especiales con que deben atenderse los servicios de la deuda y su amortización, así como los objetos a que se destina el monto del empréstito. Las sumas obtenidas por empréstitos no pueden aplicarse a otros objetos que los especificados en la ley que los autorice.	La totalidad de los servicios de intereses y amortización no pueden exceder la cuarta parte de los recursos ordinarios del Tesoro Provincial.
T. del Fuego	La Legislatura podrá autorizar, mediante leyes especiales sancionadas con el voto de los dos tercios de sus miembros, la captación de empréstitos o la emisión de títulos públicos.	Base y objeto determinados. No podrán ser utilizados para equilibrar los gastos de funcionamiento y servicios de la administración.	
Tucumán	Necesita de la sanción de los dos tercios de votos de la totalidad de los miembros de la Legislatura, entendiéndose por la totalidad de los miembros a los que estuvieren en ejercicio de sus funciones en el momento de la sanción. Corresponde al Poder Legislativo: Autorizar al Poder Ejecutivo para contraer empréstitos basados en el crédito de la Provincia..	Deben especificarse los recursos especiales con que debe hacerse el servicio de la deuda. Los fondos públicos que se emitan y el numerario obtenido por el empréstito no podrán ser aplicados a otros objetos determinados por la ley de su creación.	

Anexo 2
Argentina: Leyes de solvencia fiscal en las provincias

A diciembre de 1999 se encuentran vigentes leyes de este tipo en Salta, San Luis y Tucumán. En el siguiente cuadro se resumen en forma comparada las tres leyes.

	Salta	**San Luis**	**Tucumán**
Déficit	Equilibrio presupuestario. Se admitirá déficit presupuestario cuando sea generado por acontecimientos extraordinarios, calificados por el Fiscal de Estado a requerimiento del Gobernador.		No podrá existir déficit corriente, los gastos corrientes serán atendidos exclusivamente con los ingresos corrientes. Se exceptúan de este cálculo las erogaciones de carácter extraordinario[61].
Uso del Crédito		El uso del crédito debe responder a las siguientes pautas: deberá destinarse a gastos de capital; deberá tomarse a largo plazo; y podrá comprometerse, como máximo a la tasa de interés que resulte del promedio de tasas de mercado financiero nacional o internacional.	El Estado Provincial solo podrá hacer uso del crédito con el objeto de financiar inversiones o fortalecer institucionalmente su organización o refinanciar pasivos. Ningún gasto corriente podrá ser financiado con préstamos de largo plazo.
Deuda	No deberá exceder el 70% de los recursos corrientes anuales. Para este cálculo no se computaran los prestamos que contratare el Estado provincial para ser transferidos a los municipios.	La deuda total no podrá superar el 3% del PBG, ni el equivalente de recaudación de tributos provinciales correspondientes a 1,5 años. La amortización de la deuda pública deberá ser financiada exclusivamente por: recursos provenientes de la venta de activos públicos; superávit fiscal corriente; y uso del crédito, en ese orden.	
Gasto corriente		La tasa de crecimiento anual del gasto corriente no deberá superar la tasa de crecimiento anual del PBG. Si la tasa de variación del PBG resultara negativa, el gasto corriente, a lo sumo, podrá mantenerse	La tasa de incremento de los gastos corrientes no podrá superar la tasa de incremento de los ingresos corrientes. Cuando la tasa de variación de estos ingresos sea negativa, el gasto real podrá a lo sumo mantenerse

[61] La ley no especifica quien determina el carácter de extraordinario.

	Salta	San Luis	Tucumán
		constante. El gasto corriente no deberá superar el 50% del Presupuesto total. Los gastos corrientes deberán financiarse exclusivamente con recursos tributarios corrientes. El producido de la venta de activos y de otras transferencias de capital no deberán destinarse a financiar gastos corrientes.	constante. Se exceptúan las erogaciones de carácter extraordinario. El producido de la venta de activos no podrá utilizarse para atender gastos corrientes.
Gasto en personal	No podrá superar el 65% de los recursos corrientes netos.		No podrá superar el 65% de los recursos corrientes netos. ingresos netos: total de ingresos corrientes menos transferencias a Municipalidades y Comunas Rurales.
Presupuesto Plurianual		El Poder Ejecutivo elaborará un presupuesto plurianual de al menos tres años.	El Poder Ejecutivo elaborará un presupuesto plurianual de al menos tres años.
Municipios	Invitase a los Municipios a adherirse a la presente Ley.	El Poder Ejecutivo acordará con los estados municipales el dictado de normas legales en concordancia con lo dispuesto en la presente Ley.	
Difusión		Será obligación del Poder Ejecutivo la publicación semestral de la ejecución presupuestaria con detalle de gastos, recursos, déficit y endeudamiento en forma desagregada.	

SUB-NATIONAL GOVERNMENTS AND CREDIT MARKETS: SELECTED CASES

By
Maria E. Freire, Marcela Huertas, Benjamin Darche *

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Executive Summary

Within the framework of increasing decentralization, the need for many local governments to access international and domestic capital markets is growing. As urban migration increases, local authorities are under pressure to provide more services with fewer resources from the central government, and an inadequate tax base to provide them independently. Sub-national borrowing is one method to finance such investments, and makes sense in cases where the useful life of the service is long (such as schools and roads). However, the risks of sub-national borrowing are very high for central governments, especially in new democracies where the boundary between national and sub-national governments is vague. A central government can have its credit ruined in international markets by defaults of local governments. This report examines sub-national access to domestic and international capital markets, using case studies from Argentina, Brazil and Colombia. These case studies highlight both the challenges raised by allowing sub-national access to different types of debt financing, and the need for a regulatory framework that protects all interested parties: local governments, central governments and the bond issuers. When the necessary precautions are in place, however, local capital markets can be a viable and useful source of finance. At the end of the report, a roadmap is provided to outline the necessary conditions that allow sub-national authorities to access this financing without jeopardizing the national fiscal stability.

Introduction

The growing interest of sub-national governments in accessing domestic and international capital markets has raised ambivalent reactions among policy makers. On the one hand, mayors and governors believe that capital markets will bring cheaper and longer-term capital to finance infrastructure projects as well as opportunity for good business. On the other hand, central governments are concerned with the effect it may have on the overall national fiscal situation. The reality show increasing numbers of cities which have been issuing bonds: during 1991-98, there were 120 cases in Latin America, 150 in ECA, 11 in East Asia and near 500 in South Africa. Asia's local bond market is estimated at $477 billion; Czech municipalities have issued municipal bonds to offset the negative impact of declining transfers into capital outlays. Poland, Russia, South Africa, and Zimbabwe have active bond markets.

Worries that fiscal decentralization may contribute to structural deficits and fiscal imbalances are common in Latin American and other countries. In countries where the main policy priority is to control aggregate public sector borrowing, there is a genuine concern that fiscal decentralization may accentuate this problem. Whenever traditions of fiscal responsibility are weak, accountability is immature and administrative discipline is poorly developed, there is a risk that lower level governments may abuse their borrowing authority, contributing to aggregate fiscal imbalance with accompanying adverse macroeconomic consequences (Bird, 1995; Prud'homme, 1995; Tanzi 1996). There is a generalized consensus that without a proper regulatory framework, easy access to borrowing (e.g. to debt financing) may lead to aggregate fiscal imbalances.

However, many would argue that with adequate legal framework and with the macro fundamentals in place, local access to capital markets will be compatible with macro fiscal instability while promoting the development of an important segment of the financial markets. Necessary conditions include the existence of supervisory authorities; judicial enforceability of contracts and agreements, adequate accounting, disclosure, and reporting standards and availability of skilled staff.

This paper reviews the experiences of some recent bond issues (including Brazil, Argentina and Colombia) and illustrates the dynamics of the capital markets and the regulatory and fiscal impact issues these transactions raise. Part I provides background on the macroeconomic framework, Part II summarizes the bond issues, and Part III identifies the main issues and makes recommendations on the framework that needs to be put in place to guarantee a healthy function of sub-national markets.

I. Decentralization, Local Government Borrowing and National Fiscal Stability

A. Overview of the Latin American Region

Decentralization has been a reality in Latin America in the last decade. Nations throughout the region have shared responsibilities with local governments, backed by automatic revenue transfers that more than doubled local government revenues, while achieving a democratic transition. Virtually every mayor and council member in about 13,000 units of state and local government is now chosen by democratic vote.

By international standards, however, LAC countries are relatively centralized. For the average OECD country, 35% of the public spending is the responsibility of local governments; in the case of LAC, local governments account for only 14% of public spending. The situation varies significantly among large countries (where the share of sub-national spending is above 45%) and smaller ones.

Decentralization has a significant impact on public finances. In some countries, decentralization has been adopted as a mechanism for reducing central government deficits and cutting aggregate public-sector expenditures. For example, central governments in Central and Eastern Europe have turned over highly subsidized activities like housing supply and water provision to local authorities to run at their own expense.

In Latin America, local authorities have secured sufficient transfers or shares of centrally collected taxes to finance services at their current or mandated level. In Argentina, Bolivia, Brazil, Venezuela, and other countries, revenue-sharing commitments for several years into the future were spelled out in national laws so as to reduce the financial risks of decentralization for local governments.

Actually, decentralization in Latin America has favored local government budgets. In general, the process has started by transferring a larger share of centrally collected revenues to localities, with only few spending obligations being shifted to local authorities. Only after the transfer of revenues is well under way has the devolution of services begun. For example, in Brazil, the 1988 Constitution shifted 6% of total public revenues from the central government to the sub-national governments. The new constitution did not, however, transfer any expenditure responsibility to states and municipalities. The result: a windfall gain for municipalities but a tightening of the central government's fiscal situation. In countries like Argentina and Colombia the process was similar: subnational governments ended up with relatively more revenues than additional responsibilities (see Stein, 1998 and Terimassiani, 1997).

Why decentralize? Decentralization seems to be primarily a politically driven process supported by increasingly influential local authorities. From an economist point of view, the most common arguments are those of Tiebout (1961), Musgrave (1969) and Oates (1972) who argue that decentralization would promote a more efficient allocation and delivery of local public services, as well as improving the relationship between local preferences and the provision of local services. Ongoing Bank work tries to establish the nature and extent of such benefits.

However, decentralization can also entail costs in terms of distribution equity and macroeconomic management. The most serious risk is the fact that local governments may have no incentives to behave in a fiscally responsible manner. On the one hand, expenditures are more easily decentralized than revenues (there are few good local taxes). This difference between assumed responsibilities and own revenues (or vertical fiscal gap) is generally financed by transfers from the central government. Heavy reliance on revenue transfers may weaken the budget constraints of sub-national governments. This is especially the case where the sub-national governments have borrowing autonomy and the central government cannot avoid bailing them out in case of financial trouble. In some cases, foreign borrowing by sub-national government can ruin a national government's credit in international markets, if the market fails to distinguish between local government defaults and central government performance.

B. Three Cases of Financial Autonomy and Fiscal Adjustment

Argentina, Brazil and Colombia have the three most decentralized public sectors in Latin America (see Table 1) and along with India are the most decentralized democracies in the world. Sub-national governments account for about half of public spending in Brazil and Argentina and almost 40% in Colombia. In Argentina and Brazil, the 1980s saw the return of democracy, the strengthening of federal practices and also poor macroeconomic performance with unsustainable fiscal imbalances. While national issues were at the core of the fiscal crises, inter-governmental fiscal relations and fiscal management of sub-national governments also played crucial roles (Dillinger and Webb, 1998). Sub-national deficits made a significant contribution to the aggregate public sector deficit and stabilization was not possible without a strict control of sub-national deficits.

Table 1
Decentralization in Lac, 1995

Country	Sub-national / Total Govt. Spending
Argentina	49.3
Brazil	45.6
Colombia	39.0
Bolivia	26.7
Mexico	25.4
Venezuela	19.6
Uruguay	14.2
Chile	13.6
Honduras	12.3
Peru	10.5
Guatemala	10.3
Ecuador	7.5
Trinidad	7.2
Paraguay	6.2
El Salvador	6.0
Nicaragua	5.2
Panama	3.2
Dominican Rep	2.9
Costa Rica	2.3
Avg. LAC	14.6
Avg. OECD	35..3

Source: IDB, Latin America, a Decade of Reforms, 1999

1) ***Argentina***

In April 1991 Argentina introduced a highly successful stabilization plan (the Convertibility Plan). Among other measures, the plan fixed the exchange rate to the dollar, required that the monetary base not exceed the dollar value of international reserves (which transformed the Central Bank into a Currency Board) and removed the power to devalue the currency from the Ministry of Economy. A difficult fiscal adjustment was necessary to bring down inflation and real interest rates. This was achieved with massive privatization, government lay-offs, imposition of a severe budget constraint on provinces as they were prohibited from borrowing from the provincial Banks and the Central Bank.

The effect of this budgetary constraint was not felt until 1994 The Tequila crisis in December 1994 hit the Argentine economy especially hard, leading to an important capital outflow, economic slow down and substantial reduction of provincial revenues . The crisis was a test for the hard budget constraint put in place by the Convertibility Law. At first, provincial governments faced the fall in revenues by trying to borrow from their own banks and the Treasury. Since the Central Bank was unable to print money or rediscount provincial banks, and the national treasury refused to bail out the provincial governments, provinces ran into arrears, paid staff and suppliers with bonds, and borrowed from the banks pledging their shared revenues (*coparticipacion)*[1]. By mid-1996, provincial debt had reached $17 billion, compared with $5 million in 1991.

By the end of 1996, it was clear that the budget constraints were there to stay. As the central government refused automatic bailouts[2], most of the provinces began adjusting their expenditures. First they cut the wage bill 5% in real terms in 1995 and another 5.5% in 1996. A small recovery in revenues (4%) associated with GDP recovery was enough to cut the provincial deficit in half.

The impact of sub-sovereign borrowing on the national fiscal condition in Argentina was offset by the macroeconomic constraints placed by the Convertibility Law. Provinces had no choice but to honor their debt service payments to commercial banks and international creditors because direct transfers of co-participation revenues secured these payments to the provincial creditors. The provinces did not receive their revenue transfers until after creditors were paid. This created a strain on provincial operating budgets, which led to substantial adjustments in less than two years. [3]

2) ***Brazil***

In 1997, Brazil per capita sub-national debt reached $800 per inhabitant. This was the highest in Latin America and one of the highest in the world: (Argentina averaged $500). This situation resulted from a series of debt crisis at provincial level which were absorbed by the central government, without taking measures to promote/impose stricter rules in subnational borrowing. The first crisis occurred in the late 1980s with the international debt crisis. Brazilian states – which had borrowed heavily to finance infrastructure projects during the 1980s -- defaulted on foreign debt and the federal government (which had guaranteed much of the debt) had to absorb it. The second crisis came with the default of states to federal financing institutions (principally CEF). In both cases, the states' debt was rescheduled over a 20 year period with a generous grace periods on payment of principal and a cap on debt service to current revenues

[1] These transfers are appropriated at the source by the public bank (*Banco de la Nacion*)..

[2] There were very few cases in which the central government assisted some provinces. The two or three cases took the form of grants and to pay salaries in arrears.

[3] The Provincial Structural Adjustment Loans negotiated by the Bank with selected provinces aimed at supporting the provincial governments to implement these adjustment programs.

The third crisis was a consequence of the 1994 stabilization plan which brought down annual inflation rates but led to high real interest rates. The major default was of state bonds. States were unable to liquidate the bond debt (R$31 billion) and the federal government authorized the exchange of state bonds for federal or central bank bonds. All state debt (principal and interest) was rolled over and debt service above the cap was automatically capitalized. By 1996, the bond debt grew had reached $51.7 billion (5.4% of GDP). Combined with the debt assumed by the failed state banks, at the end of 1996, the stock of state debt assumed by the federal government totaled $123 billion (Dillinger, 1997).

During 1997-99, a more comprehensive approach to the restructuring of state debt was undertaken, which involved sale of state assets, and commitments by states to adjustment programs, but the burden of the ever growing state debt remained with the federal government. Dillinger (1998) estimates that Brazil's sub-national government deficit due to unpaid interest obligations is more than half the overall public sector deficit.

Since early 1999 -- in the aftermath of the major financial crisis which led to a major currency devaluation -- significant progress has been achieved towards strengthening the sub-national budget constraint and improving commitment to fiscal targets. The government program includes (i) guaranteed debt collection ; (ii) establishment of financing constraints; and (iii) a new fiscal code (Law of Fiscal Responsibility recently introduced in the Senate) that will seek to further strengthen fiscal discipline at the federal and sub-national level, including the mandatory establishment of fiscal targets and limits on debt. In addition, a constitutional amendment limits personnel expenditures and introduces penalties on non-compliance. The Federal Government has cut most sources of financing to the states and has completed debt rescheduling agreements with most states. These agreements require that the states service their debt obligations with the federal government, which can now be enforced with recourse to constitutionally mandated transfers as well as to the governments' own revenues.

3) *Colombia*

The 1991 Constitution devolved substantial expenditure responsibilities to Colombian municipalities and departments. However, the decentralization process is rather limited. On the one hand, most of the departments and municipalities lack the institutional capacity to effectively perform the assigned functions (Terminassian, 1998). On the other hand, the central government determines norms for expenditures such as education and health, further limiting decentralization. In addition, the role of own source revenues in sub-national financing is very small, and most sub-national revenues come from earmarked central government transfers. In these circumstances the flexibility of the local governments to allocate expenditures is very limited, a fact which constrains the accountability of these governments.

Colombia's case exemplifies how decentralization can contribute to macroeconomic imbalances. Heavily dependent on transfers from the central governments, sub-national governments have contributed to a deterioration of the overall fiscal position between 1991 and 1996. The largest source of growth in central government administration expenditures has been current transfers, mainly to the local governments. This reflects the importance that transfers have as a major source of revenue for the local governments and the need to reform the system and improve the revenue raising ability of sub-national governments to increase own-source revenues which will improve elected officials' accountability to their constituents.

In addition, given the lack of flexibility of the earmarked transfers, and the nationally determined use of transfers, these transfers limit the effective decentralization of expenditures and encourage the use of credit. On the one hand, banks have an incentive to lend based on the strength of constitutionally increasing transfers from the nation and on the fact that local governments have earmarked resources that they are unable to use. On the other hand, local government have inadequate incentives to raise own source revenues and have easy access to debt finance. In fact, sub-national borrowing has increased rapidly -- at more than 50% per year in nominal terms. During the same period the stock of local government debt doubled from 1 to 2 percent of GDP between 1993-1996.

The Ministry of Finance has taken several measures to curb the growth of sub-national debt:

- Higher collateral requirements - in 1995, the amount of revenues that might be used as collateral increased from 130% to 150% of the guaranteed loans;
- Credit institution have to increase their ratio of net worth to loans to sub-national governments;
- In 1997, the Law of Sub-national Debt established a system of warning signs based on stock and flow indicators of sub-national governments and specified the central government entity that must approve the requests. The indicators are: (i) interest payments as a percentage of operating surplus; (ii) the stock of debt as a percentage of current revenue.

C. Why do Local Governments Borrow?

Part of the responsibilities of local governments is to provide basic services. For that they will need to invest in infrastructure. Pressure for investment are particularly heavy in urban areas undergoing rapid migration. It is estimated that Asia alone will need to invest $280 billion a year over the next 30 years.[4] Some of the investment will come from private sources; however publicly financed infrastructure will continue to be necessary, especially to finance public goods. Traditionally, central governments would take care of this type of investment. However, the move towards decentralization imply that subnational governments will need to raise funds and finance those outlays.

To finance these investments, local governments can use local taxation (e.g. property taxes) and/or current savings. But these may be insufficient to finance all infrastructure investments. A supplementary source is debt. In principle, there is much to be said for financing infrastructure through debt. Roads, schools, and pipelines have long useful lives, and debt spreads out costs of infrastructure to match its useful life.

But where will they borrow? The experience of industrial countries suggests two basic approaches: municipal bonds and municipal funds. *Municipal bonds* are often used in the USA and Canada (sub-national bond debt is about $7 billion in these two countries). Here, the markets are stable, the macroeconomic situation has created conditions favoring long-run investment, capital markets are developed and the rules and laws and known and enforced. In most developing countries, the conditions are quite the opposite. Long periods of macroeconomic instability discourage long-run commitments; the legal framework is often faulty in its capacity to protect investors, and information is not transparent. However, and in spite of these problems, the markets for sub-national debt are expanding quickly. Some experiences have gone wrong (e.g. Brazil and Istanbul) but in other countries are genuinely interested in building up firm legislation to protect investors on sub-national debt and favor a healthy subnational capital market.

Municipal funds and banks have been used in Europe. They were initially financed by the central government and tried to substitute for the reluctance of private capital to finance small municipalities[5]. More recently, MDFs have developed in many developing countries. Under an MDF, the central government bears the ultimate risk of municipal default. Some governments have insisted on prudent lending standards and

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[4] Brockman and Williams 1996.

[5] In their initial years, many of them (including Credit Local de France, the Spanish Banco de Credito Local, and the British Public Works Loans Board) financed their operations through loans from the central government. In effect, central governments used their strong credit standing to raise money cheaply in capital markets and on-lent the proceeds to municipalities through the MDF

strict debt service enforcement. Others have suffered high levels of default. Recently MDFs have been encouraged to include private participation or even to be sold out to private interests[6].

Bonds, banks and MDFs can operate simultaneously, as they do in the U.K. In all cases, the success of the financial instrument depends on a stable macroeconomy, a legal framework defining the rights of lenders and borrowers, and a supply of long-run savings. Central governments, specifically, will need to adopt a legal framework for municipal borrowing, defining the rights and obligations of lenders and creditors and a procedure for municipal bankruptcy.

D. The Need for Controls

Controls and regulation over sub-national borrowing and debt stock are needed to avoid excessive indebtedness at the local and national level. Some controls apply to the design of the inter-governmental fiscal relationship trying to reduce the cases that may favor excessive dependence on the central government or lack of clear accountability. These examine such factors as (i) correspondence between responsibilities and tax raising power; (ii) the need to guarantee stable and predictable transfers from the center; and (iii) the need to avoid concurrent responsibilities so that the lack of one level of government will not translate in additional effort from the other part of the government. Other type of controls focus directly on the total amount of debt or borrowing, and are discussed below.

Regulatory Framework and Direct Controls: Regulation of sub-national borrowing is especially needed in new democracies due to the lack of a clear boundary between national and local government liability, causing sub-national defaults to be passed onto the national government. In addition, the national government can have their credit ruined in international markets by defaults of local governments. To address these risks, central governments may want to limit annual or accumulated deficit or stock of debt; and/or impose controls on specific debt instruments. Table 2 summarizes the main controls used in Latin American countries to control the borrowing by their sub-national governments. Some of these controls include:

- Prohibit Borrowing (Chile): this has the advantage of eliminating excessive borrowing but at the cost of severely restricting the investment capacity of state and local governments, unless funds are made available in some other fashion.
- Impose restraints on a local government's deficit, or on total debt stock. Only Colombia has a limit on total debt[7]. Most of the others either have no quantitative control on total debt or use the debt service/revenue ratio to control outstanding debt.
- Set limits on the ability of sub-national governments to use their future claim on intergovernmental transfers as a guarantee for new loans. While these arrangements reduce the cost of financing by transferring the risk to the national government, it limits the ability of the market to signal an unsustainable fiscal position until the guarantee is exhausted.

[6] Under Colombia's FINDETER program, private banks originate all municipal loans and bear the full risk of default, with the government acting merely as a second-tier bank to provide liquidity. The Czech Republic's MUFIS acts along similar lines[6]. (Indeed, many of the European MDFs have shifted to market sources to finance their operations and are in the process of privatization.)

[7] Colombia is the only country in Latin America that has a regulatory framework in place to control the indebtedness capacity of the municipalities in accordance with their operating surplus. In 1997 a law was passed to identify three levels of indebtedness known as the street light system. This system establishes three levels of emergency by following two economic indicators: the first one measures liquidity and the second one measures solvency. The latter is only used for the "red level," or for highly indebted municipalities. The "red level" represents a danger in the capacity to repay the debt (Perry and Huertas, 1997).

- Install a proper framework to allow for project finance. Sub-national governments should be able to pledge the cash flow of a development project to secure finance. However, clear default rules should be enacted so as to clarify property rights and restrict the possibility of bailouts.
- Refrain from bailing out sub-national governments to convey the image of independence and the fact that the market should be responsible for its own decisions when lending non-guaranteed money to sub-national entities.

Table 2
LAC Countries – Controls on Sub-National Borrowing

Country	Borrowing must be authorized	Debt numerical constraints	Constraints to use the debt	Can use tax sharing as guarantees?
Argentina	Yes; by central Gov. in case of foreign debt	Debt service <20-25% revenues	For invest. And reforms	Yes
Bolivia	By central and local		for investment	Yes
Brazil	by national and state		For project	Yes
Chile	It is prohibited			No
Colombia	Domestic: by local legislation. External: By national legislature	Debt service <40% current revenues; debt/current rev <80%	For investment	Yes
Costa Rica	Domestic: by local legislation. External: By national legislature	Debt service <10% of municipal revenues		No
Dominican Rep	Domestic: by local legislation. External: By national legislature	No	No	No
Ecuador	No authorization required	Debt service<20% of revenues	For investment	No
El Salvador	No formal authorization is required	No	External: for investment	
Guatemala	National legislature		No	No
Honduras	Domestic: by local legislation. External: By national legislature		No	No
Mexico	States and Municipalities are not allowed to contract external debt	Some states limit debt service of municipalities to 35% of revenues	For investment	Yes for municipalities
Nicaragua	Yes	No	For investment	No
Panama		None		No
Peru	No authorization for domestic or external unless the guarantee is required	Established annually	Investment	No
Uruguay	By national legislature	Determined in the annual budget		No
Venezuela	Special law Not authorized to borrow abroad	No	No	No

Source: Latin America After a Decade of Reforms, Economic and Social Progress, 1997 Report, IDB

Regulations are not always effective and can easily be violated. However, they are especially important in the case of foreign borrowing. Foreign markets may not distinguish between the default of sub-national governments and default of the central government. Control in this case would be required to prevent local government defaults from undermining the central government's own external borrowing. In addition, allowing local governments to have their own foreign debt can only complicate foreign exchange management. For most of the other cases, the best regulation would be for the central government to see local government borrowing as a private transaction between local government and the lender and refuse to bail local government defaults.

II. Summary and Lessons of Six Bond Offerings

This section briefly summarizes the six domestic and international bonds issued by sub-national governments in Argentina, Brazil and Colombia. The cases were drawn from the universe of sub-national bond issues sold in the Latin American domestic and international capital markets between 1991 and 1997, as indicated in Appendix 7.

We selected the cases to represent large and small bond offerings in domestic and international capital markets under different macroeconomic situations as described in Part I. The cases also form the basis of the lessons learned about sub-national capital markets presented at the end of the report. Table 3 provides a summary of the cases, which is followed by a short discussion of their salient features. Appendices 1 through 6 contain a more detailed description of each case.

Table 3
Summary Description of Sub-National Bond Issues

Province / City	Amount	Purpose of the Issue	Market	Issue Date	Maturity Date
Buenos Aires (City)	US 500 million in series	Refinance City's Debt Stock	Eurobond		
First Issue	US 250 million	"	"	4/11/97	4/11/07
Second Issue	LIT o.1 trillion	"	"	5/23/97	5/23/07
Third Issue	USD 150 million	"	"	5/28/97	5/28/04
Fourth Issue	LIT 69,000 million	"	"	6/10/97	1/6/00
Guaymallen (City)	US 2 million	Public Works	Domestic		
Series One	US 1 million	Gutters	"	12/1/96	8/1/99
Series Two	US 1 million	Street pavement	"	7/1/98	7/1/99
Ibague (City)	Pesos 8 million	Civil Works	Domestic		
Series One	Pesos 4.8 million	Road and Transport Infrast.	"	7/1/96	7/1/01
Series Two	Pesos 3.2 million	Road and Transport Infrast.	"	7/1/97	7/1/02
Mendoza (Prv)	US 125 million	Refinance Province's Debt	Eurobond	8/2/96	7/25/02
Rio de Janeiro (City)	US 125 million	Refinance Existing Debt	Eurobond	7/12/96	7/12/99
Valle del Cauca (Prv)	Pesos 50 billion	Debt Restructuring	Domestic	12/26/96	12/26/03

Issue Price	Interest Rate	Collateral	Rating
Buenos Aires: Par, discount or premium			B1 Moody's / S&P BB-
	semi-annual at 11.25%		
	annual at 10%		
	annual at 10.5%		
	annual at 9.5%		
Guaymallen: Par	annual at 10%	Treasury Bonds	AAA S&P and domestic rating agency
Ibague: Par		Gasoline Taxes	A+ Duff & Phelps, Colombia
	DTF + 3.5%		
	DTF + 2%		
Mendoza: 100% Fixed Re-Offer	Fixed at 10% per annum	88% Oil Royalty	BB Duff & Phelps Int. / AA- Duff & Phelps Ntl.
Rio de Janeiro: 99.96% Fixed Re-Offer	Fixed, at 0.375% per annum	Unsecured	BB Duff & Phelps / B+ Standard & Poor's
Valle del Cauca: Par		Liquor Sales Tax	A by Duff & Phelps

A. The Cases

City of Buenos Aires. The City of Buenos Aires issued USD equivalent 500 million Euro Medium Term Notes (EMTN) in the international debt markets. The EMTN program allows the issuer to offer the notes with maturities from 30 days to 30 years in a variety of currencies. The city took advantage of good market conditions and sold all the notes in four series within two months. The first series comprised a USD 250 million tranche with a 10-year maturity. The notes were sold via the 144a private placement market in the U.S. at an interest rate of 11.25%, about 370 basis points above the 2006 U.S. Treasury Note (the benchmark). The remaining series of notes were denominated in Argentine Pesos, USD, and Italian Lira with maturities ranging from 3 to 10 years. The note proceeds were used to refinance the city's debt stock and the liabilities of its bank, Banco de la Ciudad de Buenos Aires.

Municipality of Guaymallen, Argentina. The municipality sold two series of USD one million in the local Mendoza market. The notes were sold in 1996 and matured in 1999, within the current mayor's term. The municipality had planned to offer three series of the notes, but the finance director did not want to extend the note maturities beyond the term of the current mayor (1999). Therefore, the last one-million USD series was canceled. The notes were secured by the central government revenue transfers (co-participation) and were also collateralized by USD denominated Argentine treasury notes. The collateral gave the notes a AAA rating and provided local investors with sufficient comfort to allow the underwriters to sell them primarily to retail buyers in the Mendoza area. The note proceeds were used for public works improvements.

City of Ibague, Colombia. The City of Ibague sold two series of 5-year notes in 1996 and 1997 denominated in Colombian Pesos. The notes were secured with gasoline taxes collected by a special trust created by the city. The trust collects the gasoline taxes and pays the debt service on the bonds. This trust mechanism and a sufficient debt service coverage ratio (gasoline taxes to total debt service) allowed the issue to receive an A+ domestic rating from Duff & Phelps, Colombia. The city offered the first series of notes at an interest rate of 3.5% over the benchmark DTF which then declined to 2% over the DTF for the second series. The first series paid a higher rate because of the uncertainty associated with the viability of the trust mechanism. This uncertainty was reduced for the second series as reflected in the lower interest rate. Proceeds of the notes were used for road and infrastructure improvements.

Mendoza Province, Argentina. Mendoza issued its inaugural international bond in August 1996 with a USD 125 million six-year offering. Oil royalties paid by oil companies secured the bonds. Much of the due diligence for the bond issue was focused on the legal issues for the oil royalty payments. These issues included the terms and conditions of the oil concessions, the validity of oil company permits, the relevant hydrocarbon laws, the province's rights to the oil royalties and other revenues sources, as well as the validity of the collateral documents and arrangements. The bonds were priced at 403 basis points over the 2002 U.S. treasury at a fixed interest rate of 10% and sold to U.S. institutional investors in the 144(a) private market. Proceeds from the bonds were used to refinance the province's existing debt.

The City of Rio de Janeiro. The purpose of Rio's USD 125 million three-year note issued in 1996 was to help the city refinance its existing short-term debt. The notes were a general obligation of the city and were not secured by any dedicated revenues or collateral. Because of the general obligation structure, the due diligence process required that the city present detailed information on its economic base, financial operations, and management. The city's financial statements had to be converted to international accounting standards[8]. Investors showed much confidence in the city as they bought the bonds at a price that was only 25 basis points higher than the price of an equivalent sovereign bond. This relatively low spread to an equivalent sovereign issue reflected the comfort investors had in the city's general financial condition. The bonds were 2-3 times oversubscribed at an interest rate of 10.375% and a yield that was 403 basis points over the benchmark 1999 U.S. Treasury note.

Department of Valle del Cauca, Colombia. The Valle de Cauca offering had a similar structure as the Ibague bond issue: a dedicated tax revenue source to secure the bonds. However, in the Valle del Cauca case the tax revenue was on liquor sales rather than gasoline sales. Similar to Ibague, a trust mechanism was established to insure that the tax revenues were first used to pay debt service on the bonds before passing them on to the department. Unlike Ibague, the Valle del Cauca bond received an A rating, one notch below the rating of the Ibague issue. This might have been due to a different trust mechanism. In the Valle del Cauca transaction, the department retained collection responsibilities whereas the Ibague bond required the trust to collect and deposit tax revenues for debt service payments. The 50 billion Colombian Peso seven-year Valle del Cauca bond issue was sold in part to refinance more costly debt from Findeter, a government agency that funds municipal loans. The remaining bond proceeds were used for capital improvements.

B. Analysis, Lessons Learned and Recommendations for the Further Development of Sub-national Capital Markets

This report now analyzes the six case studies from several perspectives. First, it examines whether they were unsecured general obligation bonds or bonds secured by specific revenues and why these particular structures emerged. It then identifies the constraints for Latin American local governments to access to the domestic and international capital markets and provide some suggestions as how to alleviate these constraints. The constraints include (i) lack of local government creditworthiness and poor institutional capacity; (ii) lack of an adequate regulatory framework and supervisory authorities of the domestic capital market and (iii) development of the domestic capital market. From these observations, a set of recommendations is made.

[8] If a sovereign or a sub-sovereign, as Rio de Janeiro, register the bond issue in the SEC, the sub-sovereign has to fulfill schedule B. This means that the sub-sovereign has not to change its accounting principles. (Private corporations have to fulfill schedule A and change their accounts to American accounting principles). The Eurobond market requisites are less restritives that those applied by the SEC. As a consequence, Rio de Janeiro had to change its accounts to international accounting principles, because the accounting plan was not good and the financial advisors asked for the change.

Box 1

The importance of Marketing and Management

The importance of Marketing: When an issuer is raising funds in the capital markets, he/she is simultaneously selling a product. In a local government the product is the economy of the city and the financial creditworthiness of the local government. Deutsche Bank, IBM or Walt Disney can have easier access to the capital markets than Banco de la Pequeña y Mediana Empresa, Computadores Reunidos or Moya Films. This doesn´t mean that the last three companies can not access the capital markets, but they need to do marketing. In the financial markets this means road-shows, presentations, bilateral meetings and good and timely urban economic and financial information.

Budget: Size means to be frequent in the capital markets and frequency means liquidity in the secondary market. This is very important in public issues and, in lesser extent, in private placements. To access to the American market the amount of the issue has to be, at least, US$ 100 million. The average is above US$ 200 million. Private placements in the European market can be smaller, but, al least, Euro 25 millions.

As a consequence of marketing and size only the most important cities and regional governments of LAC can access the international capital market through general obligation issues.

The example of the Basc Country is well-known, but for a bad political situation. In the first half of the 90's the Basc Country has raised successfully public issues in the European, Japanese and American markets. The main goal was to introduce its name in the World as a peaceful country. For this reason, these issues meant the possibility of road-shows, presentations, bilateral meetings, media, etc., that permits the Basc Government to talk about the good situation of the Basc economy, that the country has good infrastructures, skilled personnel and so on. (the Basc Country has approximately 2.4 millions of inhabitants)

1) *International Bond Structures*

Bonds can either be secured by a dedicated revenue source or another form of collateral, or they can be an unsecured "general obligation" with payment of debt service based on the "full faith and credit" of the issuer. Whether or not some form of dedicated revenue source or other type of collateral to secure the bonds was necessary for the issuers in these case studies depended on the recognition of the issuer's name by investors and the perceived importance of the city within the country. It appears that many international emerging market investors develop their view of a sub-national entity primarily by their assessment of the sovereign's credit rating and their general knowledge of the sub-national issuer.

Name recognition is also directly related to investor perceptions about moral hazard – the willingness of the sovereign to bail out the sub-sovereign when a bond defaults. To gauge the moral hazard, investors look at the sovereign's behavior regarding bailouts of sub-sovereign domestic and international obligations. Fear that the sub-sovereign will contaminate the name of the sovereign in the capital markets drives the latter to bail out sub-sovereign deadbeats. This is detrimental to sub-national fiscal discipline, and is a scenario that is much more likely to occur with larger well-known municipalities. The smaller sub-national issuers are politically and financially less important and cannot always rely on bailouts. However, from a bondholders point of view, the lack of additional security in the form of a dedicated revenue source or some other collateral is offset by investor perception that the sovereign will bail out the municipality in case it gets into trouble and cannot make its debt service payments. The case studies seem to demonstrate, although it is difficult to prove, that an implied government bailout was priced into the international bond issues for the 'general obligation" bond structures.

Box 2
Moral hazard or "big brother"

Bail outs or moral hazard are known in the capital markets as the "big brother"- The creditworthiness of the City of Barcelona is a consequence of the economy of the city and the financial performance and management, but also as a result of its big brother , the Kingdom of Spain-. This effect, more than the name, is related to the importance of the local government in the economy of the country,. Size is another time the word, but the big brother doesn't mean "the father". The investors know that there is not an automatic bailout, but wait some kind of support from the National Government. For example, when Spain began to be member of the Euro, Moody's upgrade Spain from AA2 to AAA, as Germany and France, because they think that Spain will have some implicit bailout, if it is needed.

In addition to the issue of name recognition, the underwriters of the case study offerings had to take into account the issuer's desire for future bond sales to determine the appropriate bond structure. In the case of Buenos Aires, its goal was to diversify its borrowing sources as general liquidity in the market place began to tighten as a result of the Tequila crisis. Restructuring its outstanding short-term debt was also an important consideration, but the need to find additional funding sources was paramount.

The primary lesson learned from the case studies is that cities of LAC can access the international capital markets with general obligation type of bonds if :

(a) they have a credit rating of international independent agencies,
(b) they present good economic information of the city and timely financial information of the local government through road-shows, advised by financial intermediaries with good international reputation, and
(c) the budget size of the city permits to consider that the city will be present in the market with some frequency.
(d) In another case, they can access the capital markets through private placements and revenue bonds".

2) *Domestic Bond Structures*

The change from general obligation to revenue type bonds has contributed to the development of the local, but undeveloped bond market. In addition, the newly created purchasers of local bonds such as pension funds, mutual funds and other institutional investors are more sophisticated and are aware of the history of local government general obligation debt and the political influences that control repayment of the debt. They now require additional security to purchase bonds. These factors have led to the further evolution of "dedicated revenue" types of structures as demonstrated in the Ibague and Valle del Cauca issues in Colombia (gasoline and liquor taxes) and in Guaymallen in Argentina (government treasury bills and co-participation revenues). We expect that dedicated revenue funds will continue to be the primary bond structure for local bond market issues in the near future, especially small and medium size municipalities. This will most likely be the case as central governments increasingly shift from a paternalistic financial and political policy to one of decentralization and local fiscal control.

We expect that the dedicated fund type of revenue bond structure will continue to evolve. As decentralization proceeds, local government should be given new taxing powers and the ability to raise revenues for specific purposes. These new sources, such as a gasoline tax, can be used to secure bonds issued for a specific improvement, like road pavement in the Ibague case. Taxpayers are more willing to absorb the additional cost for gasoline if they can see the direct benefit of their tax payments. This rationale can also be used for other types of taxes that local government may be authorized to levy as the process of decentralization evolves. They will require new revenue sources to fulfill service mandates imposed by decentralization. These revenues can then be used to secure bond issues and legal structures developed to insure that an independent third party collects the revenue and distributes it to the bondholders.

3) *Constraints to the Development of Sub-national Credit Markets*

The following analysis of the constraints in sub-national credit markets allows us to summarize the findings of the case studies, as well as make recommendations towards their future development.

Credit Ratings and Credit Rating Agencies

Credit ratings have become an essential element of international bond issues and are used more frequently in domestic bond offerings. The case studies indicated that credit ratings were an integral part of the bond offering process. We expect that credit ratings will continue to play a central role in the development of sub-national municipal markets for both domestic and international bond issues. However, several problems related to international and domestic credit ratings were apparent in the case studies.

International ratings required a more stringent set of rating criteria than the domestic ratings. This is probably due to the fact that international investors have used credit ratings for several decades to complement their own credit risk analysis and have clear expectations as to the depth and quality of the rating process. Domestic ratings, on the other hand, were done for a variety of purposes. In Colombia ratings are necessary for regulatory purposes and in Argentina as a disclosure gesture to inform investors about the financial condition of the municipality. There are a wide variety of domestic credit rating agencies that use different methodologies for their credit ratings. A standard has not developed, as one generally finds in international ratings, but the latter also has significant differences in analytical approaches between rating agency companies.

One of the findings of the case studies that demonstrate the importance of the rating agencies in the development of the domestic capital market was the Valle del Cauca issue that used dedicated liquor taxes to secure the bonds. The details of the structure were developed jointly by the financial advisor, underwriter and the rating agency. They defined the most appropriate mechanisms for revenue collection and distribution to bond holders. In the industrialized economies rating agencies frequently dictate specific bond covenants and terms and conditions for the issuer to achieve a certain rating goal. In the case of Valle del Cauca, this method was applied and we expect to see it occur more frequently.[9] However, unless relatively standard criteria is developed among the rating agencies to achieve certain credit ratings, this process can send confusing signals to the domestic market. It may be worthwhile to establish a self-regulatory mechanism among the private rating agencies to develop a set of rating guidelines for municipal bond issues, although competitive business pressures may prevent cooperation among these companies.

Ideally, the credit rating process for international and domestic bond issues should be the same except for the obvious issues associated with sovereign related risks such as foreign exchange, currency convertibility and legal matters associated with particular bond structure. Analysis of the municipality's

[9] The international rating agencies try to assess objectively the local government creditworthiness, but as all process of evaluation, they apply a lot of subjective appraisal. They try to solve the problem through evaluation meetings that participate a team of different experts

financial operations (financial statements, budget, liquidity, operating balance, etc.), administration, economic base, debt management and political factors should use the same general obligation debt criteria for all issuers. Financial criteria for dedicated revenue debt should also be the same (e.g. tax forecasts, debt service coverage ratios, etc.). However, even among the international credit rating agencies, there is a difference in methodology in assigning a rating because of a different emphasis on the certain factors. Some factors may have more weight in the rating than others. Nevertheless, a self-regulatory body or a government regulatory agency could prepare credit rating guidelines for international and domestic bond sales.

The case studies indicated that credit ratings in the domestic market appear to be more of a regulatory requirement than a service requested by investors, although this is beginning to change, as ratings become more common. The structure of the bond issue also plays a role in whether or not a rating is necessary, as does the issuer's perception as to whether the cost of the rating is needed to place the bonds.

One of the factors that distinguished the international credit ratings from the domestic ratings appeared to be the quality of the information provided by the issuer to the rating agencies, especially financial statements. The underwriters in the international bond issues were concerned about the quality of the financial statements and in one case had them audited by an external accounting firm using international accounting standards. In another case the financial statements were converted to international standards as part of the due diligence process. This did not appear to be the case for the domestic ratings. The due diligence process for the international issues required that the underwriters restate the financial statements using international accounting standards. This was a costly, lengthy process and could have been used by the municipality to initiate a change in its accounting standards. But this opportunity was lost as neither the underwriter nor the issuer had any incentive to change its accounting standard, especially if the resulting standard did not conform to legal auditing requirements. Developing appropriate accounting standards is a major issue that has to be tackled at the national level so those municipalities have an incentive to change. National Governments should develop a Public Administration Accounting Plan. The local governments that accomplish this plan can access easier the domestic market and probably the international market as well.

Institutional Development and Capacity

An important factor contributing to the success of the case study bond issues was the level of staff development and their experience in municipal financial management. Most staff members did not have any experience with bond issues and recognized the need for external advisors and underwriters to assist in the process. However, the way in which the external advisors were used depended on the ability of the municipal administration to understand the details involved in preparing for the offering: gathering financial statements and statistics; rating agency presentation and strategy; regulatory applications and permits; preparation of the offering circular, etc. The most time consuming activity was organizing financial statements and financial performance information and presenting it in a format acceptable to the rating agencies. This was especially difficult for the international bond issues as the staff had to first understand the need for presenting financial statements using international accounting standards and then provide the support to the underwriters to complete the conversion. Preparation for domestic issues was simpler, but still required, in some cases, a reorganization of the municipal accounts to even produce a financial statement. The lack of adequate financial accounting and reporting systems is a major impediment to the efficient development of both the international and domestic bond markets. A good supervisory authority (e.g. Securities and Exchange Commission) that could publish guidelines of the legal and financial information that the local government has to register, assuring transparency.

Another area that will require substantial effort to facilitate development of the sub-national capital market is the need for disclosure and due diligence standards for offering circular documents. There is a huge gap between the quality of the offering circulars used in the international issues and the disclosure provided for domestic investors. A self-regulatory body should develop some basic standards for domestic capital market issues that follow the standards used for international issues. The most important guideline is the need to prepare adequate financial statements, as discussed above. The guidelines should take into account the cost of securing the information to insure that small and medium size municipalities are not prohibited from entering the market because of excessive bond preparation costs. The World Bank may consider a grant or loan fund for a country to support the organization of a self-regulatory body and the preparation of disclosure guidelines for the municipal bond market. It may also consider a special fund to provide assistance to municipalities to prepare disclosure documents for municipal bond issues. This effort can be started with a pilot program such as the "city assistance" strategy.

Development of a Professional "Infrastructure" for Domestic Bond Issues

Both the international and domestic bond issues had a variety of external advisors and professionals to assist in the preparation and placement of the domestic and international offerings. They managed the due diligence process; prepared the rating agency strategy and presentation and incorporated changes to the bond structure in response to rating agency comments. Bond market professionals also prepared the offering circular; developed the pre-sales strategy; and negotiated the bond price with the issuer and investors. The municipal staff gained valuable experience in following the details of a bond offering

Although the professionals were hired only to assist the municipalities in the bond offering process, the staff lost the opportunity to make general improvements in their financial management systems that would accelerate the development of the municipal markets. Municipalities may consider expanding the role of the external advisors to prepare a checklist of items the municipality should improve based on the disclosure and accounting guidelines developed by a national bond professional association or self-regulatory body, as proposed above. Ideally, however, the checklist should be made by regulatory and supervisory authority, who are political independent and can serve the general purpose of improving the capacity of the sub-national government.

The pricing of domestic offerings has to be based on competitive bidding, with a supervisory authority taking care of transparency of the process and that insight information has not occurred. If the domestic market is incipient, then a self-regulatory body could provide valuable assistance is in the pricing of domestic offerings. Due to limited bond volume, a small secondary market, lack of regulations regarding bond underwriters' guidelines and a variety of other factors, pricing of domestic bond issues in small markets is not very transparent. Municipalities do not know if they are receiving a fair price for their bonds (this is also the case for international offerings). For example, in one of the domestic issues with two tranches, the period to sell the first tranche was rather extended indicating a need to increase the price to attract investors. The second tranche sold off to a single investor in a short period indicating that the price might have been too cheap for the investor (interest rate too high and/or bond discount too great). The second tranche probably sold much faster because the bond security (a dedicated revenue source) was understood by the market and it was willing to purchase the bonds at a higher price the second time around. In an international issue the initial offering price was two to three times oversubscribed indicating strong demand and/or a low price with a spread to the equivalent U.S. treasury security of about 400 basis points. The spread declined to 225 basis points in the secondary market demonstrating either a bullish market for Emerging market debt and/or a high initial price; probably a combination the two factors. In both of these cases the issuer had no way of knowing whether they received a fair price because of the lack of pricing data. To obtain better information about pricing, a self-regulatory body could help establish rules for the dissemination of municipal bond prices in the primary and secondary municipal bond market. Municipal officials can also hire independent financial advisors to negotiate the pricing of bond issues with underwriters.

The case studies also pointed to another difficult issue regarding professional services: How do the municipalities know what professional assistance is necessary for the bond sale and the price they should pay for that assistance? Most of the professionals hired for the case study bond issues were retained on a negotiated basis[10]. Municipalities should consider the competitive selection of bond professionals. This makes the selection process more transparent and also provides the municipality with competitive pricing for professional bond services. . In the selection of financial advisors, underwriters, etc., it is very important to take into account their reputation in the capital markets. The credibility of the local government improves if a good financial advisor and/ or underwriter works with the local government. When a local government has a good reputation, the process can be the opposite. A financial advisor wants to work with this local government, because it increases its reputation.

Municipalities may also consider hiring a financial advisor prior to selecting a bond underwriter, as was the instance in some of the case studies. The financial advisor should provide the city with a long-term debt management strategy and an initial bond structure based on that strategy. The advisor can also do a significant amount of preparatory work for the bond issue. This includes organizing the financial statements and other documents to submit to the rating agencies; obtain regulatory approvals for the bond issue; and prepare terms of reference and a tender document for the competitive selection of the underwriter.

Regulation of the Sub-national Capital Market

Part I of the paper discusses the need for greater fiscal regulation of sub-national bond issues. The focus of this regulation is to ensure that sub-national governments are fiscally sound and do not threaten a country's macroeconomic stability. This type of regulation is more closely associated with improving the financial condition of municipal government before the central government allows it to issue bonds in either the domestic or international markets. The basic premise is that municipal borrowing should not occur if it creates an additional financial burden on the central government. The best way to avoid a negative impact on the national government is to require limits on total outstanding debt, as is the case in Colombia. Part I of this paper also discusses other options to maintain the financial health of municipalities.

Regulation can also include controls on the parties involved in bond transactions. The controls should insure that taxpayer revenues are used properly and municipalities are paying a fair price for their bond issues. This type of regulation was briefly discussed above in regards to guidelines for due diligence and disclosure documents, accounting standards, and bond pricing.

There are several options for developing bond transaction regulations and regulatory bodies. One option is to establish a self-regulatory body like the Municipal Securities Rule Making Board (MSRB) that regulates the municipal bond market in the U.S. This non-government entity is comprised of representatives from the municipal bond industry (primarily underwriters), public citizens and government agency representatives. It provides guidelines for the preparation, sale, disclosure and secondary trading of municipal bonds. Another non-government association, The Government Accounting Standards Board (GASB), promulgates accounting standards. However, neither the MSRB nor the GASB have the legal authority to mandate changes in the management of the municipal bond market. This remains with the Securities and Exchange Commission, a government agency that regulates the broader securities market.

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[10] Selection of underwriters for international issues was done on a "competitive-negotiated basis", with price as the primary selection criteria.

Another option is to delegate self-regulatory activities to other players in the nascent domestic municipal market – commercial banks, non-government organizations, trust organizations – whichever entities represent the interests of the parties involved in the market. International Emerging markets have self-regulatory bodies, such as the International Securities Dealer Association to maintain standards for Eurobond issues.

It may be premature to establish a self-regulatory body for the municipal market until the market reaches a certain volume of transactions and/or the central government establishes debt limits for sub-national governments to maintain macroeconomic stability. Nevertheless, the World Bank and other national and multilateral organizations interested in the further development of sub-national capital markets should begin to consider how to regulate municipal bond transactions to avoid potential corruption, insider trading and other negative behaviors that can severely damage an incipient municipal market.

Price Volatility, Market Demand and Investor Perceptions

The extent and duration of price volatility can sometimes be used as an indicator of the maturity of a market (breadth and depth of the primary market and volume of secondary trading) and the overall credit quality of the market participants. Price volatility in the international and domestic capital market for sub sovereign debt has many causes. The underlying cause is the lower credit quality of the issuers (after controlling for macroeconomic conditions) and narrow secondary markets. Uncertainty about the ability of issuers to make debt service payments combined with political uncertainty about their willingness to pay is the basis of the volatile conditions. This general condition applies to both the international and domestic capital markets.

The case studies demonstrated the volatility of both the international and domestic markets, but they each have their unique cultural characteristics. In the international emerging markets, bond prices of debt from the developing countries seem to move in blocks for regions and the market as a whole; they generally go up with good news such as progress on fiscal and monetary reforms; reduced inflation; currency stability; declining budget deficits, etc. Prices go down as a block on bad economic and political news: currency instability and potential for devaluation; deteriorating current account balances; anticipated budget deficits; changes in critical cabinet ministers, etc. International investors have begun to discriminate between countries and reward good economic policy with higher bond prices. But investors seem to move in a herd and punish most countries with lower prices during a crisis, such as the recent turmoil created by the problems in Asia. Emerging market investors have been recently criticized by officials in Latin America for failing to distinguish between emerging market regions, such as Asia and Latin America, not to mention the lack of discrimination within a region.

Extreme volatility in the international capital markets will continue for some time until the developing countries improve their credit condition and achieve solid investment grade ratings, in the A to A+ range. Until that time the markets will continue to move more on changes in political uncertainty, such as the election or appointment of government officials that change or reverse appropriate economic policy. They will also remain volatile until investors feel confident that economic policy will improve credit conditions measured by indicators such as General Government Balance/GDP, General Government Debt/GDP, Net Public Debt/Exports, etc.

As mentioned earlier, name recognition and the perceived credit condition of the sovereign issuers plays a significant role in the pricing of sub-national debt. Sub-sovereign debt will follow the lead of the sovereign in the capital markets, as demonstrated by the case studies. When the volatility of sovereign bonds subsides, investors can begin to discriminate between countries with higher or lower credit ratings rather than indiscriminately punishing all countries when a severe problem arises in one country. Once this sovereign discrimination takes place, investors can then differentiate between sub-sovereign entities with different credit ratings. However, this will most likely not occur for some time. High volatility in the sovereign market will remain until the major economies in a region achieve stable investment grade ratings. In the meanwhile only internationally recognized cities and regions will be able to access the capital markets on an unsecured or general obligation basis, with some occasional exceptions.

The case studies demonstrated that name recognition, size and management were the most important factors in determining the price of the bond issues (after taking into account the sovereign credit rating). Even with good financial indicators, a sub-sovereign entity that is not recognized by investors will pay a higher price and may not be able to access the markets at all unless it uses a dedicated revenue source to secure the bonds. These factors will act as natural obstacles for sub-sovereign governments seeking capital in the international capital markets and will most likely close the market for medium and small size issuers in Latin America.

Market demand and pricing in the domestic markets has a different cultural base than the international capital markets. The case studies illustrate that investors are skeptical about the willingness of elected officials to repay debt obligations, not to mention the ability of these entities to service their debt. They are also skeptical of newly elected officials to honor the obligations of a previous administration. In one case, the third tranche of a bond issue was canceled because the current administration's term was completed prior to the repayment of bond principal. The finance officer was concerned that the new administration would not honor the obligation of the previous administration and he decided to cancel the third tranche. This occurred in a municipality with a good financial record.

Most of the domestic investors who are familiar with the operations of sub-sovereign government rely more on their feelings of trust in the entity's willingness to pay rather than their ability to pay, especially in the medium and small size municipalities. This occurs for several reasons. First, it is very difficult to accurately determine the financial status of small and medium size municipalities. The accounting systems used by these local governments usually are not capable of forecasting the municipality's future cash position. The entities are managed by crisis as financial officers scramble to find the funds to meet critical payments such as payroll and essential vendors. This circumstance requires investors to demand bond structures that isolate the revenues used for debt service from the local government administration. This has resulted in the "dedicated revenue" bond structure described in the first part of this section. We expect that dedicated bond structures will be the most common form of bond issued in the domestic capital markets until investors feel secure that the culture of municipal political and financial management changes. These changes are slowly occurring as local officials are held more accountable to voters and financial management becomes an important political issue.

III. A Road Map to Understanding Sub-national Capital Markets

The case studies, although not representative of the general capital market universe, provide some interesting lessons and confirm some of the key factors that have to be in place before one thinks about local access to capital markets. Sub-national bond markets can be an important source of credit as is the case in the US and Canada. However, some basic conditions are required as a pre-requisite for successful development of a local government capital market:

➢ **Macroeconomic balances and Regulatory Framework** – The macroeconomic situation should be stable – macroeconomic instability increases the risk of long-term commitments. One of the reasons for the long established tradition of municipal bonds in the USA and Canada is the stable macroeconomic situation which has led to an important component of long-term savings and investments.

- Subnational borrowing should be clearly inline with the macroeconomic requirements. This may require strict limits in sub-national debt, including banks, bond issues, municipal development funds, etc..
- The regulatory framework should be transparent and enforceable and adapted to the circumstances of the local government. Access to international markets should be disciplined and the impact of exchange rate risk clearly evaluated.
- Access to domestic market should be promoted and regulated in parallel with the development of long-run sources of savings.
- Inter-governmental fiscal relations should be predictable, stable and leading to a stable flow of revenues to the subnational governments. (The case of Vietnam exemplifies the problems associated with lack of a clear inter-governmental fiscal framework: see Box 3).

➢ **Developed Internal Capital Markets**: Before any sub-national capital markets can be created, the country capital market needs to be in place and functioning. This requires six conditions

- Long-term funds should be available; financial markets should be deep to facilitate the supply of savings through formal networks

Market regulatory and supervisory system: The regulations and the authority that supervises all the participants of the market must be implemented. Two well known and successful models are the American system , based on a complete and exhaustive regulation and, the other hand, the London system, based on contracts and agreements, supported by a group of good lawyers in the City, but both system has in common the judicial enforceability of the contracts

Box 3
Intergovernmental Relationships in Vietnam

The Vietnamese system of intergovernmental fiscal relationships has been in flux over the past 10 years. A new budget law has been established by the central government on March, 1996 and amended on May, 1998. Before the law, assignment of revenues to the various levels of government changed from year to year; expenditures were guided by negotiation and political influences. The 1996 law established some structure. It defined the revenue authority and expenditure responsibilities of the various levels of government administration. A substantial vertical gap remains to be filled but no decisions have been taken on how to transfer new tax raising power to local governments. In addition, the implementation of the new budget law appears to exhibit some of the discretionary elements of the previous arrangements, at least in some of the "provincial cities. Data are poor and indicators vary according to the source.

Ho Chi Minh issued a city bond in 1996. It was the first and the last of sub-national access to markets in Vietnam. In 1995, Ho Chi Minh was the first city to access the capital markets in Vietnam. It placed a revenue bond to finance a toll road. The bond had a maturity period of 3 years and was placed with an interest rate of 17% p.a. The Bank for Investment and Development of Vietnam (BIDV) in HCMC was part of the team preparing the term of the bond and its issuance procedures. The BIDV was also the biggest buyer of the bond. The bond had some particular characteristics: Coupon fixed at inflation adjusted figure. The buyers were banks and public companies. There was no credit rating and no underwriters – the bond was bought at the Peoples' Committee Agency

- *Skilled personnel*: Skilled and pragmatic personnel is needed in the supervisory authority, issuers, brokers and portfolio managers. A special consideration has to be made in the training of financial advisers, owing to the financial knowledge is not broadly diffused among private investors. Investors should be familiar with the system; there is à need for a secondary market so that investors can sell their assets prior to maturity (increasing the liquidity of otherwise illiquid assets
- *Market organization*: The market can be, physically, a place where brokers meet to buy and sell securities, according to the regulations of this market. The future is an information system that integrates the clearing system, the spot market and the derivative market. The software has not to be developed. For example, the Swedish and the Australian stock exchanges use a software developed by a Swedish company, the Spanish stock exchange use the software of the Toronto stock exchange. The main problem is the communications network, and the implementation of the information system depends of this infrastructure.
- *Rating agencies and bond insurers* should be encouraged to play their role informing the public of the risk of the operations.
- *Market size*: The most important factor to develop a sub-national market is to develop the national market, helped by regulations, and also supervision, that permits the development of insurance companies, mutual funds, pension funds, etc., and in general, institutional investors as a way that permits the transformation of savings in long-term funds. The critical points in this process of creating long-run savings structures are the following:

  a) When the mutual funds, the pension funds, or other institutional entity begins to be implemented successfully, one may face a risk of excess demand for securities, price increase and more incentives for additional offerings. This situation together with lack of skilled personnel may bring serious problems for the market.

  b) The development of a capital market needs the support and collaboration of the domestic banking system. The international banks, that know this business and compete with the domestic banks, can help accelerate the development of the capital market and, in particular, the process of collaboration of the domestic banks.

  c) The National Treasury has a leading role in the development of the domestic capital market. Not only it sets the regulatory framework, but is own behavior in capital markets sets the benchmarks against which the prices of other issues are fixed.

  d) The national government may be in a situation of competing with local governments to issue bonds and finance their deficits. This may lead to a conflict of interest, especially, if the market is narrow. A regulatory framework well defined and transparent is essential to prevent discriminatory positions of the central government.

- *Liquidity*: A sub-sovereign can rise founds a good prices in the capital markets if its issues offer liquidity. The problem can not be resolved only with the implementation of market makers, t depends of the budget size, size means to be frequent in the market and this helps that the issues have liquidity. In another case, the alternative , usually more expensive, because a premium is paid for not being liquid, is private placements. The private placements, on the other hand, introduce the sub-sovereign in the market and prepare it for future public issues.

➢ **Local Governments** should have a good fiscal and management system and capacity to generate consistent and strong revenues. They can. improve their attractiveness to borrowers by

- instituting accounting, auditing, and disclosure standards that are compatible with international standards.

- improving the quality of their collateral by allowing central governments to deduct debt service directly from intergovernmental transfers or pledging a specific tax or other revenue source to service debt on a specific loan.
- Making sure that loan contracts can specify that the payment of debt service on a specific loan will be given contractual priority—or prohibit a municipality from issuing additional bonds backed by the same revenue source until a specific debt is retired.

In many countries with recent/shallow domestic capital markets, those conditions may not be present. The first problem is the quality of municipal or sub-national management and accounting, which is often quite poor and incomplete. The second problem is the shortage of long term savings, as decades of hyperinflation have destroyed any habits of regular savings. Regulation and economic policy can also be an impediment. Examples are controls over interest rates or impediments against the development of institutional sources of savings such as pension funds, and insurance companies. Finally the legal system may not be prepared to deal with default, and local governments may not have the ability or the authority to raise taxes, as these fall under the central government control.

Over the long term, national governments should address constraints on the domestic capital market. To mobilize private long-term savings, there is a need to eliminate interest rate caps; remove regulations that restrict the growth of insurance companies, mutual funds, and pension funds; improve the quality of information in the market by enabling regulatory authorities to evaluate the financial health of institutions; and facilitate the development of private rating agencies; and strengthen legal frameworks. Finally, there is a need to make local governments more attractive to potential lenders. Central governments can strengthen a local government's revenue position by assigning broad tax bases to local governments and freeing local governments to determine tax rates. Local governments can, in turn, render themselves more attractive to bondholders by using this power prudently – for example, by keeping tax rates low they leave headroom for increasing rates if necessary.

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ong, unblemished credit history.[11]

[11] Petersen and Hammam 1997; Dailami and Leipziger 1998.

Appendix 1
Ciudad de Buenos Aires, Argentina

I. Description of the Bond

Ciudad de Buenos Aires – USD 500 million Euro Medium-Term Note Programme, Individual Notes Due From 30 days to 30 years from Date of Issue

Feature	Details
Issuer	City of Buenos Aires
Arranger	Chase Manhattan International/Chase Bank AG
Dealer	Chase Manhattan International
Currency	Various hard currencies, including USD, Pesos, Liras, Sterling, Francs, Yen, ECU, etc
Amount	Up to USD 500 million equivalent in series
Maturities	Variable per series 1-5 years. Variances to be approved by the Central Bank
Issue Price	At par, discount or premium over par per series
Method of Issue	Continuous basis with syndication, if need be, and minimum offerings of USD 10 million equivalent
Interest Rate	Each series can be at fixed, variable or zero coupon
Fixed Rate Notes	Can be payable in arrears on agreed dates
Variable Rate Notes	Interest borne separately in each series by reference to benchmarks such as LIBOR, LIBID, etc
Interest Periods	As agreed between issuer and dealers
Zero Coupon Notes	Do not bear interest and normally issued at a discount
Withholding Tax	Principal and interest free and clear of this tax
Denominations	Definite Bearer and Registered Notes as agreed
Optimal Redemption	Pricing Supplement to state redemption conditions
Listing	Luxembourg Stock Exchange (or as otherwise specified in the applicable Pricing Supplement)
Status	Direct, unconditional, unsecured, unsubordinated ranking pari passu with all obligations of Issuer
Negative Pledge	Negative pledge in respect of specific factors
Covenants	Interest cover charge applies. Other specific and standard covenants included in Condition 4 of Offer Document
Cross Default	In respect of present and future indebtedness, etc
Governing Law	English
Selling Restrictions	Several restrictions included
Transfer Restrictions	Several restrictions on Registered Notes in reliance of Rule 144A
Clearing System	Euroclear and Cedel for Bearer and Registered Note and DTC for Registered Notes under Rule 144A
Pricing Supplement	Issue price, date, maturity, principal amount, interest rate applies to any Notes
Use of Proceeds	As specified in Pricing Supplement

A. Purpose of the Issue

The City of Buenos Aires initiated its USD 500 million Euro Medium Term Note Programme in March 1997. The program was divided into individual series of notes, issued for 30 days to 30 years from the date of the Programme's inception. The individual notes could be issued in a variety of currencies, including the Argentinean Peso, USD, Italian Lira, etc. The purpose of the Programme was to refinance the city's debt stock and restructure one of its banks – Banco de la Ciudad de Buenos Aires. The latter received USD 100 million. Four series of notes have been issued under the Programme within a two month time span and the entire Programme has been drawn down. The first note series was issued in US dollars and targeted primarily to the USD market. The intention was to gain credibility in the USD market and to build on this placement in other markets.

The program is the city's first foray into the international bond market. Each of the individual transactions sold out well and was 200% over-subscribed on average. The city has a sound administration and reasonable international reputation. These considerations overshadowed a growing fiscal deficit in recent years, brought about mainly by structural problems built into the current account. The city's debt at the time of the issue represented only 1.4% of its GDP. This, coupled with a targeted reform program, helped achieve reasonable ratings, which strengthened market perceptions.

The individual notes were placed at the higher end of the spread threshold. However, with the exception of the Peso denominated offer, the city was quite interested in a geographic and investor diversified placement and perhaps less with all-in costs. The role of the underwriter and its internal financial staff cannot be underestimated. This is indeed a common feature of such landmark issues.

B. The Underwriting and Marketing Process

The underwriting and marketing process was led by Chase Manhattan. The first issue involved 10 co-managers, including:

Banco Bansud
Banco Frances del Rio de la Plata
Credit Suisse First Boston
JP Morgan Securities
SBC Warburg
Banco de Credito Argentino
Banco Rio de la Plata
Deutsche Bank
Lehman Brothers
UBS

In the case of the Peso issue (USD 150 million equivalent), there were only four co-managers: Banco Bansud, Banco de Credito Argentino, Banco Frances and Banco Rio de la Plata.

The first issue under the program (USD 250 million) sold extremely well in the market, despite a the rapidly weakening Argentine sovereign issues priced off the US Treasury benchmark (US Treasuries 2006) during the marketing phase. The latter went from 330 basis points to 370 basis points over the benchmark in just one morning. The city's main concern was clearly to have a successful issue at all costs. Its second objective was to have a widely distributed placement with a strong US participation. In a tightening market situation with the benchmark Treasuries performing poorly, the issue was a resounding success at the higher spread spectrum. The transaction was 2 times over-subscribed with two-thirds of the notes sold to US investors. Another important feature was that it attracted new money (rather than investors selling out of existing portfolios). This can be considered a major achievement from the point of view of the city.

The second USD 150 million equivalent in Pesos issue was struck in record time – with marketing starting on a Friday and the price fixing taking place on the following Monday. The market timing was carefully selected to coincide with a healthier market tone. The deal had first been tested in March. However, at the time the city was concerned about the price and the relationship between the peso and the Argentine Treasury 2006 benchmark. The spread differential during the marketing period of the first USD 250 million issue in April was 140 basis points. The USD 150 million equivalent in Pesos was launched in an environment with a narrower 95 basis point differential. In this instance, the city expressed concern about the all-in cost of Pesos over what was achievable in USD. The issue was subsequently fixed at about 70 basis points greater than where the city could do a seven year dollar tranche. As pointed out, these considerations were overshadowed by a strategy to diversify the city's presence in as many markets as possible. This is one of the reasons why the peso transaction was later accompanied by the lira offering. The latter's performance was equally impressive. Chase was able to place the peso and lira denominated notes in record time with investors pre-targeted during the preparation process.

The EMTN program as a whole was highly successful. The book or order demand was high in all cases – about 2 times oversubscribed. The entire individual series of notes were sold out. This, coupled with the unsecured nature of the notes, highlights the high level of investor confidence in the Administration. Interest for the individual offers came mainly from institutional investors, who purchased on average about 90% of the issues. The split between markets was more or less the same. The high coupons on each of the notes, nevertheless, also attracted considerable interest from retail investors. The notes thus far seemed to have experienced a strong secondary market demand.

II. Conclusions and Lessons Learned

Some external and internal factors were important in the analysis of this case:.

- ***External Factors***

<u>Macroeconomic Conditions</u>

The macroeconomic context (of the country and the city) played a major role in the issue. The principal effect was its influence on the city's credit rating and investor perceptions. Key variables taken into account were the Convertibility Law and its associated measures and the economic growth pattern of the city. The city's resilience to the Tequila Crisis, for example, was a major achievement that helped solidify the city's credit rating. The importance of the city to the overall national GDP, employment and income was also taken into account in the credit rating and investors' risk perception. Another aspect of the economic context was the high contribution of the city to the total Co-participation revenue and its correspondingly low level of revenues in return. The city simply does not depend on central government transfers as is the case with other local government authorities.

<u>Bond Market</u>

Bond market conditions at the time of the note sale had a major impact on the placement dates and price arrangements. They also determined the overall underwriting and marketing process. An issue of this size and complexity could not be sold on a "firm bid" underwriting basis. The underwriting industry does not provide firm underwriting bids for sub-sovereign Emerging market issues. The underwriter in this instance carried out extensive market checks and was able to forecast the placement of the issues significantly in advance of the actual sale. There were nonetheless rapidly changing conditions at the time of placement for the first and third series (USD 250 million and USD 150 million Peso series). The underwriter faced higher bond prices because of increasing Argentine sovereign bond spreads vis-à-vis the US Treasury

2006 benchmark. The issuer had to make difficult pricing decisions. Because the city was more interested in a wide distribution than on all-in costs, the first series in particular sold at the higher end of the "spread to Treasuries" spectrum. The peso series reversed this pricing process as market timing was more carefully assessed. The lira issues were targeted at specific investor groups at high spreads.

- ***Internal Factors - Issuer Related***

  Administration and Reputation

The administration's professional staff, and its reputation, were major factors behind the success of the issue. It is important to bear in mind the difference between financial performance and the city's image. The latter showed significant weaknesses. But in this instance, the reputation of the city was strong enough to deflect at least some weaknesses.

Financial Flexibility and Reforms

Financial flexibility and reforms were one of the single most important factors that had an impact on the preparation of the issue and its rating. The subject was extensively covered by the underwriter and the rating agencies and occupied a major portion of the Offering Circular. One of the greatest concerns of the rating agencies in particular was the fiscal gap and the reforms being put in place to reduce it. The rating agencies view the fiscal deficit as a function of structural problems on the income and expenditure sides of the accounts, and to some extent questioned/cautioned the city's ability to address these problems in the immediate future.

It is essential to bear in mind that the issue itself is a function of this deficit and hence a mounting short term debt – comprising late payments to suppliers and loans/capitalization needs of Banco de la Ciudad de Buenos Aires. The bond was driven by the need to restructure these short-term obligations. The fact that the notes were launched is in some way recognition of the difficulty in tackling the structural problems.

- **Internal Factors - Issue Related**

It is important to note the perception and questions by investors during the road shows for the note sale. In most cases, the concerns were about the reform program and in particular the measures aimed at collecting a higher share of uncollected taxes, cutting back expenditures and the prospects for the privatization of Banco de la Ciudad de Buenos Aires. In contrast, in the case of Mendoza, the questions concerned the legal tittle to oil royalties. These questions are all essentially about bond security. However, none of the investors expressed interest in the likelihood or steps needed for a possible bail out. The same issue would be treated differently in Brazil where there is a long track record of bailouts, and thus a stronger element of moral hazard.

- **Financial Credibility**

The single most important lesson from the issue is that the issuer needs to demonstrate strong financial operations. When there is a fiscal gap (as is the case here), the important consideration is to have the mandate and reform program aimed at balancing the position. Buenos Aires would not have been able to issue the notes with a poorly defined program of reforms. It would also have been in a more difficult position had its fiscal gap not narrowed in the previous financial year. The gap had widened too quickly and would have raised serious concerns at with the rating agencies. The financial gap problem was also largely compensated by a low debt burden. At 1.4% of GDP, it is one of the lowest in Argentina and Latin America.

- **Due Diligence and Rating**

The issuer would not have been able to enter the international, or even the domestic market, on an unsecured basis without the information base to facilitate due diligence and the rating process. These two tasks are crucial in determining issue strategies, structures, underwriting and sales. The due diligence process always focuses on legal, commercial, financial and operational aspects. It is often structured around rating agency requirements. The city was able to support both processes efficiently.

- **Role of Underwriter**

There is no doubt that the role of Chase was of paramount importance in the success of the issue. A landmark transaction of this nature normally puts greater emphasis on the role of the underwriter. The latter can plan the preparation process, support the due diligence, manage the rating process, assess market conditions and define the final strategy and structure. The role and efficiency of the underwriter is, however, influenced by the quality of the information base and the local government's staff. In this instance, both teams integrated well and played to their strengths.

The Buenos Aires issue is a landmark transaction matching issuer with issue strengths. The transaction was well managed both from the point of view of preparation, offer and placement.

Appendix 2
Province of Mendoza, Argentina

I. Description of the Bond

Features	Details
Amount:	US$ 125 million
Market:	Eurobond
Issue Date:	Offered August 2, 1996, Closed August 8
Issue Price:	100% Fixed Re-Offer
Interest Rate:	Fixed at 10% per annum
Interest Payment Period:	Quarterly on 25th of January, April, July and October commencing 25th of October 1996
Maturity Date:	7 years to July 25 2002
Amortization:	Same as Interest Payment
Ranking:	Direct; not subordinated
Security:	See Collateral
Collateral:	(i) 88% of Oil Royalty payments to the Province (ii) Argentine Collection Account, US Collection Account and Debt Service Reserve Account.
Guarantees:	None
Source of Principal & Interest Payments:	Oil Royalty payments to the Province by certain oil producers under long term concessions to be deposited in the Argentine Collection Account.
Debt Service Reserve Account:	Minimum balance of debt service due on the next Quarterly Payment Date.
Excess Collection Trigger Events:	(i) Debt Service Coverage Ratio falls below 1.2 for three consecutive collection periods, or (ii) Proved Reserves divided by Production Level (yearly basis) falls short of the remaining maturity.
Positive Covenants:	♦ Ensure validity and perfection of security and assignment documents ♦ Maintain all necessary government approvals and permits ♦ Ensure its rights under oil concessions are maintained
Negative Covenants:	♦ Create, transfer, etc. other liens on its rights to oil royalties and other properties ♦ Modify the oil concession agreements
Major Risks:	♦ Termination of dedicated oil concessions ♦ Political risks on the regulations of the oil industry ♦ Fluctuation in world oil prices ♦ Oil reserves and future production ♦ Currency risks ♦ Country risk
Pertinent Conditions Precedent:	The notes were issued subject to certain international and local credit ratings (see Credit Ratings)

Features	Details
Events of Default:	♦ Usual events of default on non-payment of debt service and non-compliance of terms and conditions. ♦ Default on other outstanding indebtedness in an aggregate principal amount of at least US$ 10m. ♦ Debt service reserve account falls below minimum requirement for six consecutive collection periods. ♦ Adverse changes to fiscal and constitutional laws affecting the dedicated concessions and assignment of royalties.
Credit Ratings	♦ Duff & Phelps International, BB ♦ Duff & Phelps Argentina, AA (Local) ♦ Ratto & Humphreys, AA+ (Local)

A. Purpose of the Issue

The province, as was the case with other provinces, had a short-term debt structure. As a result of the Convertibility Plan, the province was unable to roll over existing obligations. An international bond issue with longer-term maturity and at fixed cost of funding became an attractive alternative.

Financial considerations aside, the province viewed the issue as a good opportunity to further expose it to the international market, gain credibility and diversify its funding sources. This was particularly important in attracting direct foreign inward investments for the province's privatization program.

The international bond issue was structured as a single transaction. However, the underlying intention was to pave the way for further issues in the future as existing short-term debts mature and the province's capital expenditure program expands.

B. Type of Bond

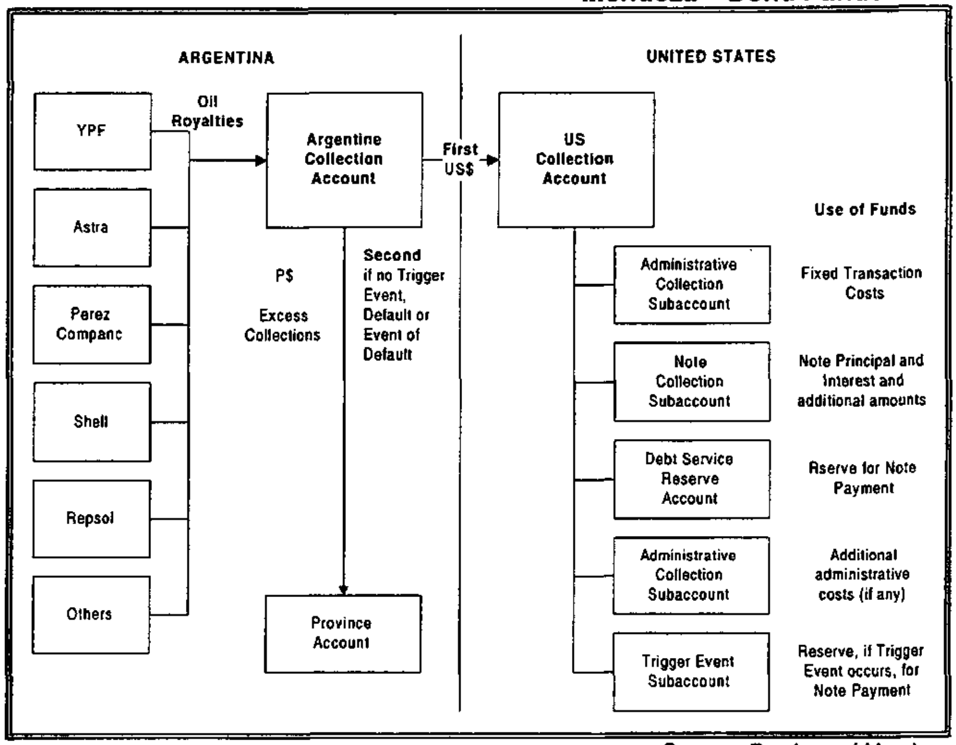
The Province of Mendoza issued the notes in August 1996 for a period of six years, maturing in July 2002. The notes were the province's first public debt issue, and the first oil royalty backed structure for a Latin American issuer in the international market.

The notes were secured by a priority interest in 88% of all future oil royalty payments due to the province from oil companies. A three-month debt service reserve was also funded from excess royalty collections. A tight security package and bond structure was essential to insure the success of the province's first international bond issue.

The transaction was successfully placed despite a long marketing period and the disruption of the Cavallo resignation. Investor interest came mainly from US and European institutional investors attracted to the relatively high 10% coupon

One of the primary factors that lead to the success of the issue was the pledge of oil royalties and the flow of these funds to an off-shore collection account, as shown in Figure 1, below.

Figure 1
Mendoza – Bond Funds Flow



Source: Province of Mendoza

II. Impact of the Issue

The credit rating and the due diligence process were the most important elements of the marketing strategy.

Credit Rating

The international, and local, credit rating process required detailed and accurate financial and economic information, which took the underwriting team a considerable amount of time to gather. Although this effort yielded dividends, not only in the success of this issue, but also in shortening significantly the preparation time of the second issue, there was little evidence that the actual financial reporting and accounting standards used by the province were restructured. The province, however, took further steps in tax reforms and implementing expenditure control programs following this issue. This resulted in an improvement in its fiscal performance and eventually an upgrading of its foreign currency general obligations rating to "BB" by Duff & Phelps.

Due Diligence Process

Legal due diligence, performed by Argentine counsel, was particularly important in the transaction process. The key aspects of the bond issue the legal team examined included the oil concessions (terms and conditions, validity of permits, oil royalties), the relevant hydrocarbon laws, the province's rights to the oil royalties and other revenues sources, as well as the validity of the collateral documents and arrangements. Other important legal matters were the regulatory and constitutional framework governing the province's tax raising powers, expenditure responsibilities and debt issuance capability.

The financial and economic due diligence process was by far the most difficult part of the entire bond preparation process. The main obstacles were insufficient statistical information, and the lack of Provincial financial information.

Appendix 3
Guaymallen, Argentina

I. Description of the Bond

Guaymallen Municipality – Titulos De Obras Publicas (TOG2), Second Tranche of a US$ 3 million Global Programme, Collaterised Against Treasury Bonds (Bote 3), Enhanced with Co-participation Revenues As Required.

The US dollar denominated notes were marketed in the local Mendoza area. The complete note program was USD 3 million divided into three series or tranches of USD 1 million each.

The first tranche (TOG1) was issued in December 1996. It had a maturity of two years and seven months and was successfully placed. TOG1 had an interest rate of 10% and five equal principal repayment periods. The placement was made entirely in the Bolsa de Comercio de Mendoza. The issue was underwritten by Mercado de Valores de Mendoza SA, with an over-subscription of 220%. The transaction was backed by Argentina Treasury bonds (BOTE 3) in the amount of USD 1.19 million. These were deposited with a fiduciary company in Mendoza – Caja de Valores de Mendoza SA.

TOG 2 was the second issue in the series. It is important to note that a third series did not materialize – principally as a result of the incumbent administration wishing to avoid transferring new debt obligations to an incoming government in 1999. TOG 2 has a relatively short maturity of one year, with 50% of the note's amortization taking place at the end of January 1999 and the balance at the end of July 1999. The interest rate is 9.5% (fixed and significantly lower than the previous series), representing a 300 basis point spread over the Argentine Treasury Note. The minimum purchase was USD 100 per lot with multiples of USD 100. The issue was sold at par value, with commissions and costs charged to the issuer. The collateral base, to cover principal and interest payments, was Argentina Treasury Bonds held by the municipality (Series 3 or BOTE 3). However, in contrast with the previous series, the amount of pledged collateral rose from USD 1.19 million to USD 1.26 million. This security package was further enhanced through pledges of co-participation revenues from the Mendoza Province. In common with the previous issue, the BOTE 3 treasury bonds were placed in trust for the duration of the bond period with the same fiduciary firm – Caja de Valores SA. Underwriting was once again the responsibility of Mercado de Valores de Mendoza SA. The record 48 hour placement was also made in the Bolsa de Comercio de Mendoza.

A. Purpose of the Issue

The issue was to gain experience and credibility in the domestic bond market and to help raise funds for civil works/capital projects. In contrast with many other public entities, Guaymallen did not come into the market to restructure or rollover existing debt. The city wished to "experiment" with the bond market in order to pave the way for an orderly entry into the emerging local capital markets. The restrictions imposed by the Convertibility Law on local bank municipal and provincial government finance motivated Guaymallen to explore alternative funding sources. The bond market provided this opportunity.

The city structured the bond issue in three series for experience and to establish contact with different operators in the Mendoza Exchange. The administration was less concerned with price and collateral than with a successful placement. In the longer run, its objective is to issue, as needed, on a non-recourse basis.

B. Type of Bond

Despite the healthy financial standing of the municipality, the issue was structured around a high collateral base, supported by treasury bonds amounting to USD 1.26 million. The collateral was pledged free of liens and placed with a fiduciary and paying agent, Caja de Valores S.A. The higher collateral base for the second tranche, TOG2, contributed to an interest rate that was lower than the TOG1 tranche.

♦ Permits/authorizations

The municipality handled all the relevant permits and authorizations:

- The Executive Council – approved a certificate within the provisions of a Decree No. 350/98 regarding municipal finance.
- Provincial approvals and consents – under Decree No. 686/97, published in the Official Bulletin of the province and order No 4429/97, the province had to approve the transaction.
- Ministry of Finance – a permit from the MOF was required in order to issue debt in hard currency (resolution Nos. 1075/93 and 327/95).
- Rating – the city selected Magister/Bank Watch and Standard & Poor's.

The second issue was prepared and placed in six months. This compares favorably with the first series, which took over a year. The second series benefited from the experience gained by municipality staff. The timing in the first series was affected by lack of expertise, administrative hold ups and some internal resistance to raise funds through a bond instrument.

♦ Rating

The municipality engaged the services of two separate rating agencies to rate the issue:

- Magister/Bankwatch Calificadora de Riesgo
- Standard & Poor's

The advisor and the financial department staff managed the rating process. The rating agencies focused their attention on the image and credibility of the municipality, legal due diligence (a focus on the fiduciary arrangements) financial standing, debt stock obligations, information systems and intergovernmental relations. They also assessed in more broad terms the economic base and structure of the city and the level of investment flowing into the area. Notwithstanding these variables, however, the key focus of attention was the collateral base pledged by the administration. This enhanced the risk profile of the credit issue and eliminated most, if not all, of any other concerns that might have arisen in other due diligence areas. In addition to the collateral, co-participation revenue transfers further secured the bonds. The rating agencies assessed the central government revenue transfer payment track record. These transfers would make good any shortfalls resulting from a forced sale of treasury bonds and/or other municipality repayment income. Both agencies rated the issue AAA.

C. Subscription and Sale

The municipality mandated Mercado de Valores de Mendoza to underwrite the issue. This entity had also handled the first series, with great success. The entity was also considerably cheaper than three commercial banks that had approached the administration for the same purpose. Mercado de Valores was mandated by the city directly without tenders. The commission charge amounted to 1% of the bond par amount, a very competitive rate in the market for an issue of this nature. Mercado de Valores was thus solely responsible for distribution of the bonds with the Mendoza Stock Exchange, primarily among personal and some institutional investors. The underwriting contract was firm and required the underwriter to purchase the bonds. However, to insure its ability to re-offer the bonds, Mercado de Valores had undertaken an extensive pre-sale contract to assess its own risks. This study involved its traditional agents/clients in the Exchange – some of whom are its shareholders.

- **Marketing & Distribution**

In common with the first issue, TOG 2 was more than twice oversubscribed. The issue was placed entirely in the Mendoza market within a record period of 48 hours. The underwriter placed the issue entirely through a selected list of agents contacted before the underwriting contract was signed. The brokers/agents re-offered the bonds to about 20 individual investors. The issue has not changed hands much since the placement date. The secondary market is tight. This situation is unlikely to change between now and the maturity date. The issue was placed during the peak of a bull market period. The actual placement dates coincided with the inception of the Asian crisis and confidence has since been eroded quite considerably. The small amount of the total transaction, its tight structure and collateral fueled investor interest.

II. Impact of the Issue

A. *Benefits*

The issue was targeted at institutional investors in the Mendoza Exchange. This had been the approach taken in the previous placement – with great success. The main motivation by the municipality was to expand its coverage/image among top investors in and beyond the province. The experience was also intended to increase the staff's know-how and capabilities, paving the way for work on future issues. A third issue was not considered appropriate: it would have overlapped with the administration period of the incumbent mayor and raised the debt profile of the city to historically high levels.

Conclusions and Lessons Learned

Guaymallen is a landmark capital markets case study for a small to medium sized municipality in Latin America. Some of the lessons learned from the Guaymallen bond issue are as follows:

- **Market Testing**

The issue was not driven by short-term debt financing requirements (a common feature in all other cases except Ibague), nor by capital development expenditure programs (although the funds were specifically assigned to complete infrastructure-related civil works). The main reason for the issue was to gain experience in the capital markets and to prepare staff and politicians for future bond issues. The municipality understands the difficulties experienced by other administrations with a past high dependency on short-term expensive debt. It also understands the risks associated with late payment delays to contractors. The latter has been another traditional short term funding measure used by municipalities and provinces across the country. The city placed all these considerations within the context of restricted bank lending; itself the result of Central Bank policy reform measures. In view of these events, and given the need to maintain services, upgrade infrastructure (whilst continuing to attract increasing private sector investment), the city targeted the bond market as one its future funding options. This experimentation with the process and the players will increase its ability to react and respond to market conditions. It will also pave the way for a future non-recourse bond issue.

- Importance of Financial Discipline

The city's strong financial discipline and disclosure is a model for other institutions, but there is still room to improve. Guaymallen could benefit from a better information system, budget process and control. The concept of a supervisory commission for financial management is also an innovative element, and one that should be replicated throughout the region.

The Guaymallen issue is one of the most interesting case examined. It highlights the aspirations of well-run administration with a strong financial standing. It also outlines the shortfalls of market demand (tight market) and the incompleteness of the due diligence and rating process. Guaymallen is well placed to becoming one of the first such issuers to sell an unsecured general obligation bond in the domestic market.

Appendix 4
Rio de Janeiro, Brazil

I. Description of the Bond

A. Purpose of the Issue

The purpose of the issue was to refinance domestic debts that had shorter maturity periods and higher costs of funding. The municipality is prohibited under Federal Constitution to issue new debt, both internationally and domestically, except for this purpose. Furthermore, the municipality considered that an international debt issue would not only raise the city's profile vis-à-vis foreign investors but also pave the way for further transactions in the international market. The issue was the first of its kind offered by a Latin American municipality.

B. Type of Bond

Features	
Amount:	US$ 125 million
Market:	Eurobond
Issue Date:	Offered July 2, 1996 Closed July 12,1996
Issue Price:	99.96% Fixed Re-offer
Interest Rate:	Fixed at 10.375% per annum
Interest Payment Period:	Quarterly on 25th of January, April, July and October commencing on 25th October 1996
Maturity Date:	3 years to 12 July 1999
Principal Payment/ Amortization:	Same as interest payment
Ranking:	Direct and unsubordinated, except for certain municipal bonds that may be used to pay taxes under certain circumstances
Depository	DTC
Source of Principal & Interest Payments:	Municipal revenues, with Chase Manhattan as paying agent
Positive Covenants:	□ Standard
Negative Covenants:	□ Standard
Major Risks:	□ Currency Risks □ City Credit Risk □ Country Risk □ Poor debt service history

The Municipality of Rio de Janeiro issued in July 1996 a $10^3/_8$% US$ 125 million three-year unsecured Eurobond. This made Rio the first city in Latin America to issue an unsecured bond in the international capital markets. The issue's registration follows standard Eurobond procedures and is listed on the Luxembourg Stock Exchange and traded in the PORTAL Market. The notes are deposited with or on behalf of DTC. Chase Manhattan is the Paying Agent.

Despite the fact that this was the municipality's first public international debt issue, the notes were unsecured. The issue price was 99.96, providing a yield at launch of 10.6611% which was 25bp above the Brazilian benchmark, or 400bp over the 1999 US Treasury Note at the time of the sale.

The transaction was considered to be highly successful as evidenced by the relatively small 25 basis point spread to the sovereign bond. The book demand was high – 2 to 3 times oversubscribed. The underwriters without the need to retain any bonds in their account sold out the entire issue. The successful sale was accomplished in the last year of the Maia administration and with no collateral. Foreign investor confidence in Rio combined with a comparatively attractive yield were the main reasons for the underwriting success. Interest came mainly from institutional investors who purchased 95% of the issue. This was split 58% US, 25% Japan and 17% Europe. The high coupon also attracted interest among retail investors who took up the remaining 5%.

There was a deep secondary market for the issue and the bond performance improved over time. The spread on US Treasury narrowed to just 225 basis points one year later, reflecting a continuing rise in investors confidence in the city brought about by consistent improvements in city finances and a positive Emerging market tone (which has rapidly deteriorated since the spread of the Asian crisis).

C. Subscription and Sale

Merrill Lynch acted as the lead underwriter for the issue under a fixed-price re-offer arrangement. The underwriting discount was 0.75%, 60% of which represented selling commission and the remaining 40% underwriting/management fee. The underwriter's discount was on the low side in comparison to a typical fee of 3% for this type of Emerging market transaction. However, the low fee was necessary in view of Merrill Lynch's long-term interest in Latin American sub-sovereign debt issues. The market was viewed by many of the leading investment banks as having high growth potential. As such, competition was strong. Merrill Lynch competed against 19 other investment banks for the Rio underwriting mandate.

Merrill Lynch formed a syndicate consisting of 8 co-managers who were leading investment banks targeted for their distribution networks in the US, Europe and Japan.

Figure 2
Rio de Janeiro - Syndicate Members

Syndicate Members	Underwriting Amount US$ million
Merrill Lynch Inc	101
Bayerische Vereinsbank AG	3
BB Securities Ltd	3
Commerz Bank AG	3
Dresdner AG	3
Nomura International Plc	3
Salomon Brothers International Ltd	3
Swiss Bank Corporation	3
Yamaichi International (America) Inc	3
Total	125

Source: Merrill Lynch

The issue was marketed in the US under Rule 144A to qualified institutional investors and outside the US under Regulation S. The most important part of the marketing process was the road shows. Before the final placement, Merrill Lynch presented the city administration and the bond transaction on road shows in the US (New York, Boston, San Francisco, Los Angeles, the Mid West and Colorado). The presentations to investors were made by the city administration itself. They were well prepared and made significant inroads into improving the city's overall credibility vis-à-vis investors.

The key pricing factor was market sentiment. This was the first city issue and was being offered without collateral. Investors looked primarily to the strength of the city administration, which had the reputation of a well-managed operation. The book order indicated that there was strong demand, but only at a significant spread to the US Treasury yield. Issuers were driven by yield. The issue was finally priced at 400 basis points above the 1999 US Treasury yield (which equated to 25 basis points above Brazilian benchmark). At this price, the issue was 2 to 3 times oversubscribed. Following the initial launch, the issue developed a deep secondary market. The spread on US Treasury narrowed to 225 basis points.

II. Impact of the Issue

The bond issue helped Rio establish an excellent reputation, particularly in its success in substantially improving fiscal performance and promoting transparency. The city has a number of supporting factors. It has a diversified economic base and plays an important role in the Brazilian economy, accounting for 7.5% of the GDP. Against these strengths, however, the city still suffers from a weak socio-economic profile, which will place an increasing strain on its finances.

The bond issued helped motivate the city to implement a comprehensive system of fiscal controls, tighter tax administration procedures, transparency and accountability. Two international auditing firms audit financial statements. This has contributed significantly to the city's good fiscal performance, and enhanced its reputation in the international market. Despite these efforts, the city still suffers from serious information gaps, and inconsistencies vis-à-vis world standards.

A negative impact for the city is Brazil's long and controversial history of sub-sovereign debt crises and central government bailouts. While it was clear that the issue was sold purely on the credit strength of the municipality, previous local government bailouts indicated that there was an implicit government guarantee that was incorporated into the investors overall view of the credit risk.

Conclusions and Lessons Learned

The transaction preparation process was crucial to the credit rating process, particularly the preparation of financial statements prepared with international accounting standards and the general due diligence process.

The underwriting and marketing process affected the final uptake of the issue as well as the offer price. The underwriting syndicate ensured that the placement was given a geographically large coverage. In addition, the small size of bond allocations to co-managers and small lot size illustrated the strong market demand.

Even though two international auditing firms audited the city's financial statements, the city still suffered from serious information gaps. In addition, interpretation of the financial statements was rendered meaningless due to the inconsistencies and differences that exist between Brazilian accounting standards and international accounting standards. Brazilian accounting standards do not necessarily reflect the economic and financial reality of municipal operations.

Appendix 5
Ibague, Colombia

I. Description of the Bond

Features	Concept
Offer Date	July 1996 and July 1997
Issuer	Municipality of Ibague
Agent	Fiduciaria Global SA
Amount	Pesos 8 million
Tranche 1	Pesos 4.8 billion
Tranche 2	Pesos 3.2 billion
Collateral	Future gasoline taxes
Interest Margin	Variable over DTF +3.5%
Maturity	maximum
Placement	Five years
	Bogota, Medellin and Occidente

The Titulos were placed in two separate tranches of 4.8 million and 3.2 million pesos. The first tranche was sold in July 1996 and the second in July 1997. The second tranche sale was conditional on the gasoline tax cash flow performance for the first tranche issue. The gasoline tax was the security and collateral for the bonds.

Both tranches were placed with brokers on the exchanges of Bogota, Medellin and Occidente. The maturity period was five years. The interest margin for the first tranche should have been based on the variable rate DTF plus 2.75%, in line with Central Bank rate guidelines for this type of maturity. However, this particular type of transaction fell outside the standard regulation and the actual market spread was DTF + 3.5%. DTF is the average rate for a 90-day period for banks and other financial institutions that participate in the certificate of deposits market. The relatively high spread for the first tranche reflected tight local market conditions at the time, the risk profile of the municipality, and the perceived uncertainty regarding gasoline tax income. The second tranche attracted a margin of DTF +2%. The interest and principal payment schedules were arranged in monthly, quarterly or semi-annual installments, with semi-annual principal payments restricted to about 17.5% of the total. The amortization choice could be delegated to issue holders. However, two additional conditions formed part of the structure: 40% of the principal could be repaid by the 48th month and 60% by the 60th month.

Duff & Phelps of Colombia gave the issue an A+ rating. The gasoline tax revenue performance during the first 12 months of the issue was fully satisfactory. This factor, combined with a hike in the tax rate from 14% to 20%, eased the marketing period and allowed for the successful placement of the second tranche.

A. Purpose of the Issue

The issue proceeds were used to help finance a series of civil works aimed at improving road and other transport infrastructure within the city's jurisdiction. Although there were alternative funding instruments in place for infrastructure investment, the city's financial advisers suggested a bond transaction structured around gasoline tax revenues to complement these sources. The city could raise the gasoline tax if necessary, a fact which helped it receive the A+ rating. Another crucial advantage of this type of revenue-backed transaction is that it is not included in the measure of the city's direct or official debt stock. All "titularizaciones" of this nature are exempt from the debt indicators used by the government to manage municipal debt capacity, although the law has tightened on this since the time of the Ibague issue.

The projects selected for finance under the new bond facility were as follows:

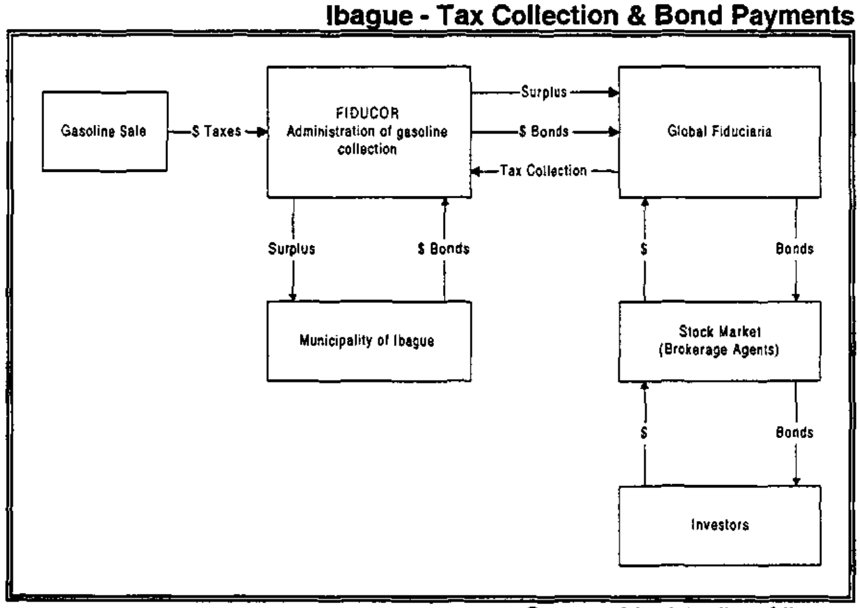
- ♦ Autopista Barrio Eduardo Santos – Descanso del Papa – construction, extension and maintenance
- ♦ Maintenance and extension of road systems
- ♦ Construction of viaducts and access roads in local districts
- ♦ Construction and expansion of various rural roads
- ♦ Provision of 20% of the funding required for the construction and development of Avenida Ambala and Avenida 79.

The issue was the first of its kind for the municipality and only the second in the entire country using gasoline sales tax revenues as collateral for a bond issue. The effort was also seen as a means to enhance the city's image and reputation in the market place. Despite this, the issue was perceived as a one-off transaction rather than a debt program. It is important to note that the municipality had a healthy financial standing at the time, matched by a reasonably ambitious plan to invest in services and facilities over the medium term. In contrast with many other local government issues in Latin America at the time, the Ibague transaction was not intended to refinance short or long term debt obligations.

B. *The Structure*

Figure 3, below illustrates the structure of the Ibague bond transaction.

Figure 3
Ibague - Tax Collection & Bond Payments



Source: Municipality of Ibague

The advisors for the transaction were Fiduciaria Global, backed by Corporacion Financiera de Occidente. Global was also appointed agent/manager for the transaction.

Corporacion Financiera de Occidente is a limited liability company registered under Colombian corporate laws. With appropriate certificates from the Superintendencia Bancaria, it can act as a financial advisor to municipal governments. Occidente's role in the bond transaction was to assist the authorities with its design and structure. The firm also undertook limited financial and organizational due diligence of the municipality and supported the work on gasoline market assessments and projections.

Fiduciaria Global was established in 1992 as a limited liability company with a mandate to establish fiduciary and financial advisory operations. The firm is registered and approved by the appropriate authorities, including the Superintendencia Bancaria. Global is based in Bogota, and is a subsidiary of a larger group that has changed its name to UCN. The firm had a track record with the type of fiduciary operations envisaged under the Ibague bond issue. Their role in the transaction was to co-ordinate the work of Occidente and Ibague, and manage the transaction process. Some of Global's other tasks were as follows:

- Administration of revenues
- Co-ordination of the rating process and rating company
- Support with the preparation of the circular
- Management of appropriate permits, approvals and consents.

C. Subscription and Sale

The issue was difficult to place. Revenue backed transactions of this nature were fairly new in Colombia at the time of the sale. Although municipalities could raise gasoline taxes, originally the maximum rate allowed by central government was 14%. This was later increased to 20%, providing a strong impetus for municipalities to raise funds. Other assets eligible for collateral purposes include debts, company shares, fixed assets and cash-flow. In more recent years, municipalities have also tried to collateralise duties on beer and liquor sales. The underlying objective in all cases is that the funds raised need to be assigned to infrastructure development.

Despite these considerations, revenue-backed operations of this nature are difficult to establish and market. The government was, and remains, generally unhappy with the concept, the state accounting bodies are unclear on its accounting treatment and most investors were concerned with the legal aspects – particularly in connection with the title to, and the transfer of, public revenues of this nature. In addition, most investors were initially concerned about the fact that the collateral was structured around future rather than existing revenues. The advisers and the municipality staff recognized these problems and agreed to structure the operation in two tranches, the second contingent on the performance of the first. This measure provided additional support and incentives to the investors.

The issue was placed entirely in the domestic market. There were some significant differences between the tranches:

- The first tranche was placed with a relatively small number of institutions through 5 brokers operating in the three Stock Markets in Colombia. The brokers were awarded quotas against a firm underwriting commitment and an average commission fee of 1%. The brokerage arrangement was not subject to an open tender. The order period was long and the margin correspondingly high. The original buyers of the first tranche were as follows:

- The second tranche was acquired by one single broker in the Medellin area, for subsequent marketing and distribution to institutions in the various exchanges. The commission rate in the second tranche was negligible. The success of the first transaction impacted on this, as well as on the actual uptake by institutional investors.

Figure 4

Ibague First Tranche Uptake

	Investors (Millions)	Amount
1	Insurance Company	350
4	Pension Funds	1,400
2	Insurance Companies	730
1	Investment Fund	100
2	Fiduciaries	250
1	Mutual Fund	100
1	Bank	200
2	Cajas Compensacion	1,550
1	Company	120
	Total	4,800

Source: Municipality of Ibague

The bonds remain with a limited number of institutional investors. Trading has been narrow. The capital market in Colombia is small and the level of liquidity tight. Ownership has been mainly with the following bond holders:

Figure 5

Ibague Second Tranche Uptake

	Investors (Millions)	**Amount**
1	Insurance Company	1,350
5	Pension Funds	2,850
3	Insurance Companies	1,730
1	Broker	600
3	Fiduciaries	300
1	Bank	200
7	Employees Funds	850
2	Cajas Compensacion	1,550
3	Companies/Others	120
	Total	8,000

Source: Municipality of Ibague

The broker shown in the table above is the same one that acquired the issue on behalf of Ibague.

II. Impact of the Issue

A. Benefits

Credit Rating

The credit rating process was very beneficial to the municipality. Duff & Phelps awarded the issue a credit rating of A+. The rating is quite high by local municipal risk standards and reflects mainly the strong collateral base. The two tranche series helped considerably in reducing the risk profile, especially the second trance which was contingent on the revenue collection performance of the municipality during the first year of operations. The second issue was placed a year later and Duff & Phelps has maintained its A+ rating for both issues.

In contrast with some of the other case study credit ratings, the strong collateral base for the Ibague transaction simplified enormously the due diligence effort by the rating agency.

The gasoline tax revenues, and the structure put in place for their collection and transfer to bond holders, effectively "ring-fenced" the issue from the municipality's financial standing and shifting conditions in business, financial and political environment. This is a significant consideration and an important lesson for other municipalities wishing to enter the bond market – although the rating approaches differ considerably between different Latin American countries. It should also be noted that the process in Ibague was eased by the fact that the city was classified under the "green light" category, meaning that its financial performance and debt structure was manageable and that it could issue bonds without central government approvals. It is highly unlikely that the issue would have been processed had the city been classified in any other category – with or without the collateral base.

The selection of Duff & Phelps was relatively easy: it is the only international agency operating in Colombia that provides domestic ratings.

B. Difficulties and Weaknesses

The analysis of the Ibague case reflects several difficulties and weaknesses. The offering circular does not provide detailed information about the economic structure of the city. Although the bonds are collateralized by the gasoline tax, the fiscal condition of the city is important to gauge political risk. The trustee may be able to collect gasoline taxes as long as the city maintains a positive operating balance. If the city's financial condition deteriorates, it may consider negating the fiduciary contract and capture the gasoline revenues. The probability of this political risk is much reduced if the city is in good financial health. From this perspective the offering circular should review the economic base and financial condition of the city.

Another important omission from the circular and rating report is information on demographic factors. There is no data to provide details on density, growth rates and age distribution of the city's population. A declining or rapidly aging population will always tend to put a significant constraint on public finances – since it shrinks revenues or accelerates service demands, especially on health care. High population growth is likely to be the real situation in Ibague. This can be regarded as a positive feature in the context of the issue since it could be partially attributed to high in-migration of working-age population, and in the context of the collateral, of a greater number of vehicles and skilled workers. Another important aspect of demographics is the size of the dependent population (the portion under 15 and over 65). These groups place demand on services but contribute less to income. The circular does not cover this basic requirement.

Although the financial information in the prospectus provided an interesting account of performance and expectations, under normal circumstances, it would have been virtually impossible to decipher its validity, depth and degree of timeliness. Much of the data is collected manually and reported late. Without the gasoline tax collateral and a sound fiduciary set up to handle gasoline tax revenues, the transaction may not have stood the due diligence tests of most discerning financial investors, and in this sense it might have failed. The rating report also attached importance to this collateral aspect, largely ignoring the inadequacies of the financial reporting system and the financial performance. The deal was effectively "ring-fenced" from other existing and future activities by the municipality. This includes the actual institutional/administration capabilities since the collection and distribution of taxes were responsibilities mandated to fiduciary concerns.

C. Conclusions and Lessons Learned

The issue strategy and structure were of paramount importance to the success of the issue. The main consideration here was a broad investor approach and the use of the collateral base.

The issue was targeted at the institutional sector with considerable pre-sale marketing efforts. The first series was more difficult to place, although the strategy was largely adhered to. The key element behind success was the collateral and two series tranching approach. This provides an important lesson, particularly for landmark operations of this nature. The collateral base was backed by a tight fiduciary arrangement. Without the collateral and fiduciary arrangements, it is unlikely that the issue would have enjoyed the same reception. This fiduciary arrangement was much less well defined in the case of Valle del Cauca, with serious consequences, especially in terms of rating and market credibility for the issuer. Most future collaterised issues in Colombia will most likely have to follow the arrangements made by Global Fiduciaria in the case of Ibague.

The main lessons learned from the issue are as follows:

- Its "one-off" nature
- Deficient information system, budget controls and financial planning

- *One-off Issue*

The one-off nature of the issue is a weakness and a lesson for future transactions. Although the issue was divided into two series, the overall market perception is for a one-off transaction linked to a specific investment program.

- *Information, controls and planning*

A common denominator with similar issues (by municipalities or provinces) is the weakness of the information system. This will need to be remedied over time if the city is ever to appear in the market without collateral. The same requirement could apply even for collaterised issues if at any time in the future the credit rating agencies decide to introduce tighter disclosure and efficiency criteria. The remaining constraint is the lack of detailed financial planning. The latter should include a better awareness of different financial instruments. Budgeting and control is also a major deficiency.

In conclusion, Ibague can be regarded as a successful issue, taking place in more difficult market conditions than similar issues by small municipalities in Latin America. Ibague is a useful case to highlight the potential for raising disclosure and due diligence standards. Its fundamentals are right. Eventually it should consider issuing unsecured obligations. However, significant improvement in financial reporting, controls and planning are necessary before smaller municipalities can enter the bond market with bonds secured by the city's full faith and credit.

Appendix 6
Valle del Cauca, Colombia

I. Description of the Bond

Department of Valle del Cauca, 50.000 Million Colombian Pesos Notes Collateralised Against Liquor Sale Taxes

Feature	Detail
Issuer	Departamento Valle del Cauca
Amount	P$ 50 billion
Series	Planned in 3 series varying maturities
Successful series	Series C, seven year maturity
Placement	Bolsas de Valores: 3 domestic markets
Target investors	Institutional and retail
Law	Colombian – Codigo de Comercio
Security	Tax on Liquor sales
Security arrangements	Fiduciary for bond holder repayment
Underwriter	Banco de Colombia
Agent	Fiducolombia SA
Use of Proceeds	Debt restructuring/capex programme

The notes were issued in December 1996 by the Department of Valle del Cauca for a period of seven years, maturing in December 2003. They are guaranteed by taxes collected on regional liquor sales. These taxes were structured to cover up to 130% of the debt service obligation (including principal and interest). In the event of tax revenue short falls, the Department would be forced pledged other current operating revenues. Under the prevailing capital market laws, all tax revenues that secure bonds are permanently tied to the specific debt obligation, and can not be used by the issuer for any other purpose. The law itself provides stiff penalties, and even prosecution, for non-compliance.

The bonds were placed in three domestic stock exchanges over a two-day period – during the 23rd and the 26th of December of 1996, dates considered quite unusual for this type of transaction and market. The main reason for selecting these dates was the department's fiscal shortfall.

The issue was directed at domestic institutional and personal investors and is listed in the stock exchanges of Bogota, Medellin and Occidente. Institutional investors purchased most of the bonds in the Bogota Stock Exchange. The proceeds were intended to cover the financing requirements of projects under the capital budget (25 billion pesos) and to refinance existing debt (25 billion pesos). The total transaction was structured around three separate tranches, with an amount of 50,000 million pesos each.

- Tranche A: five years maturity – not placed
- Tranche B: six years maturity – not placed
- Tranche C: seven years maturity- successful placement

The inability to place the first two tranches was a function of poor issue price structure, relatively long maturities and bear market conditions. For the first two tranches the market was tight and the department had to compete with other transactions. The market improved considerably towards the period coinciding with the third tranche. The high price margin paid by the city was the most important factor in the sale of the third trance. In addition, longer maturities were not a concern by the time the third trance was sold, as the market entered into a bull market phase.

A. Purpose of the Issue

The bond concept and preparation process was led by the administration itself. The entity had gathered considerable expertise from a previous issue with similar characteristics in 1991. The issue was required to meet debt obligations and to help fund capital expenditure. A summary of this investment program is shown below:

Concept	Works (Number)	Amount (Mil Peso)
Public Works	47	5,556.4
DATT	2	355.2
Education	39	2,539.2
Health	53	3,226.8
Hacienda	10	2,687.8
Community Development	31	2,743.0
Agriculture	9	546.8
Indeval	10	915.0
Acuavalle	7	2,399.1
Government	4	296.0
Valorizacion	3	3,300.0
Visevalle	4	352.0
Social Programmes	2	190.0
Total	221	25,107.3

In terms of the refinancing outstanding debt, the department targeted the following specific obligations:

Institution	Amount (Mil Peso)	Margin	Issue Date	Maturity Date
Banco Uconal	1,800.0	DTF + 6.0	Apr 95	4/00
Caja Agraria	1,500.0	DTF + 4.5	Oct 94	10/99
Caja Agraria	2,080.0	DTF + 4.5	Jun 94	06/99
Corfiboyaca	3,600.0	DTF + 6.0	Apr 95	04/00
Banco del Estado	800.0	DTF + 6.0	Dec 94	12/99
Banco Industrial	3,000.0	DTF + 6.0	Jan 95	06/00
Banco Industrial	1,833.3	DTF + 6.0	Jul 95	07/00
Banco Ganadero	6,600.0	DTF + 5.0	Apr 96	04/01
Las Fes	2,500.0	DTF + 5.0	Apr 94	04/99
Bancafe	1,286.6	DTF + 5.0	Oct 93	10/97

B. Subscription and Sale

The bonds were placed in just two days between the 23rd-26th of December. The pre sale efforts by Banco de Colombia contributed to the rapid placement. It is also important to note that market conditions were highly favorable (bull market). The pre-sale work was performed among the bank's regular clients. The bank's treasury department led the work. The issue did not have a road show. The number of purchase tickets was limited, as shown below:

Figure 6
Valle De Cauca Uptake

Buyer (Mil Peso)	Tickets	Amount	% of total
Personal Investors	2	260	0.52%
Real Sector	5	1,450	2.90%
Banks	2	3,570	7.14%
Financial Corporations	5	15,650	31.30%
Trustees	9	4,010	8.02%
FCO	15	7,750	15.50%
Pension Funds	30	17,310	34.62%
Total	68	50,000	100.00%

The make-up of the bondholders has not changed significantly since the initial offering, as shown in the table below for July 1998:

Figure 7
Valle De Cauca Current Bondholders

Buyer (Mil Peso)	Tickets	Amount	% of total
Personal Investors	1	100	0.20%
Real Sector	39	10,900	21.80%
Banks	5	5,100	10.20%
Financial Corporations	9	5,300	10.60%
Trustees	1	160	0.32%
FCO	5	10,450	20.90%
Brokerage Firms	19	120	0.24%
Insurance Companies	6	1,180	2.36%
Pension Funds	15	16,690	33.38%
Total	68	50,000	100.00%

II. Impact of the Issue

The most challenging factors for the bond preparation was the due diligence process and projections related to liquor revenues. The liquor tax was the centerpiece of the collateral package. It also almost entirely defined the rating process.

The liquor tax projection was inadequate, despite a direct involvement by the department in liquor sales (through one of its companies) and the historical record of sales from the previous issue.

Due diligence was conducted by the department's own economics and financial staff, supported by a financial advisor and Banco de Colombia. The financial advisor was a financial firm with experience in similar bond issues – Comisionista de Colombia. In complete contrast with the other domestic bond case studies, the involvement of the advisor was fairly limited. This type of situation tends to develop with follow-up issues that have the same structure as the initial offering. Indeed, a key finding from case studies is that landmark issues are much more difficult to prepare and sell than subsequent operations; the problem being compounded by the lack of experience at the level of the issuer. In Valle del Cauca, the advisor went as far as to relinquish responsibility for the actual quality of the information in the placement prospectus. In contrast with other countries, however, in Colombia this exclusion is not possible i.e. the advisor is jointly and severally responsible with the issuer for the circular contents.

Conclusions and Lessons Learned

The key factor to take into consideration in this case is the regulatory framework which facilitated the issue process and its placement. The critical elements are the tax raising powers of the department, its debt structure and the formal government approval process.

Valle has considerable leverage on raising taxes. However, the administration has also inherited major service delivery responsibilities under the decentralization process. This has had a negative impact on Valle's fiscal health, and as a result will likely hinder the sale of unsecured bonds. The department's debt structure, however, is not reported as being excessively high, thus allowing it to qualify for bond sales under the "green light" category. However, the financial reporting systems that determine the department's fiscal condition are not reliable. Consequently, the "green light" allowing the department to issue bonds may be misleading.

Appendix 7
Latin America Sub-National Bond Issues

Date Issued	Place	Issuer	Currency	Amount	Type	Market	Rating	Collateral
Argentina								
8/10/93	Province	Cordoba	USD	60	GOV	Euro-Priv		
6/23/94	Province	Buenos Aires	USD	100	GOV	Euro		
10/4/95	Province	Buenos Aires	USD	100	GOV	Euro	BB-(S&P)	
11/23/95	Province	Buenos Aires	DM	107	GOV	Euro	BB-(S&P)	
2/12/96	Province	Buenos Aires	DM	169.22	GOV	Euro	B1 (Moody's) ; BB-(S&P)	
5/1/96	Province	Entre Rios	ARP	13	GOV	Dom		
5/1/96	Province	Entre Rios	ARP	22	GOV	Dom		
5/1/96	Province	Entre Rios	ARP	22	GOV	Dom		
5/1/96	Province	Entre Rios	ARP	20	GOV	Dom		
8/2/96	Province	Mendoza	USD	125.00	GOV	Euro	BB (Duff & phelps Int.); AA (Duff &Phelps Argentina);AA+ (Ratto & Humphres)	88% Oil royalty, Argentine collection Account, US collection account, Debt Service Reserve
9/18/96	Province	Buenos Aires	SFR	161.19	GOV	Euro	B1 (Moody's); BB- (S&P)	
3/18/97	Municipality	Guaymallen	USD	3.00	GOV	Dom	AAA (S&P), AAA(M/B calificadora de riesgo)	
4/3/97	City	Buenos Aires	USD	250.00	GOV	Euro	B1 (Moody's); BB- (S&P)	
4/11/97	City	Buenos Aires	USD	250.00	GOV	Dom		
05/11/97	Province	Buenos Aires	USD	250.00	GOV	Euro	B1 (Moody's)	
5/13/97	City	Buenos Aires	ARP	150.00	GOV	Euro	B1 (Moody's); BB- (S&P)	
5/23/97	Province	Buenos Aires	LIT	0.1 (trill)	GOV	Euro	B1 (Moody's); BB- (S&P)	
5/28/97	Province	Buenos Aires	USD equ.	150.00	GOV	Euro	B1 (Moody's); BB- (S&P)	
6/10/97	Province	Buenos Aires	USD	69,000.00	GOV	Euro	B1 (Moody's); BB- (S&P)	
8/14/97	Province	Tucuman	USD	200.00	GOV	Euro	BB- (S&P)	
8/22/97	Province	Mendoza	USD	250.00	GOV	Euro	B1 (Moody's); BB- (S&P)	
9/1/97	Province	Tierra del Fuego	USD	55.00	GOV	Dom&Glob		
Bolivia								
11/23/94	Municipality	Gobierno Municipal de La Paz	USD	3	GOV	Dom	n/r	CTA Receptora Sinking Found
10/8/97	Municipality	Gobierno Municipal de La Paz	USD	3.5	GOV	Dom	n/r	CTA Receptora Sinking Found
11/6/97	Municipality	Gobierno Municipal de La Paz	USD	2.5	GOV	Dom	n/r	CTA Receptora Sinking Found
11/7/97	Municipality	Gobierno Municipal de La Paz	USD	3	GOV	Dom	n/r	CTA Receptora Sinking Found
12/5/97	Municipality	Gobierno Municipal de La Paz	USD	2	GOV	Dom	n/r	CTA Receptora Sinking Found
Brazil								
6/1/93	City	Sao Paulo	REALES	99.00	GOV	Dom		
6/1/94	City	Sao Paulo	REALES	99	GOV	Dom		
6/12/96	Municipality	Rio de Janeiro	USD	125.00	GOV	Euro	B1 (Moody's); B+ (S&P); BB-(duff Phelps)	
7/2/96	City	Rio de Janeiro	USD	125	GOV	Euro	BB+(S&P)	
11/1/96	City	Rio de Janeiro	REALES	17	GOV	Dom		
6/1/97	City	Rio de Janeiro	REALES	21	GOV	Dom		
6/26/97	State	Sao Paulo			GOV		n/r	
9/1/97	City	Rio de Janeiro	REALES	21	GOV	Dom		
Colombia								
1991	Municipality	Palmira	L	1,000.00	GOV	Dom	n/r	
1991	Municipality	Pereira	L	2,600.00	GOV	Dom	n/r	
1991	Municipality	Santiago Cali	L	4,000.00	GOV	Dom	n/r	
1991	Municipality	Santiago Cali	L	4,000.00	GOV	Dom	n/r	
1992	Municipality	Cartago (Valle)	L	700.00	GOV	Dom	n/r	
3/17/93	Municipality	Medellin	L	15,000.00	GOV	Dom	n/r	
9/1/93	Municipality	Bucaramanga	L	4,976.00	GOV	Dom	n/r	
8/1/94	Municipality	Santiago Cali	L	46,437.00	GOV	Dom	n/r	
9/22/95	Municipality	Itagui	L	11,660.00	GOV	Dom	A	
9/26/95	Municipality	Rionegro	L	2,000.00	GOV	Dom	n/r	
11/16/95	Municipality	Santiago Cali	L	20,003.00	GOV	Dom	AA-, A+	
4/24/96	Municipality	Medellin	L	20,000.00	GOV	Dom	AA	

EL ENDEUDAMIENTO DE LOS GOBIERNOS SUBNACIONALES: EL CASO DE LAS PROVINCIAS ARGENTINAS

Alejandro Zentner
Juan Sanguinetti

Versión Preliminar

Indice

Abstract

El análisis de los controles al endeudamiento subnacional constituye una importante línea de investigación en los estudios sobre federalismo fiscal, y en particular, de aquellos concentrados en la relación entre la descentralización fiscal y la gestión macroeconómica. Existe abundante evidencia empírica que indica que el marco institucional de las relaciones fiscales intergubernamentales resulta clave para que un proceso de descentralización resulte exitoso, en el sentido de fomentar la solvencia fiscal de los gobiernos subnacionales y brindar los incentivos que conduzcan a una gestión pública más eficiente en términos de la cantidad y calidad de los servicios públicos provistos. En este sentido, la existencia de un régimen de transferencias intergubernamentales con cierta cuota de discrecionalidad, la posibilidad de utilizar los bancos públicos para obtener financiamiento adicional o contraer deuda flotante con empleados públicos y proveedores, la ausencia de mecanismos de control al endeudamiento subnacional o el uso indiscriminado de garantías para la contratación de préstamos con instituciones financieras, son factores que debilitan la restricción presupuestaria que enfrentan los gobernantes. El presente trabajo enfatiza los aspectos institucionales del control del endeudamiento subnacional para el caso Argentino. Se analizan los diferentes mecanismos de control del endeudamiento de las provincias argentinas instrumentados por el gobierno federal. En particular, se analiza la distorsión que introduce la utilización de los recursos del régimen de coparticipación federal de impuestos como colateral y de que manera esta distorsión impide que el mercado financiero funcione como disciplinador.

I. Introducción

En los últimos años, el análisis de la relación entre descentralización y gestión macroeconómica ha tomado preponderancia en la literatura sobre federalismo fiscal. Esta literatura ha puesto en evidencia que en los países que han adoptado una organización federal para su gobierno, la gestión macroeconómica y la estabilización de la economía se ven seriamente influidas por las normas y prácticas del federalismo fiscal.

Algunos autores han adoptado una posición "pesimista", subrayando que los procesos de descentralización podrían acarrear costos o "peligros" que en alguna medida pueden atenuar las ventajas de la descentralización, en particular, se refieren a los procesos de descentralización llevados a cabo últimamente en los países en desarrollo y en las economías en transición (Bird *et al,* 1995; Prud'homme, 1995; Tanzi, 1995).

Al respecto, Tanzi (1995) señala que existe suficiente evidencia empírica en los países en desarrollo que bajo ciertas circunstancias las jurisdicciones subnacionales han contribuido –en muchos casos significativamente- al emperoramiento de los problemas macroeconómicos. En dicho trabajo argumenta que "en diferentes países en desarrollo los gobiernos locales impulsaron aumentos en los gastos por encima de los incrementos en sus recursos, incrementando así la deuda y ocasionalmente forzando a los gobiernos centrales a salir en su rescate".

Para Ter-Minassian (1997) esta aparente contradicción entre descentralización y gestión macroeconómica es mucho mayor cuando los gobiernos subnacionales no operan en condiciones de limitaciones presupuestarias estrictas, es decir, cuando hay plena autonomía en los gobiernos subnacionales.

Claramente, la percepción de los políticos sobre la dureza de la restricción presupuestaria resulta clave para que un proceso de descentralización resulte exitoso, en el sentido de fomentar la solvencia fiscal de los gobiernos subnacionales y brindar los incentivos que conduzcan a una gestión pública más eficiente en términos de la cantidad y calidad de los servicios públicos provistos.

A su vez, existe cierta evidencia que determinados arreglos o marcos institucionales en las relaciones fiscales intergubernamentales o ciertas características de las finanzas subnacionales pueden debilitar la dureza de la restricción presupuestaria, y por lo tanto, la disciplina fiscal (Jones, Sanguinetti y Tommasi, 1997; Stein *et al*, 1999; Dillinger and Webb, 1998; Nicolini *et al* 1999). En este sentido, la existencia de un régimen de transferencias intergubernamentales con cierta cuota de discrecionalidad, la posibilidad de utilizar los bancos públicos para obtener financiamiento adicional o contraer deuda flotante con empleados públicos y proveedores, la ausencia de mecanismos de control al endeudamiento o el uso indiscriminado de garantías para la contratación de préstamos con instituciones financieras debilita la restricción presupuestaria que enfrentan los hacedores de políticas.

En particular, la literatura pone de manifiesto que las normas y prácticas asociadas al endeudamiento subnacional constituyen un aspecto clave en todo proceso de descentralización. Según cual fuese su diseño institucional-legal esta aparente contradicción entre desecentralización y estabilización puede exacerbarse.

Los controles al endeudamiento y la posibilidad latente de un salvatage por parte del gobierno central afectan directamente la percepción del mercado financiero acerca de la restricción presupuestaria que enfrentan los gobiernos subnacionales. En este sentido interesa conocer de que manera dicho nivel de gobierno accede a los mercados financieros y cual es el papel del gobierno central.

En Argentina las provincias tienen una gran autonomía para contraer endeudamiento. La constitución nacional no hace referencia alguna a las facultades de los gobiernos provinciales para contraer deuda pública. No obstante, en casi todas las constituciones provinciales se establecen límites específicos a los servicios de la deuda, y en algunos casos, al destino de estos créditos.

En la Argentina sólo existe información de la deuda provincial para la historia reciente. En los últimos años, la deuda consolidada de las provincias y la Ciudad de Buenos Aires ha crecido en forma importante (más de un 100% desde 1994). Para fin del año 1999 se espera que el endeudamiento consolidado de las provincias alcance una cifra cercana a los U$S 18.000 millones (U$S 19.500 millones si se considera la deuda aun no consolidada de la Ciudad Buenos Aires con la Nación), una deuda que representa un 50% de los ingresos anuales de dicho nivel de gobierno.

Sin embargo, la magnitud agregada del endeudamiento subnacional no es la variable más informativa para advertir el potencial problema sobre la gestión macroeconómica nacional –nótese que la deuda provincial agregada es reducida en relación con la deuda del gobierno nacional que supera en 1999 los U$S 130 mil millones.

En cambio, el potencial riesgo puede percibirse con mayor claridad analizando la gran heterogeneidad entre las performances fiscales de las distintas provincias. Existen jurisdicciones que han tenido una política fiscal ordenada y responsable, en las cuales la deuda no representa problema alguno (San Luis y La Pampa, por ejemplo). Por el contrario, en otras provincias, los altos y recurrentes déficit públicos han generado deudas importantes que obligaron a comprometer una alta proporción de sus fondos coparticipados, afectando seriamente su flujo de ingresos corrientes, comprometiendo la prestación de los servicios básicos (salud, educación, justicia y seguridad) y obligando al gobierno nacional ha realizar rescates a algunas provincias.

Al respecto, Nicolini *et al* (1999) argumentan que: "Entre los episodios que han tenido mayor repercusión pública y que por lo tanto resultarían interesantes analizar se destacan: la crisis recurrente que enfrenta la provincia de Jujuy y que desencadenó la renuncia del gobernador a fin del año pasado, la crisis de Tucumán que enfrentó durante 1993, la crisis que se desencadenó en la provincia de Santiago del

Estero y que culminó con el incendio de la casa de gobierno y posterior intervención del gobierno federal y las sendas crisis fiscales en Río Negro y Córdoba que se desencadenaron luego de la crisis del tequila. Varios han sido los mecanismos que el Poder Ejecutivo Nacional utilizó para aportar recursos adicionales a las provincias que atravesaban dificultades fiscales y financieras, entre los más importantes, deberíamos mencionar los anticipos de coparticipación, los Aportes del Tesoro Nacional, préstamos del Banco de la Nación Argentina u otras instituciones bancarias oficiales (por ejemplo, BICE), préstamos en títulos públicos (BOTESO 10) y redescuentos del Banco Central a los bancos provinciales, entre otros." Además, no puede dejar de mencionarse las recurrentes intervenciones a la provincia de Corrientes en los años 1992, 1995 y 1999.

Esta situación ha llevado a que se plantearan, desde distintos ámbitos, estrategias tendientes a solucionar el problema de la deuda de las provincias argentinas. FADE (1999), por ejemplo, ha presentado *una propuesta para modificar el perfil de vencimientos de deuda pública en las provincias*. Sin embargo, este trabajo sólo propone una tecnología financiera para atenuar la carga de la deuda en el corto plazo sin analizar como rediseñar la relación Nación-Provincias de modo de plantear una solución de fondo. Aún más, tal como está planteada la propuesta –sin una redefinición del marco institucional de la relación Nación-provincias- puede considerársela como un nuevo episodio de rescate.

Otro propuesta fue la incluida en el proyecto de ley para reformular el esquema de coparticipación federal de impuestos del Senador R. Ortega, en el cual se plantea la necesidad de acordar entre las provincias metas similares a las planteadas en el tratado de Maastricht para limitar el endeudamiento subnacional.

El propósito de este trabajo es estudiar la problemática del endeudamiento subnacional en el caso de las provincias argentinas. Es extremadamente importante este análisis, dado que si se parte de un diagnóstico equivocado las recomendaciones de política pueden no ser las más apropiadas. Un análisis integral debe incluir un estudio de las condiciones financieras de las provincias para plantear una propuesta de corto plazo, pero además debe incorporar un análisis del marco institucional del endeudamiento provincial de modo de instaurar un nuevo esquema de comportamiento fiscal provincial en el cual los comportamientos fiscales de una provincia no perjudiquen la estabilidad macroeconómica nacional y de las demás provincias.

El trabajo se organiza de la siguiente manera. El segundo capítulo, comienza con un análisis de la literatura sobre los efectos del endeudamiento subnacional sobre la gestión macroeconómica en un país federal. En el tercero se presenta el enfoque de la disciplina del mercado para los gobiernos subnacionales. El cuarto capítulo contiene un análisis de los controles al endeudamiento subnacional, adoptando un criterio normativo y empírico. El capítulo quinto profundiza sobre la problemática de la deuda provincial, presentando información sobre su evolución y composición. En el sexto capítulo se presenta de una manera estilizada la naturaleza de los controles al endeudamiento subnacional para el caso Argentino. Este análisis incluye el papel de los controles internos de cada jurisdicción subnacional, el rol del gobierno central y del Banco Central, el papel de los bancos y entidades financieras y de las calificadoras de riesgo. En el séptimo capítulo se analiza acerca de si el mercado financiero ha tenido un rol disciplinador para los gobiernos subnacionales. En el último capítulo se presenta una síntesis y las principales recomendaciones de política.

II. Los efectos del endeudamiento subnacional sobre la gestión macroeconómica. Un breve marco analítico

Una controversia de la teoría de las finanzas públicas en países con varios niveles de gobierno es acerca de qué nivel de gobierno debe ser el responsable de la política de estabilización. En la división tradicional de funciones entre el gobierno nacional y los gobiernos subnacionales que se remonta a

Musgrave (1959) se asigna al nivel central la responsabilidad de la política de estabilización. Sin embargo, contemporáneamente esta visión ha sido rebatida, asignándosele al nivel subnacional de gobierno mayores prerrogativas en cuanto a la capacidad de desarrollar una política fiscal autónoma.

A. La visión tradicional

La conveniencia de que sea el gobierno nacional quien absorba la mayor parte de las fluctuaciones en los ingresos ha sido ampliamente analizada en la literatura, por lo cual aquí sólo es menester realizar una mención sintética.

El primer argumento a favor de la centralización de la política fiscal es que el gobierno nacional posee más instrumentos de política macroeconómica que los gobiernos subnacionales. Es sabido que el uso de una moneda única a nivel nacional implica que la política monetaria deba permanecer centralizada. A su vez, dados los estrechos vínculos entre la política fiscal y la política monetaria se arriba a una conclusión que, en principio, alienta la centralización de la política fiscal.

En segundo lugar, a partir del análisis del multiplicador Keynesiano se puede advertir la ineficacia de otorgar la política anticíclica al nivel subnacional de gobierno. Esto se debe a dos motivos. El primero es la reducida magnitud relativa que, desde el punto de vista fáctico, generalmente poseen los presupuestos subnacionales considerados aisladamente. El segundo proviene del menor tamaño relativo del multiplicador fiscal que resulta del carácter abierto de las economías provinciales. Dicho carácter provoca que los estímulos fiscales promovidos por los gobiernos subnacionales sean en gran medida exportados. En ambos casos se revela la ineficacia, en el sentido de impacto relativo despreciable, de asignar a los gobiernos subnacionales el rol de la estabilización del ciclo.

En tercer término, también como consecuencia del carácter abierto de las economías de los gobiernos subnacionales, los responsables de ejecutar las políticas locales no poseerán los incentivos adecuados para llevar a cabo una política suficiente. Por un lado, las autoridades de los gobiernos subnacionales enfrentan el costo pleno de las medidas de política que emprenden, y por el otro, los beneficios de estas políticas se derraman sobre las regiones lindantes. A pesar de la similitud de este argumento con el anterior -de hecho, ambos se encuentran íntimamente relacionados- existe una fina diferencia. Mientras, en este último caso lo que resulta reducido son los *incentivos* a llevar a cabo la política macroeconómica, en el caso anterior son los *efectos* de la política macroeconómica los que resultan despreciables.

En cuarto lugar, se debe señalar que las prerrogativas que se asignen a los gobiernos subnacionales en cuanto al manejo de la deuda pueden desembocar en un resultado subóptimo. Es decir, si se permite el libre endeudamiento de los gobiernos locales en un escenario de costos marginales crecientes se generará un endeudamiento excesivo, dado que cada gobierno solo evaluará su propio costo de endeudamiento no internalizando los efectos externos producidos sobre los demás tomadores de deuda.[1] Este costo se magnifica si, en un contexto en el cual no existe información perfecta que permita distinguir claramente entre deudores potencialmente solventes o insolventes, algún participante no es capaz de honrar su deuda. Si este fuera el caso puede ser posible que el mercado penalice injustamente a deudores solventes.

Por último, y también relacionado con el manejo de la deuda, existe la posibilidad de que el gobierno nacional actúe explícita o implícitamente como prestamista de última instancia, desarticulando

[1] Este hecho no sólo es aplicable al endeudamiento de los gobiernos subnacionales sino también al gobierno nacional. Sin embargo, una mayor cantidad de deudores de menor magnitud internalizarán una menor parte de los costos externos de sus decisiones que un único deudor que los nucleé a todos. Es decir, mientras los pequeños deudores toman la tasa de interés como un dato, un gran deudor observa que la oferta que enfrenta tiene pendiente positiva. Obviamente, aunque el gobierno nacional concentre el endeudamiento público, aún no se internalizan los costos externos sobre los deudores del sector privado.

los incentivos a evaluar y monitorear el comportamiento de los deudores subnacionales. Ante la percepción de rescate, el mercado financiero, actuando racionalmente, no disciplinará en una magnitud suficiente a los gobiernos locales dado que anticipan que en el peor de los escenarios el gobierno nacional brindará el apoyo financiero. Esto es, la estrecha relación entre el gobierno nacional y los gobiernos subnacionales puede ablandar la restricción presupuestaria de estos últimos.

Los argumentos mencionados permiten advertir el conflicto entre las funciones estabilizadora y asignativa. Es decir, la descentralización de la política fiscal, que surge como la receta óptima cuando el principio bajo análisis es la asignación de recursos, presenta algunos contrapesos al centrar la atención sobre los aspectos macroeconómicos.

B. La revisión de los argumentos históricos

Recientemente la tesis que asigna la responsabilidad de la política fiscal al gobierno nacional ha sido cuestionada (Spahn, 1997; Tanzi, 1995). En el caso de una región o país grande, como la Unión Europea o los Estados Unidos, los ciclos pueden no estar correlacionados. La ausencia de correlación entre los ciclos regionales y agregados puede provenir del hecho de que cada subregión este especializada en la producción de *commodities* cuyos precios son independientes de la situación macroeconómica del país. En este caso, aunque el país no perciba la necesidad de realizar política alguna, puede ser óptimo desde el punto de vista de los gobiernos subnacionales estimular la economía local a pesar del reducido tamaño del multiplicador.

Además, los argumentos históricos suponen una economía cerrada. El esquema IS-LM incorporando los aportes de Mundell indica que en una economía con tipo de cambio flexible todo estímulo fiscal sería compensado con una variación del tipo de cambio. Sin embargo, esta ineficacia agregada de la política fiscal no es válida a nivel regional dado que si se proporciona una respuesta fiscal con variaciones regionales pero de suma cero, de modo de no alterar el tipo de cambio, se pueden conseguir efectos sobre el empleo relativo de las distintas regiones.

En el caso de los salvatages existe una controversia de sí una mayor centralización o descentralización de la política fiscal aumenta o disminuye la probabilidad de su ocurrencia.

En un sentido, el incentivo a rescatar opera a través de las externalidades, análogamente al argumento *"too big to fail"*. Un gobierno subnacional de mayor tamaño puede causar un mayor costo externo sobre las demás jurisdicciones -incrementando la prima de riesgo de la nación y de los demás gobiernos subnacionales, por ejemplo-, y por lo tanto incrementar los daños potenciales para el gobierno nacional de no rescatar (Wildasin, 1997). Debe advertirse que con este criterio, la solución consiste en fomentar aun una mayor descentralización, de modo de reducir el tamaño de las jurisdicciones y las externalidades que estas pueden generar.

En el otro sentido, el incentivo a rescatar opera a través del costo relativo del salvataje en relación al tamaño del presupuesto del gobierno nacional. Si existe un costo político fijo de dejar caer una jurisdicción entonces el gobierno nacional tendrá más incentivos a rescatar a aquellas jurisdicciones en que el costo del salvataje sea reducido en relación al tamaño del presupuesto del gobierno nacional. De este criterio se desprende que un alto tamaño relativo de los gobiernos subnacionales hace más creíble la condición de no salvataje (Eichengreen *et al*, 1996).

Otra falencia de los argumentos históricos es que sólo abordan las consideraciones de la demanda. Si se incorporan al análisis las cuestiones de oferta puede arribarse al resultado de que los gobiernos subnacionales poseen mejor información y generalmente responden con mayor rapidez a las necesidades locales.

Por último, existe evidencia que indica que la política monetaria se encuentra más desvinculada de la política fiscal en los casos en que esta última se encuentra más descentralizada, lo que implica la posibilidad de una mayor disciplina fiscal (Euther *et al,* 1996). Debe notarse que esta proposición no resulta trivial por cuanto es posible que el gobierno nacional emita dinero para realizar un rescate de los gobiernos subnacionales. Es decir, es posible que, en un contexto de altos costos de no rescatar a un gobierno subnacional, el gobierno nacional se vea obligado a emitir dinero para financiar un rescate. En cambio, si la política fiscal está centralizada, entonces el gobierno nacional controla plenamente la decisión de gastar y emitir para financiar dicho gasto.

En este último caso se advierte una disputa entre los argumentos tradicionales y los más recientes que está basada sobre un mismo hecho: el vínculo entre la política monetaria y la fiscal. Si se considera que la política fiscal debe ser compensatoria, el gobierno nacional debería concentrar la potestad sobre la política monetaria y fiscal, de modo de financiar el déficit con emisión. Si, en cambio, el objetivo de la política fiscal es mantener la disciplina fiscal, entonces existen argumentos en pos y en contra de centralizar la política fiscal.

C. El endeudamiento de los gobiernos subnacionales. La teoría de los *Bailouts*

La deuda de los gobiernos subnacionales posee principalmente dos características idiosincráticas que lo diferencian de los demás tipos de endeudamiento. En primer lugar, el mercado de crédito se encuentra distorsionado como consecuencia de la relación vertical entre los gobiernos locales y el gobierno nacional. Esta relación vertical hace que, bajo determinados contextos institucionales, la probabilidad de rescate ante un *default* de un gobierno subnacional pueda resultar elevada. En segundo lugar, las conductas fiscales de cada gobierno local generan efectos horizontales, sobre sus pares, y verticales, sobre el gobierno nacional. En particular, los comportamientos de los gobiernos poseen efectos externos no computados por cada uno de ellos.

Uno de los elementos que ocasiona una distorsión en el mercado de deuda provincial es la anticipación de un rescate a una provincia por parte del gobierno nacional. En esa sección se pretende interpretar a estos potenciales *bailouts* como el resultado esperado de un esquema institucional inadecuado de la relación vertical entre el gobierno central y los gobiernos subnacionales.

De manera abstracta, los *bailout* pueden ser analizados como el equilibrio de un juego dinámico con información imperfecta, en el cual, primeramente el gobierno nacional se compromete a no rescatar. Luego el gobierno subnacional decide una política fiscal dentro de un continuo de posibilidades que incluyen opciones de política que van desde políticas que tienen bajo riesgo de culminar en un *default* provincial (prudentes) a políticas en que con alta probabilidad no se pueda honrar los compromisos asumidos (imprudentes). Posteriormente, se produce una realización de la naturaleza que, en función de la política más prudente o imprudente que halla desarrollado la provincia, determina si dicho gobierno subnacional cae o no en *default*. Por último, el gobierno central, ante la demanda provincial de un *bailout*, decide si rescata o no.

En este juego la decisión del gobierno subnacional es secuencialmente racional, en el sentido de que la elección de una política fiscal más prudente o imprudente, se toma considerando que respuesta tendrá el gobierno central si la provincia cae en *default*. La restricción presupuestaria del gobierno subnacional será blanda si, a pesar de que el gobierno subnacional adopte un comportamiento fiscal imprudente, el gobierno central decide rescatar en última instancia. Es decir, si la percepción de las provincias es que en última instancia el gobierno nacional dará una ayuda financiera, las provincias tienen incentivos a aumentar su exposición al riesgo con políticas imprudentes. Cabe destacar que la restricción presupuestaria se vuelve menos restrictiva en la medida que el sector financiero advierta que el gobierno nacional se hará cargo de dichos compromisos.

Debe notarse que a partir de esta estilización un *bailout* no es la ayuda financiera del gobierno central a un gobierno subnacional que enfrenta un fuerte *shock* negativo, sino que además esta ayuda debe ser consecuencia de un comportamiento fiscal perverso que, previniendo el rescate posterior, incrementa la probabilidad de sufrir una crisis financiera. Es decir, para que una ayuda financiera del gobierno central sea considerada un *bailout*, el gobierno subnacional previamente debe haberse comportado imprudentemente en términos fiscales, de modo de incrementar su exposición a los *shocks*.

En cambio, si la ayuda financiera no es antecedida por un comportamiento fiscal imprudente, entonces dicha ayuda puede considerarse como una respuesta óptima dada la imposibilidad de escribir contratos completos. Por ejemplo, el episodio de una ayuda financiera no contemplada del gobierno central ante una catástrofe no puede considerase un *bailout*, dado que el gobierno subnacional no posee control sobre estos eventos. En cambio, esta ayuda puede ser el resultado de un contrato implícito entre ambos niveles de gobierno.

El problema surge debido a que en muchas oportunidades no resulta fácil determinar si los problemas financieros son consecuencia de comportamientos oportunísticos de los gobiernos subnacionales que se exponen riesgosamente, sabiendo que en última instancia serán rescatados por el gobierno central, o de fuertes *shocks* reales que a pesar de un sano comportamiento fiscal por parte del gobierno local le generen una crisis financiera.

III. El enfoque de la disciplina del mercado crediticio

La existencia de un mercado financiero provee importantes beneficios a los agentes económicos que en él participan. Por ejemplo, posibilita a los consumidores elegir un apropiado sendero de consumo a lo largo del ciclo de vida, permite a las firmas superar los obstáculos financieros de tener que solventar sus proyectos de inversión con ingresos propios, y libera al gobierno de realizar costosos cambios en las alícuotas impositivas para financiar los mayores gastos en períodos en que lo considere oportuno (permite el *tax smoothing*).

Para lograr esta tarea, en un mundo de información perfecta, el mercado financiero debe permitir que los agentes mantengan desequilibrios temporarios entre sus ingresos y sus egresos. Es decir, el mercado debe proporcionar la liquidez necesaria a aquellos agentes que *ex-post* cumplan con sus obligaciones, y por lo tanto satisfagan su restricción presupuestaria intertemporal. En un mundo de información imperfecta el problema surge debido a la imposibilidad de determinar con certeza que los desequilibrios sean sólo temporarios. En este sentido, antes de que se produzca la realización, sólo se tiene una expectativa de que el prestatario cumpla con su obligación y confirme que el desequilibrio fue sólo temporario. Sin embargo, puede ocurrir que la expectativa no sea convalidada posteriormente y el prestatario se encuentre transitando en un sendero no sostenible.

Una de las soluciones postuladas por la literatura para resolver el problema antes señalado proviene del enfoque del mercado disciplinador (Lane, 1993; Bayoumi *et al*, 1995). Aplicado al caso de los gobiernos subnacionales este enfoque postula que los agentes económicos deben pagar tasas de interés que reflejen su situación de solvencia, de manera que aquellos agentes que incurran en deudas que sólo con dificultad puedan ser servidas, enfrentarán tasas superiores para compensar el mayor riesgo de *default*, lo que a su vez reduce el incentivo a endeudarse.

A su vez, uno de los elementos centrales de la hipótesis de disciplina de mercado es la existencia de una relación no lineal entre el costo del endeudamiento y las variables fiscales (Bayoumi *et al*, 1995). En particular, se asume que el costo del crédito crece a tasa creciente con el nivel de endeudamiento, de modo que si la solvencia del prestatario se torna muy riesgosa, el mercado le restringirá el acceso al crédito. En otras palabras, el mercado controlará que sólo se le otorguen créditos a deudores solventes, inducido a que los agentes desarrollen un comportamiento prudente e imponiendo el cumplimiento de sus restricciones presupuestarias intertemporales[2].

En la literatura referida al logro de la disciplina fiscal apelando al mercado se postulan un conjunto de condiciones necesarias para que el mercado sea un mecanismo eficaz para inducir un manejo responsable de las finanzas públicas provinciales. Entre las más importantes se destacan:

a) Los mercados financieros deben ser razonablemente abiertos, de modo que cuando la solvencia de un determinado prestatario sea dudosa, los prestamistas no se encuentren cautivos y tengan la posibilidad de colocar su dinero en usos alternativos.

b) No deben existir prestatarios con privilegios en cuanto al acceso al crédito. En particular no deben existir regulaciones que privilegien al sector público en el acceso al crédito.

c) Debe existir información sobre la solvencia de los demandantes de crédito. Si esta no está disponible se presentan dos peligros: que se le otorguen fondos a prestatarios insolventes o que se le racione el crédito a prestatarios solventes por emitir señales similares a las de deudores que no hayan cumplido con sus obligaciones.

d) El sistema financiero debe poseer una fortaleza suficiente para poder asimilar sin problemas la caída de un gran deudor.

e) No debe existir la certeza ni la percepción de que el prestatario vaya a ser rescatado si no puede servir sus deudas.

Si no se satisfacen estas condiciones, el mercado no funcionará adecuadamente para prevenir un excesivo nivel de endeudamiento. Es decir, a pesar de una mala *performance* económica y presupuestaria provincial, acompañada por una suba insuficiente de las primas por *default*, la deuda puede continuar incrementándose hasta alcanzar niveles insostenibles, implicando una severa y costosa restricción fiscal futura.

Cabe destacar que estas condiciones son muy restrictivas y en general no se cumplen en la mayoría de los países, principalmente en los países en vías de desarrollo, que no poseen un maduro mercado de capitales. En particular, estos países no cuentan con sistemas de información que permitan monitorear adecuadamente los comportamientos fiscales de los distintos gobiernos subnacionales y muchos países instrumentan incentivos para colocar a los gobiernos locales en una posición ventajosa en cuanto al acceso al crédito. Además, en la experiencia internacional no resulta difícil encontrar casos en que los gobiernos centrales intervienen de modo de evitar un *default* de un gobierno subnacional[3].

IV. El uso de controles internos al sector público

La alternativa a la disciplina de mercado es establecer algún mecanismo de control interno al sector público. En este caso se puede apelar a cinco variantes: a las reglas fiscales explícitas, a los procedimientos presupuestarios, a la cooperación y coordinación de las decisiones de endeudamiento entre

[2] Utilizando datos de panel sobre las tasas pagadas por los gobiernos subnacionales en los Estados Unidos y Canadá, Goldstein y Woglom (1992) y Bayoumi, Goldstein y Woglon, (1995) han encontrado que el mercado constituye un eficaz disciplinador para los gobiernos subnacionales. Dichos trabajos analizan la relación entre los *spreads* de los bonos de varios gobiernos subnacionales americanos y ciertas variables fiscales, relacionadas con la solvencia y disciplina fiscal

[3] En el capitulo VI se analizará, para el caso argentino, si el mercado crediticio disciplina a los gobiernos subnacionales.

los distintos niveles de gobiernos, a los controles directos y a los controles administrativos o burocráticos por parte del gobierno central.[4]

Cabe destacar que ningún país adopta una forma pura dentro de esta tipología, sino que en general el control se efectúa mediante una combinación de mecanismos. Sólo en algunos casos es posible identificar con certeza cual es el mecanismo utilizado.

Sin embargo, a pesar de esta dificultad, esta estilización resulta útil para racionalizar cuales son las características preponderantes de la experiencia de los distintos países en el control de la deuda. Además, el análisis de las virtudes de cada instrumento de control resulta indispensable si se pretende avanzar en el diseño de una nueva arquitectura institucional para la coordinación de los comportamientos fiscales subnacionales en la Argentina. A continuación analizaremos los principales aspectos de esta clasificación[5].

A. Reglas predeterminadas

Aunque más recientemente este mecanismo ha adquirido una gran difusión debido a su incorporación en el tratado de Maastricht, el control mediante reglas no constituye un mecanismo nuevo. En efecto, la constitución y las leyes de muchos países establecen reglas que limitan directamente el endeudamiento de los gobiernos locales, o bien distintas variables relacionadas al endeudamiento.

El estudio de la efectividad de las reglas constituye en la actualidad un activo campo de análisis tanto teórico como empírico.[6] En general, estos estudios, basados en análisis de corte transversal y en datos de panel, sugieren que existe una asociación significativa y diferente entre los distintos tipos de metas aplicadas sobre los resultados fiscales y los resultados fiscales finalmente observados.

Es menester destacar que existen distintas formas de limitar el endeudamiento por medio de reglas. Se pueden imponer restricciones sobre el endeudamiento en sí mismo, limitando el monto o bien el destino del endeudamiento, o se puede limitar el endeudamiento indirectamente, fijando metas sobre variables que inciden directamente sobre el endeudamiento (déficit, por ejemplo) o que están íntimamente relacionadas al endeudamiento (servicios de la deuda, por ejemplo).

Un tipo especial de regla predeterminada son los presupuestos equilibrados. De manera estilizada, la fortaleza de esta restricción puede ser de cuatro niveles, dependiendo del estadio del proceso presupuestario que regule. En primer lugar, se puede entender el equilibrio presupuestario como la obligación de que el Ejecutivo presente al Congreso un proyecto de presupuesto equilibrado. En segundo término, el equilibrio presupuestario puede significar que el Congreso deba aprobar un presupuesto equilibrado. En tercer lugar, es posible que la regulación no sólo establezca la sanción de un presupuesto equilibrado, sino que además se obligue al cumplimiento de esta meta en la ejecución del presupuesto por parte del Poder Ejecutivo, aunque se permita que los desvíos entre la ejecución presupuestaria y el presupuesto sean compensados en ejercicios posteriores. Por último, la versión más fuerte y restrictiva del concepto impide que los desvíos sean compensados en ejercicios futuros, imponiendo que los ajustes deban efectuarse en cada período. Además, esta regla no sólo puede ser mas laxa o más rígida en función del estadio presupuestario que limite, sino que muchas veces lo que difiere es la amplitud del sector público que comprometen. Sólo una definición amplia del sector público hace que el espíritu de la

[4] La tipología adoptada en Ter-Minassian (1997) incorpora cuatro clasificaciones: Ccooperación entre distintos niveles de gobierno, reglas, controles directos y disciplina de mercado. Aquí se agrupan las tres primeras variantes, incorporando dos nuevas categorías (procedimientos presupuestarios y controles burocráticos) dentro de la categoría que incluye a los controles directos del sector público. Sin embargo, al analizar los controles internos al sector público, cada categoría se analizará de manera discriminada.

[5] Para un análisis completo de la problemática del endeudamiento subnacional véase Ter-Minassian (1997) y Monasterio *et al* (1999).

[6] Para un análisis integral, véase Poterba y Von Hagen (1999).

restricción sea cumplido. De otro modo, si la restricción se aplica sólo a una parte del sector público, existe el riesgo de que el endeudamiento se acumule sobre los organismos no comprendidos en la norma[7].

Debe notarse que la regla presupuestaria no resulta óptima, dado que una regla que impone el equilibrio presupuestario período a período obliga a recortar el gasto y/o aumentar los impuestos en los momentos de depresión económica. Dicho patrón de política económica no respeta ni las prescripciones de la teoría "keynesiana *standard*", ni las prescripciones que surgen de la teoría de "*tax smoothing*".

Sin embargo, en algunos trabajos se ha encontrado que los países que han evidenciado déficits persistentes han sido menos capaces de equilibrar intertemporalmente el consumo que los países con déficit reducidos (Arreaza *et al*, 1999). El hallazgo sugiere, que las instituciones que limitan el déficit mejoran la capacidad de realizar una política macroeconómica adecuada. De hecho muchos argumentos indican que la política fiscal se rige más por principios de naturaleza política que por prescripciones de optimalidad. Bajo esta concepción, el beneficio de la regla proviene en mayor medida de la limitación de la negociación política.

Pero, lo que estos trabajos sugieren es que el presupuesto equilibrado puede mejorar la *performance* de la política macroeconómica en relación a la ausencia de alguna otra regla. Lo que no se demuestra es si mediante otras reglas puede alcanzarse un resultado simétrico en términos de la limitación de la negociación política pero superior en términos de optimalidad. Desde ya que estas reglas alternativas deben ser simples, lo cual constituye uno de los pilares del debate "reglas versus discreción". De otro modo, las mismas pueden ser difíciles de monitorear o esquivadas mediante la "contabilidad creativa".

Otras reglas utilizadas frecuentemente en la experiencia internacional son el establecimiento de límites al gasto público, al cociente entre deuda y producto, al cociente entre la deuda y los recursos y al cociente entre los servicios de la deuda y los recursos. En los dos últimos casos las reglas tratan de imitar el comportamiento del mercado, en el sentido de que se permite el endeudamiento de acuerdo a la capacidad de repago de la misma.

Una regla que es utilizada en muchos casos (por ejemplo, Alemania, Suiza y en muchos estados de Estados Unidos) es la llamada regla de oro, la cual limita el destino del endeudamiento, al financiamiento de los gastos de capital. El objetivo de esta restricción consiste en impedir traspasar la carga de la deuda a generaciones futuras.[8] La argumentación es que en el caso de la deuda originada por gasto corriente la generación presente disfruta de los beneficios del gasto pero el costo de este gasto es afrontado por las generaciones futuras. En cambio, en el caso de los bienes de capital, si bien parte de la deuda es amortizada por las generaciones futuras, también la generación futura goza de un mayor stock de capital.

El control mediante reglas posee ventajas y desventajas. Entre las ventajas se cuentan la transparencia y equidad en el tratamiento de los distintos gobiernos subnacionales. Este mecanismo de control no demanda negociaciones periódicas, que pudieran culminar en resultados inequitativos en el tratamiento de las distintas regiones. A su vez, ante determinados contextos institucionales, estas negociaciones podrían ser orientadas más por factores políticos de corto plazo que por el mantenimiento de niveles sostenibles de endeudamiento.

[7] Kenyon y Benker (1984) encontraron para los Estados Unidos que estas limitaciones sólo comprendían a una media del 60% del gasto total

[8] Debe advertirse que en el caso de que la deuda pública sea solamente interna tanto los deudores como los acreedores pertenecen al mismo país. En este caso, si bien la generación futura deberá afrontar la deuda, también la generación futura recibe los pagos por amortización de este endeudamiento. Esto revela la falacia demostrada por los economistas clásicos Ricardo y Pigou. Es decir, en el caso de que la deuda sea interna no es posible trasladar la carga de la misma a generaciones futuras, sea esta originada en gastos corrientes o de capital. Este endeudamiento sólo genera efectos distributivos *intrageneracionales*. Sin embargo, en el caso de que los acreedores sean externos sí es posible trasladar la carga de la deuda a generaciones futuras. En este caso el endeudamiento originado en gastos corrientes y en gastos de capital tiene efectos distributivos *intergeneracionales*.

El principal costo es que las reglas imponen una pérdida de flexibilidad para ajustarse a los *shocks* sobre la recaudación. Este costo se ve agravado en el caso de las reglas que impiden el endeudamiento, como es el caso de la regla que obliga a mantener el presupuesto equilibrado.

B. Procedimientos presupuestarios

Una alternativa al control mediante reglas numéricas sobre variables fiscales es diseñar el proceso presupuestario de forma tal que de la interacción en este proceso se arribe a un resultado de endeudamiento deseado. En este caso se pretende establecer el contexto, o las instrucciones del juego de negociación por el cuál se decide el comportamiento fiscal de los distintos estados, confiando en que el resultado final no arroje un nivel de endeudamiento excesivo.

En relación al contexto de la negociación se presentan dos opciones: verticalista y colegiada.[9] En el primer caso, el mayor poder en la negociación del presupuesto se le asigna al Poder Ejecutivo con relación al Legislativo, y al ministro de finanzas en relación a los demás ministros. El poder legislativo tiene limitada capacidad de influir sobre la asignación y el tamaño del presupuesto. En la segunda opción, el presupuesto surge de una negociación más democrática, en la cual el Poder legislativo tiene la capacidad de influir en las decisiones y el ministro de finanzas se encuentra en una posición similar a los demás ministros.

Las características de estos dos modelos institucionales estilizados generan resultados presupuestarios distintos. De hecho, existe un intercambio entre estos modelos. En el caso verticalista resulta más probable que se arribe a un resultado fiscal equilibrado, que no comprometa la restricción fiscal y que, por lo tanto, haga del presupuesto un eficaz método de control. Este beneficio se logra al costo de un menor respeto a la heterogeneidad y a la oposición minoritaria. En el modelo colegiado el procedimiento presupuestario es más democrático, garantizando una mayor incumbencia de las minorías. El mayor poder relativo de las minorías resulta en un menor énfasis en la disciplina fiscal.

El carácter colegiado o verticalista de la negociación puede provenir de que el sistema electoral sea proporcional o mayoritario. Esto se debe a que los sistemas electorales proporcionales tienden a generar gobiernos de coaliciones y los sistemas mayoritarios incentivan el bipartidismo. En los gobiernos de coaliciones se deben consensuar las decisiones entre los distintos participes de la coalición. Dicho consenso otorga un carácter colegiado a la negociación, dejando el poder de veto en cada miembro de la coalición.

Una cuestión que resulta crucial en el caso de los procedimientos presupuestarios es el diseño institucional de la votación.[10] Por ejemplo, en 1974, los Estados Unidos reformaron la secuencia de la votación de la ley presupuesto por parte del congreso. A partir de ese año el tamaño global del presupuesto dejó de constituirse meramente por el resultado al que se arribe finalmente de la suma de cada uno de los proyectos aprobados y pasó a predeterminarse con anterioridad al tratamiento en particular de cada proyecto. Esto es, se dividió la votación presupuestaria en dos etapas, definiéndose en la primera etapa sólo el tamaño del presupuesto y en la segunda la asignación del mismo a los distintos proyectos competitivos.

El objetivo de este cambio institucional fue el de garantizar el equilibrio presupuestario. Sin embargo, los grandes déficits en las Estados Unidos en los años ochenta generaron una reconsideración acerca de los efectos que genera este mecanismo.

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[9] Alesina *et al* (1999) llaman a estas estilizaciones *hierarchica* y *collegial*.

[10] El teorema de la imposibilidad de Arrow indica que el orden de la votación altera el resultado del escrutiño. Si no se imponen restricciones en los procedimientos, si se carece de una estructura y reglas de votación, entonces se producirá un caos legislativo.

A partir de estos estudios se arribó a la conclusión de que no resulta obvio que este mecanismo deba garantizar el equilibrio presupuestario. La intuición de este resultado es que los legisladores son *forward looking*. Si cada legislador conoce perfectamente las preferencias de los demás legisladores, entonces basa su decisión del tamaño del presupuesto realizado en la primera etapa computando el resultado sobre la composición del presupuesto a que se arribará en la segunda etapa. Es decir, las decisiones son secuencialmente racionales.

Otra característica del sistema de votación que puede afectar el resultado presupuestario es la exigencia de mayorías simples o reforzadas para la aprobación del presupuesto. La exigencia de mayorías especiales puede desembocar en un vacío institucional si el congreso rechaza el presupuesto, pero, a la vez, estas mayorías especiales otorgan un carácter de consenso a las decisiones.

Es importante notar que las mayorías necesarias para la aprobación del presupuesto también otorga al contexto de negociación un carácter más colegiado o uno más verticalista.

Una cuestión relevante acerca del procedimiento presupuestario es el grado en que el Poder Legislativo tiene la capacidad de realizar enmiendas al presupuesto. Bajo un sistema de reglas cerradas el Poder Legislativo tiene la capacidad de veto, es decir puede votar favorablemente o en contra del presupuesto planteado por el Poder Ejecutivo que es quien plantea la agenda. La alternativa a las reglas cerradas es un sistema de reglas abiertas. Bajo este sistema el Poder Legislativo puede discutir y enmendar cada punto particular del proyecto de presupuesto planteado por el Poder Ejecutivo.

En cuanto al control presupuestario por parte del Poder Ejecutivo una opción aplicada en algunos estados de los Estados Unidos es la llamada *line item veto*. Dicho mecanismo otorga al Poder Ejecutivo el poder de veto sobre algunas partidas presupuestarias, limitando los efectos de las presiones de los grupos de interés sobre el Poder Legislativo.

C. Cooperación y coordinación entre los distintos niveles de gobierno

En algunos países la forma de control de endeudamiento utilizada consiste en coordinar las metas de endeudamiento mediante acuerdos de cooperación entre los distintos niveles de gobierno. En este mecanismo los gobiernos subnacionales son copartícipes con el gobierno central en la definición de las metas macroeconómicas. Este hecho hace que los gobiernos subnacionales no sólo se sientan partícipes de los objetivos macroeconómicos, sino también que sean responsables de las consecuencias que un endeudamiento excesivo podría acarrear. La cooperación y coordinación del endeudamiento constituye la forma de control más respetuosa de la autonomía que deberían gozar los gobiernos locales en un sistema federal de gobierno (Gandenberger, 1997).

Sin embargo, este tipo de control parece más adecuado en países que posean una alta disciplina fiscal. Si esto no sucede, el proceso de negociación puede desembocar en conductas fiscales insostenibles (Ter-Minassian, 1997). En particular, si no existe una fuerte imputabilidad sobre todos los actores involucrados de los costos que puede generar un alto nivel de endeudamiento, se corre el riesgo de que el endeudamiento sea percibido como un recurso común, al cual todos los actores involucrados en la negociación intenten depredar.

Los mecanismos de negociación de endeudamiento pueden ser bilaterales o multilaterales. En el primer caso, del cual puede citarse como ejemplo Dinamarca, la negociación se realiza entre el gobierno central y cada gobierno local aisladamente. En el segundo, la discusión se desarrolla en un ámbito en el cuál se negocian, simultáneamente, los límites del gobierno central y de todos los gobiernos subnacionales.

Si los acuerdos son bilaterales se corre el riesgo de que los gobiernos subnacionales no reciban un trato equitativo. Este hecho, a su vez, puede desembocar en que los gobiernos subnacionales que no satisfagan las metas prefijadas aleguen que su incumplimiento se explica por un trato no equitativo en la negociación.

Australia es un país en el cual la negociación es multilateral y cooperativa. En dicho país, las negociaciones de endeudamiento y la consistencia de este con los objetivos macroeconómicos son desarrolladas en el ámbito de una institución federal llamada *Loan Council*, en la cual están representados todos los estados y el gobierno nacional.

En el caso de Alemania, las negociaciones también poseen un carácter multilateral. La negociación se realiza en dos etapas. En la primera se fija el endeudamiento agregado del gobierno central y de los gobiernos locales, y se distribuye verticalmente que porcentaje de este endeudamiento puede ser tomado por los gobiernos locales y que fracción por el gobierno central. En la segunda etapa, la fracción de la deuda pública asignada a los gobiernos subnacionales se distribuye horizontalmente entre estos.

En España, a partir de 1992, existe también un procedimiento en dos etapas similar al caso alemán. Sin embargo, en este caso la negociación es bilateral entre el gobierno central y cada comunidad autónoma. Los límites al endeudamiento para cada comunidad se fijan en los llamados "Escenarios de Consolidación Presupuestaria".

D. Controles directos

En algunos países, principalmente en aquellos que poseen una estructura unitaria de gobierno, el nivel Nacional controla directamente el endeudamiento de los gobiernos locales. Dado que los gobiernos locales deben pedir autorización al gobierno central para endeudarse, este tipo de control resulta el modo más efectivo para limitar el excesivo endeudamiento. Sin embargo, se contrapone a esta virtud el hecho de que bajo este sistema de control se restringe excesivamente la necesaria autonomía de los gobiernos subnacionales en un esquema descentralizado. Esta desventaja provoca que difícilmente se adopte un sistema de controles directos en un país federal.

Los controles directos pueden adoptar distintas formas. Estas pueden ser: límites al endeudamiento fijados anualmente para cada gobierno subnacional, centralización del endeudamiento por parte del gobierno central y posterior repaso de los créditos a los gobiernos subnacionales, examen y autorización de las operaciones de crédito que deseen desarrollar los estados subnacionales por parte del gobierno central, prohibiciones al endeudamiento en determinados tipos de deudas, como por ejemplo deudas con el exterior. En este último caso, el argumento es que este tipo de endeudamiento puede comprometer los objetivos de la política monetaria y cambiaria desarrolladas por el gobierno central.

Un país unitario que aplica el control directo de endeudamiento de sus gobiernos subnacionales es Japón. Las pautas anuales de endeudamiento se negocian en un plan financiero anual, denominado "Plan Fiscal Anual de los Gobiernos Locales" que se aprueba por el parlamento nacional simultáneamente con la aprobación del presupuesto nacional. Chile es otro país unitario que restringe directamente el endeudamiento de los gobiernos locales. En Chile las municipalidades tienen vedado el acceso a los mercados de crédito interno y externo, salvo autorización expresa del gobierno central (Yañez *et al*, 1993).

Un país federal que instrumenta el control directo de endeudamiento es India. En este país los gobiernos tienen vedados los mercados internacionales de crédito. A su vez, en el caso del endeudamiento interior, los estados que mantienen deudas con el gobierno nacional deben solicitar autorización en el caso de que deseen endeudarse. Cabe destacar que todos los estados se encuentran endeudados con el gobierno nacional. Además, en la India, el gobierno central ha regulado el sistema financiero de forma tal que mantiene un mercado cautivo de colocación de deuda, el cual le brinda un sistema adicional de control, dado que el acceso a este mercado esta reservado para emisiones aprobadas por el gobierno central.

E. Control burocrático

Es usual que los países diseñen mecanismos de control burocrático. En estos casos los gobiernos centrales articulan procedimientos que los gobiernos subnacionales deben satisfacer para endeudarse. Los procedimientos consisten en el cumplimiento de ciertos requisitos exigidos por un determinado organismo del Gobierno Nacional. Estos requisitos pueden incluir la presentación de información acerca del estado de las finanzas públicas del gobierno subnacional, acerca de las características del endeudamiento en términos de tasas, amortizaciones, etc. y acerca del destino de los fondos.

Además, en algunos casos, el cumplimiento de estos trámites puede resultar necesario para que los prestatarios accedan a ciertos privilegios otorgados a los créditos con los gobiernos subnacionales, lo cual constituye un incentivo para que estos se cumplimenten.

Este método de control resulta más utilizado en el caso de algunas democracias federales, en las cuales el gobierno nacional no tiene la prerrogativa de restringir directamente el endeudamiento de los gobiernos subnacionales y no existe una instancia institucional en la que los representantes de cada nivel de gobierno acuerden ciertos estándares o procedimientos en lo referido al crédito público. Cabe destacar que como este tipo de control generalmente es paralelo a algún otro mecanismo más restrictivo, en muchas oportunidades no se lo considera como una alternativa en sí misma. Sin embargo, en el caso argentino los procedimientos administrativos para el endeudamiento constituyen un elemento esencial, razón por la cual esta alternativa de control se incorpora separadamente.

Debe notarse que puede confundirse este tipo de control, con los controles directos, especialmente cuando los gobiernos subnacionales deben pedir autorización para endeudarse, como en el caso Argentino. La diferencia en este caso es de grado y no de tipo. Es decir, si bien bajo los controles burocráticos y administrativos el objetivo es fundamentalmente informar acerca de las operaciones de crédito y cumplimentar una serie de procedimientos administrativos, en el caso de los controles directos los gobiernos subnacionales, o bien tienen prohibo el acceso a determinados tipos de endeudamiento, o bien deben solicitar autorización del gobierno central si pretenden endeudarse.

V. El endeudamiento de las provincias Argentinas

A. El contexto institucional

La organización del sector público argentino contempla cuatro niveles de gobierno: el federal, las provincias (con sus 23 jurisdicciones), el Gobierno de la Ciudad de Buenos Aires y más de 1.300 gobiernos locales incluyendo municipios, comunas, comisiones municipales, juntas de gobierno, comisiones de fomento y comunas rurales. En la constitución sancionada en 1853 se adoptó la forma republicana y federal de gobierno, previendo un sistema con tres poderes: un poder ejecutivo a cargo de un presidente, un poder legislativo compuesto por un congreso bicameral y un poder judicial, presidido por la Corte Suprema de Justicia. En dicha constitución las provincias delegaron al gobierno federal una serie de poderes y atribuciones, incluyendo entre otras cosas, la potestad sobre la recaudación de ciertos impuestos, aunque con ciertas limitaciones. Las provincias tienen sus propias constituciones, algunas sancionadas con anterioridad a la Nacional, y eligen su propio gobernador, sus legisladores y jueces sin la intervención del gobierno federal.

La constitución argentina establece en su articulado las competencias y funciones asignadas a cada nivel de gobierno. En particular describe los recursos e impuestos que cada jurisdicción puede establecer para poder financiar las funciones que presta. Básicamente, determina que la Nación utilizará para financiar sus erogaciones los recursos del comercio exterior y los impuestos indirectos, mientras que las provincias se financiarán mediante tributos sobre la producción y el consumo de bienes específicos. Establece, además, la facultad al gobierno federal de imponer impuestos directos por tiempo determinado.

No obstante, la incorporación de nuevas funciones y responsabilidades en el gobierno federal obligó a recurrir a nuevas fuentes de recursos. Esto derivó, primero, en la creación de nuevos impuestos en concurrencia con los provinciales, y luego, el diseño de regímenes de coparticipación federal de impuestos, mediante los cuales la Nación imponía gravámenes sobre el consumo, la renta y el patrimonio, constitucionalmente reservados a las provincias, para luego compartirlos en una proporción fija con las jurisdicciones que adherían.

Desde principio del año 1988 el marco general de las relaciones financieras entre la Nación y las provincias se estructura sobre la base de la ley 23.548 de coparticipación federal de impuestos. Dicha ley establece como impuestos coparticipables a todos aquellos tributos nacionales existentes y a crearse con la excepción de los derechos de exportación e importación, los impuestos incluidos en regímenes especiales de coparticipación y aquellos con asignación específica. La masa coparticipable se distribuye del siguiente modo: a) 42,34% en forma automática a la Nación, b) 56,66% en forma automática al conjunto de las provincias y c) el 1% restante se asigna al fondo de Aportes del Tesoro Nacional, destinado a atender situaciones de emergencia y desequilibrios financieros en las provincias. La distribución secundaria de las transferencias se determina por coeficientes fijos establecidos en la ley. Es importante señalar que aún cuando la distribución primaria y secundaria no tiene en la norma una fundamentación explícita, ésta permitió darle a las relaciones financieras intergubernamentales un encuadre legal definido y transparente, limitándose los aportes discrecionales que caracterizaron los años 80 (Jones, *et al* 1997).

Con la reforma constitucional del año 1994, el sistema de coparticipación federal de impuestos adquiere rango constitucional.[11]

En términos del gasto público, Argentina constituye el país más descentralizado de América Latina, con aproximadamente el 48% de los gastos ejecutados desde el nivel subnacional de gobierno[12]. En contraste, la distribución de recursos tributarios se encuentra sumamente concentrada en el nivel federal de gobierno, ya que cerca del 70% de los recursos tributarios son generados por dicho nivel. Esta distribución de funciones y potestades lleva a un alto grado de desequilibrio fiscal vertical que debe ser cubierto mediante mecanismos de transferencias de recursos desde el gobierno federal. El principal mecanismo de transferencias lo constituye el anteriormente mencionado régimen de coparticipación federal de impuestos. Por este sistema, durante 1999 el gobierno federal transfirió a las provincias y la Ciudad de Buenos Aires más de $ 900 millones mensuales.

B. La evolución de las finanzas y el endeudamiento provincial durante el plan de convertibilidad

Luego de una década de fuerte inestabilidad macroeconómica, el la década de los noventa se implementa un ambicioso programa de reformas económicas estructurales. Estas incluyen la reforma tributaria, la privatización de todas las empresas públicas, la concesión de servicios públicos, una fuerte reducción del déficit público, la descentralización de los servicios de salud y educación, el levantamiento de restricciones a las inversiones extranjeras y la apertura y liberalización de la economía, entre otras medidas. Asimismo, en abril del año 1991 se lanza un exitoso programa de estabilización -plan de

[11] La nueva constitución establece en sus cláusulas transitorias la obligación de sancionar antes que finalizara el año 1996 un nuevo esquema de coparticipación federal de impuestos. Vencido el plazo estipulado por la Constitución Nacional, en el año 1999, el gobierno federal intentó negociar con las provincias un proyecto de reforma, pero fracasó.

[12] Si se excluyen del cálculo los gastos por seguros sociales (seguridad social y obras sociales) la participación de los gobiernos subnacionales en el gasto público argentino trepa al 64%.

convertiblidad-, por el cual se fija la paridad del dólar a un peso (equivalente entonces a 10.000 australes) y se le prohibe al Banco Central la emisión de moneda sin respaldo. Por su parte, en septiembre de 1992 se dicta una nueva carta orgánica para el Banco Central que refuerza su autonomía del poder político. Con relación a las provincias la nueva carta orgánica restringe la posibilidad de otorgar líneas de redescuento (préstamos) a los bancos provinciales[13].

Como resultado de estas reformas económicas, la economía Argentina se estabiliza y logra un crecimiento sólo interrumpido por la crisis del tequila y, más recientemente, por la crisis internacional. No obstante esos episodios, el crecimiento de la economía alcanza un 6% anual promedio para el período 1991 y 1998.

Para los gobiernos provinciales el programa económico generó un sustancial crecimiento en los recursos. Si consideramos solamente el primer año del plan de convertibilidad los recursos girados en el marco del régimen de coparticipación federal de impuestos aumentaron en términos nominales un 22% -si se consideran la totalidad de los recursos girados desde el gobierno federal el aumento en los ingresos provinciales alcanza al 50%-. Aunque en menor magnitud, también se observó un incremento en los ingresos tributarios propios (ver Cuadro 1).

Cuadro 1

Finanzas Públicas Provinciales y de la Ciudad de Buenos Aires. Período 1989-1999

(en millones de pesos corrientes)

	1989*	1990*	1991	1992	1993	1994	1995	1996	1997	1998	1999
Ingresos corrientes	**12,330**	**11,620**	**14,643**	**21,591**	**24,777**	**26,778**	**26,002**	**27,930**	**30,831**	**32,012**	**31,057**
Tributarios propios	3,242	3,791	4,678	7,364	8,794	9,681	9,167	9,772	10,892	11,614	11,008
Otros ingresos propios	2,496	1,452	1,422	2,246	2,730	3,272	3,411	3,745	3,610	3,648	3,409
Transferencias nacionales	6,592	6,377	8,543	11,981	13,253	13,825	13,424	14,413	16,329	16,749	16,640
Gastos corrientes	**11,149**	**11,876**	**13,997**	**19,816**	**23,477**	**25,033**	**25,197**	**25,481**	**27,628**	**29,665**	**30,894**
Gastos de consumo	7,959	8,730	10,153	14,347	16,975	18,181	18,341	17,821	19,182	20,524	21,747
Intereses de la deuda	516	219	266	353	471	571	721	1,004	1,052	1,181	1,279
Transferencias corrientes	2,674	2,927	3,578	5,115	6,031	6,281	6,135	6,656	7,394	7,960	7,868
Ingresos de capital	**78**	**189**	**216**	**212**	**739**	**588**	**689**	**1,147**	**1,800**	**1,080**	**998**
Gastos de capital	**2,115**	**2,225**	**2,250**	**2,584**	**3,788**	**4,529**	**4,745**	**4,672**	**5,115**	**5,081**	**4,034**
Ingresos totales	**12,409**	**11,809**	**14,859**	**21,804**	**25,515**	**27,365**	**26,691**	**29,077**	**32,631**	**33,091**	**32,055**
Gastos totales	**13,264**	**14,101**	**16,247**	**22,400**	**27,265**	**29,561**	**29,942**	**30,153**	**32,743**	**34,746**	**34,928**
Resultado financiero:											
con privatizaciones	**-855**	**-2,292**	**-1,388**	**-596**	**-1,749**	**-2,196**	**-3,252**	**-1,076**	**-112**	**-1,655**	**-2,873**
sin privatizaciones	**-855**	**-2,292**	**-1,388**	**-596**	**-2,064**	**-2,364**	**-3,480**	**-1,724**	**-1,377**	**-2,233**	**-3,340**

Nota: (*) Actualizados a pesos de abril de 1991

Fuente: Susbsecretaría de Programación Regional

Los gobiernos provinciales reaccionaron a este flujo de recursos incrementando en forma significativa sus erogaciones, en especial, las de carácter corriente. En los primeros años del plan de convertibilidad, este fuerte crecimiento en los recursos significó una disminución de la necesidad de financiamiento de las provincias, aún cuando el crecimiento de las erogaciones había sido, también, importante. A partir del año 1993 esta tendencia se modifica. Las finanzas provinciales comienzan a transitar por un sendero de desequilibrio fiscal que alcanza su máxima expresión en el año 1995 con un déficit de $ 3.500 millones, como respuesta al fuerte impacto en las finanzas subnacionales ocasionado por el efecto tequila.

[13] En la década de los 80 era una práctica común el endeudamiento de los tesoros provinciales con sus propios bancos. Por el otro lado, el Banco Central otorgaba líneas de redescuento a los bancos provinciales para otorgarle liquidez.

Como es ampliamente conocido, la crisis desatada por la devaluación mexicana, en diciembre de 1994, impacto con fuerza en la economía Argentina. Durante el año 1995, la economía experimentó una severa crisis bancaria y crediticia, que socavó la confianza de los inversores locales y extranjeros. Esto provocó una importante fuga de capitales, la pérdida de reservas internacionales del Banco Central, un aumento en la tasa de interés y una caída en el nivel de actividad de la economía.

La crisis de financiamiento puso de manifiesto la fragilidad de las finanzas públicas provinciales. La brusca caída de los niveles de actividad –durante el año 1995 el PIB disminuyó un 4,4%-, la pérdida de recursos tributarios tanto nacionales como provinciales, y la rigidez de los presupuestos provinciales generaron un fuerte desequilibrio presupuestario. Esta situación se vio agravada en algunas provincias como consecuencia de la crisis que azotó a la banca provincial producto de la fuerte desconfianza de los ahorristas. Esta desconfianza desencadenó corridas bancarias en los bancos provinciales ocasionando importantes pérdidas de depósitos que debieron ser cubiertas con recursos corrientes de la tesorería provincial. Este factor agravó la crisis de liquidez de los gobiernos provinciales[14]. Como consecuencia de estos hechos las provincias tuvieron serios problemas para hacer frente a los pagos de salarios y haberes jubilatorios. En algunas jurisdicciones se llegaron a acumular retrasos de entre cuatro y seis meses de salarios a los empleados públicos.

Producto de esta crisis se produce, en el año 1995, un significativo aumento del endeudamiento provincial. El stock de la deuda aumenta un 31%, pasando de $ 11.120 millones, en 1994, a prácticamente $ 14.600 millones en 1995[15]. Dicho stock de la deuda representa el 5,6% del Producto Interno Bruto de 1995 y el 55% de la totalidad de los ingresos provinciales de dicho año (ver Cuadro 2).

Cuadro 2
Deuda provincial. Evolución 1995-99

Período	en mill. de U$S	var. %	en % del PIB	en % de IT (1)
1994	11,120,400		4.3%	40.6%
1995	14,572,868	31.0%	5.6%	54.6%
1996	15,644,445	7.4%	5.7%	53.8%
1997(2)	14,822,582	-5.3%	5.1%	45.4%
1998	15,786,618	6.5%	5.3%	47.7%
1999	16,745,720	6.1%	5.9%	52.2%

(1) Ingresos Totales
(2) El stock de deuda en el año 1997 disminuye como consecuencia de la cancelación de deuda de la provincia de Buenos Aires
Fuente: Elaboración propia en base a información de la Subsecretaría Programación Regional, de las propias provincias y calificadoras de riesgo.

Una fuente habitual de financiamiento de los déficit provinciales ha sido el endeudamiento con los propios bancos provinciales. Al respecto, información disponible sobre el stock de la deuda provincial para 1996 indica que las provincias de Buenos Aires, Córdoba y la Municipalidad de Buenos Aires habían

[14] Las provincias que se vieron financieramente más afectadas por la crisis de sus bancos fueron Río Negro, Córdoba y Mendoza. En los tres casos el gobierno federal debió asistir financieramente con recursos extraordinarios. Al respecto véase World Bank (1996), Nicolini *et al* (1999) y Damill (1997).

[15] En Argentina existen grandes dificultades con la información fiscal de las provincias. Con respecto a la deuda subnacional, la información fue elaborada con datos de la Secretaría de Programación Económica y Regional, datos de las mismas provincias e información de las calificadoras de riesgos. La información presentada no incluye deuda sin consolidar del Gobierno de la Ciudad de Buenos Aires con el gobierno nacional por $1500 millones.

tomado préstamos de sus respectivos bancos por aproximadamente $ 3.000 millones (ver Cuadro 3). En el año 1995 el stock de deuda con los bancos públicos y privados supera los $ 5.000 millones, representando un 36,6% del stock de la deuda provincial (ver Cuadro 4).

Cuadro 3
Endeudamiento Provincial. Principales Entidades Bancarias acreedoras

Entidad	1996 en miles de $	en %	1997 en miles de $	en %	1998 en miles de $	en %
Total préstamos	**5,982,698**	**100%**	**4,186,834**	**100%**	**5,041,041**	**100%**
Galicia y Buenos Aires	784,479	13.1%	1,459,167	34.9%	1,627,986	32.3%
Río de la Plata	441,381	7.4%	527,673	12.6%	664,379	13.2%
BBV Banco Frances	551,478	9.2%	538,419	12.9%	615,009	12.2%
Bansud	247,351	4.1%	294,522	7.0%	332,493	6.6%
Banco de la Nación Argentina	26,065	0.4%	18,733	0.4%	227,072	4.5%
Quilmes	181,775	3.0%	73,566	1.8%	213,572	4.2%
Ciudad de Buenos Aires	497,557	8.3%	244,700	5.8%	202,854	4.0%
Argemofin	140,336	2.3%	143,844	3.4%	163,966	3.3%
Banco de la Provincia de Córdoba	181,216	3.0%	99,507	2.4%	162,354	3.2%
Cargil Trading	60,083	1.0%	123,654	3.0%	130,685	2.6%
Credit Lyonnais	101,206	1.7%	89,904	2.1%	75,867	1.5%
Banco Hipotecario Nacional	74,659	1.2%	69,795	1.7%	69,478	1.4%
BankBoston	66,113	1.1%	69,809	1.7%	66,595	1.3%
Banco Provincia de Buenos Aires	2,044,019	34.2%	20,570	0.5%	59,200	1.2%
Comafi	33,905	0.6%	65,623	1.6%	55,532	1.1%
BERSA	25,006	0.4%	21,365	0.5%	36,018	0.7%
Otros	526069	8.8%	325983	7.8%	337981	6.7%

Fuente: Subsecretaría de Programación Regional

Cuadro 4
Deuda Provincial. Composición
(en millones de pesos y en % del total)

Período	Préstamos con ent. financieras	Títulos públicos	Organismos Internacionales	Deuda Flotante	Resto (1)	Total
1994	s/d	s/d	s/d	s/d	s/d	11,120
1995	5,333	215	1,485	4,301	3,239	14,573
1996	6,242	346	1,771	3,499	3,787	15,644
1997	4,638	1,587	2,326	2,901	3,370	14,823
1998	5,240	1,802	3,032	2,542	3,170	15,787
1999 (2)	5,590	1,890	3,225	2,861	3,180	16,746
1995	*36.6%*	*1.5%*	*10.2%*	*29.5%*	*22.2%*	*100%*
1996	*39.9%*	*2.2%*	*11.3%*	*22.4%*	*24.2%*	*100%*
1997	*31.3%*	*10.7%*	*15.7%*	*19.6%*	*22.7%*	*100%*
1998	*33.2%*	*11.4%*	*19.2%*	*16.1%*	*20.1%*	*100%*
1999 (2)	*33.4%*	*11.3%*	*19.3%*	*17.1%*	*19.0%*	*100%*

(1) Incluye deuda con el Gobierno Nacional y deuda consolidada.
(2) A junio de 1999.
Fuente: Elaboración propia en base a información de la Subsecretaría Programación Regional y calificadoras de riesgo.

La otra fuente históricamente importante de financiamiento de los gobiernos provinciales ha sido la postergación de los pagos de salarios, haberes jubilatorios y endeudamiento con proveedores y contratistas. En 1995, como consecuencia de la crisis de liquidez que afectó a la mayoría de los gobiernos provinciales se fueron acumulando compromisos de pagos que no pudieron ser efectivizados a tiempo.

Esto generó una deuda flotante que superaba los $ 4.000 millones (30% del stock de la deuda). Asimismo, en Argentina el gobierno nacional constituye otro acreedor importante de las provincias. A través de los créditos en títulos públicos (BOTESO 10) y redescuentos del Banco Central a los Bancos Provinciales el gobierno nacional había asistido financieramente a las provincias que atravesaban por dificultades financieras[16]. En 1995, este componente de la deuda provincial alcanzaba los U$S 1.500 millones.

En 1996 las nuevas autoridades provinciales impulsan una importante cantidad de reformas estructurales. Estas reformas incluyen, el recorte de los presupuestos, el dictado de leyes de emergencia económica, la privatización de la banca provincial, de las empresas de energía eléctrica y el traspaso de los sistemas jubilatorios a la Nación[17]. Estas reformas, aún en marcha, generaron una sustancial mejora en las finanzas provinciales. El déficit provincial disminuyó sustancialmente, al pasar de un nivel de $ 3.500 millones a $ 1.700 millones en 1996 (ver Cuadro 1).

A su vez, durante 1996, la mayoría de las provincias emprendieron acciones tendientes a mejorar el perfil de su endeudamiento, aprovechando que las condiciones de los mercados resultaban más favorables que las existentes en 1995. Esta reprogramación de la deuda con entidades financieras y bancarias permitió acceder a tasas de interés más bajas, a plazos de vencimientos más extensos, e incluso, a períodos de gracia. La tasa de interés promedio del endeudamiento con bancos disminuyó, para las provincias, 4 puntos al pasar del 16,4% en el año 1995 al 12,4% en 1996 (ver Informe Económico Regional, Abril de 1997).

No obstante, a pesar del alivio financiero que significó para los tesoros provinciales este proceso de reprogramación de la deuda, el endeudamiento de las provincias y la Ciudad de Buenos Aires aumentó, producto de la necesidad de financiamiento y el reconocimiento de pasivos contingentes de los bancos provinciales. En efecto, la deuda provincial aumenta, en 1996, un 7,4%, con lo cual el stock a fin del ejercicio alcanza una cifra de U$S 15.600 millones, un 5,7% del PIB (ver Cuadro 2).

En 1996 el stock de la deuda con bancos y entidades financieras aumenta significativamente, alcanzando los U$S 6.000 millones, representando el 40% de la deuda total (ver Cuadro 3). Paralelamente a este crecimiento de la deuda con entidades financieras se produce una disminución de la deuda flotante. El otro componente de la deuda que registra una suba importante es la deuda con organismos multilaterales de crédito.

En 1997 las finanzas provinciales vuelven a mejorar, registrándose una nueva disminución en el déficit sin privatizaciones (ver Cuadro 1), considerando el resultado global con privatizaciones el déficit se reduce sustancialmente[18]. El stock de la deuda provincial diminuye por efecto de la cancelación de la provincia de Buenos Aires de su deuda con su banco oficial[19]. Con esta cancelación la deuda provincial alcanza a los $ 14.822 millones, disminuyendo 5,3% con relación al stock de 1996.

En 1997 las provincias continúan aprovechando la gran liquidez en los mercados financieros para reprogramar el perfil de vencimiento de la deuda. A su vez, en varias provincias se instrumentaron programas de financiamiento con el mercado de capitales a través de la emisión de títulos provinciales con calificación[20]. Las jurisdicciones que han emitido este tipo de instrumento financiero son: Buenos Aires,

[16] Un análisis de los préstamos en BOTESO 10 a las provincias puede verse en Sanguinetti J. (1999).

[17] Para un informe más detallado de estas reformas, véase World Bank (1996), Nicolini *et al* (1999) y Sanguinetti J. (1999).

[18] Los ingresos por privatizaciones, en el año 1997, superaron los U$S 1.500 millones.

[19] En los primeros meses del año 1997 el gobierno de la provincia de Buenos Aires canceló pasivos con el Banco de la Provincia de Buenos Aires por $ 1.906 millones. La deuda se había originado por el financiamiento de la construcción de la central de generación eléctrica de Bahía Blanca y deudas contraídas por la Dirección de Vialidad. Para cancelar el capital adeudado, la provincia entregó a su banco, bonos cupón cero del Tesoro de los Estados Unidos con vencimiento en el año 2025. Por otra, se estableció el pago mensual de los intereses (Informe Económico Regional, Diciembre de 1997).

[20] En realidad este proceso comenzó a mediado del año 1994 cuando la provincia de Buenos Aires coloca el primer tramo del Programa de Eurobonos a Mediano Plazo. La primera emisión se realizó el 14 de julio de 1994 por U$S 100 millones a un plazo de 3 años con amortización del capital a fin del período. Los títulos devengaron una tasa de interés del 9,5%.

Mendoza, Tucumán, Chubut, Formosa, Tierra del Fuego y la Ciudad de Buenos Aires. En el Cuadro 5 se indican las características principales de estos instrumentos financieros.

Cuadro 5
Títulos públicos provinciales. Principales características

Jurisdicción	Bono	Plazo	Tasa	Volumen emitido (mlns US$)	Mercado de colocación	Calificación			
						S&P	Moody´s	D&P	Otras
Ciudad de Bs. Aires	Tango	7 / 8 años	10%	500	Internacional	BB-	B1	B1	
Buenos Aires	Series 1, 2 , 3 y 4	3 años	9,5% / 11,5%	500	Internacional	BB-	BA3		
	Serie 5	5 años	10%		Internacional	BB-	BA3		
	Serie 6	7 años	7.75%		Internacional	BB-	BA3		
Chubut	BOGAR (1)	8 años	Libor + 3,5%	15.2	Local				AA+ (1)
Entre Ríos	Bonos Clase C	6,7 años	TE BCRA +5,22%	70.0	Local				AA+ (1)
Mendoza	Eurobono	6 años	10%	93.8	Internacional		B1	BB	
	Aconcagua 2007	10 años	10%	250.0	Internacional		B1		BB-
Neuquén	TIPRE	6 años	Libor 180+4%	70.0	Local	AAA (1)			AAA (1)
Santiago del Estero		10 años	Bono global +2%	120.0	Internacional			BB-	
Tierra del Fuego	Albatros	6 años	9%	55.0	Internacional		B1	BB-	
Tucumán	EUROBONO (Serie 2 y 3)	10 años	9.5%	364.3	Internacional			BB-	

Fuente: Economía & Regiones
(1) Calificación para el mercado local

En 1998 el ciclo de las finanzas públicas provinciales se revierte mostrando un empeoramiento en el resultado financiero sin privatizaciones –el déficit alcanza una cifra de $ 2.200 millones-. Este desempeño en las finanzas subnacionales obedece principalmente a un menor ritmo de crecimiento en los ingresos, en particular, los de origen nacional y un aumento sostenido en los gastos provinciales. Como resultado, la deuda de las provincias aumentó un 6,5% ubicando el stock de la deuda provincial en U$S 15.800 millones.

Del análisis de la composición de la deuda se advierte un significativo incremento de la deuda con organismos multilaterales de crédito, en gran parte, como consecuencia de los créditos otorgados a las provincias en el marco de la privatización de los bancos provinciales[21]. Asimismo, los créditos de los bancos y entidades financieras con garantía de los recursos coparticipados aumentaron cerca de $ 600 millones en 1998. Dentro de estos créditos merece ser destacado los créditos otorgados por el Banco de la Nación Argentina por más de $ 230 millones (ver Cuadro 3). Es importante mencionar esto dado que una de las medidas adoptadas en la crisis del tequila había sido restringir la cartera de préstamos del Banco Nación a los gobiernos provinciales con el objeto de endurecer la restricción presupuestaria provincial. Otro hecho que merece se destacado es el uso del Fondo Fiduciario para el Desarrollo Provincial (FFDP) para asistir financieramente a la provincia de Jujuy. Si bien el FFDP había sido creado exclusivamente para asistir a las provincias que se comprometían a privatizar sus bancos públicos, en 1998, el gobierno

[21] Estos créditos fueron otorgados para sanear las entidades financieras previo a su privatización. Hasta el momento el Banco Interamericano de Desarrollo y el Banco Mundial han aportado más $ 1.316 millones a este programa (Informe Económico Regional julio de 1999).

nacional otorgó un préstamo a la provincia de Jujuy por U$S 40 millones mediante un convenio de asistencia financiera que establecía una serie de condicionalidades fiscales[22].

En 1999 las finanzas de los gobiernos provinciales continuaron empeorando. En algunas provincias la situación fiscal se agravó significativamente, generándose conflictos sociales, como en la provincia de Tucumán, Río Negro, Tierra del Fuego y Corrientes[23]. La proyección del resultado financiero consolidado para las 24 jurisdicciones subnacionales indica un desequilibrio de más de $ 3.300 millones. Por su parte, la información disponible de la deuda provincial indica, a junio de 1999, un stock de deuda de U$S 16.700 millones, que a fin del ejercicio podría alcanzar los U$S 18.000 millones.

En la composición de la deuda del año 1999 se destaca la alta participación de los créditos con entidades bancarias y financieras (33,4%), el stock de la deuda con organismos multilaterales (19,3%) y la deuda consolidada (19%).

Si se analiza el stock de la deuda provincial (cerca de U$S 18.000 millones a fin del ejercicio 1999) en relación a la deuda federal (U$S 130.000 millones) se arriba a la conclusión de que la magnitud agregada del endeudamiento no es el principal problema. En cambio, la performance fiscal de las provincias presenta una gran heterogeneidad. Es decir, en ciertas jurisdicciones las finanzas poseen un compromiso tal que está latente la posibilidad de que el gobierno federal tenga que salir en su rescate.[24]

En el Cuadro 6 se indica la evolución de esta deuda provincial para el período 1994-1999, advirtiéndose aumentos significativos en algunas de ellas. Los casos más elocuentes en cuanto a crecimiento del stock nominal de la deuda corresponden a Corrientes, Chaco, Chubut, Jujuy, Mendoza, Neuquén, San Luis y Tierra del Fuego.

En el cuadro 7 se analiza la sostenibilidad de ese endeudamiento medida a partir de la relación con los ingresos provinciales. Del cuadro se advierte la delicada situación en la que se encuentra un gran número de jurisdicciones, en particular, se destaca la comprometida situación de las provincias de Corrientes, Chaco, Chubut, Fomosa, Jujuy, Misiones, Río Negro y Tucumán, con un stock de la deuda que supera los recursos provinciales.

[22] Según la información brindada por funcionarios de la provincia estas condicionalidades no se habrían cumplido satisfactoriamente.

[23] Con relación a los conflictos sociales cabe subrayar que ninguna provincia entró un *default* financiero ya que los préstamos con entidades financieras, bancos, e inclusive con el gobierno nacional presentan como garantía los recursos coparticipados, con lo cual nunca dejaron de ser cancelados. En cambio, esta crisis si pusieron en peligro la prestación de los servicios públicos básicos. En corrientes, por ejemplo, los alumnos prácticamente no tuvieron clases durante 1999.

[24] Probablemente el caso más dramático sea la provincia de Corrientes, que luego de varios meses de graves conflictos sociales las nuevas autoridades debieron intervenir la provincia y hacer frente a una pesada deuda salarial con fondos nacionales.

Cuadro 6
Deuda provincial. Evolución 1994- 1999 por jurisdicción
(en miles de pesos corrientes)

Jurisdicción	1994	1995	1996	1997	1998	1999*
TOTAL	11,120,400	14,572,868	15,644,445	14,822,582	15,786,618	16,745,720
G.C.B.A.	1,390,400	1,246,579	1,099,800	1,165,900	1,095,900	864,900
Buenos Aires	2,929,700	2,827,475	3,275,411	1,487,370	1,545,100	1,596,000
Catamarca	306,700	241,467	323,323	385,831	397,151	434,981
Córdoba	1,000,000	1,318,000	1,121,678	1,179,228	1,104,459	1,141,203
Corrientes	532,900	656,570	717,836	761,803	948,491	1,041,050
Chaco	539,900	568,445	526,021	832,345	1,020,112	1,187,536
Chubut	101,300	250,929	344,444	408,891	474,329	689,582
Entre Ríos	414,300	551,588	608,083	523,592	600,921	643,459
Formosa	365,400	731,563	723,769	732,499	768,221	812,516
Jujuy	224,200	438,498	594,606	634,831	676,223	717,751
La Pampa	0	33,040	83,810	82,726	81,768	78,972
La Rioja	597,500	485,838	506,033	448,268	462,890	471,864
Mendoza	311,000	1,160,143	1,086,000	1,357,000	1,059,386	1,058,424
Misiones	254,700	519,971	538,973	636,312	720,514	782,160
Neuquén	58,200	280,030	307,670	304,790	397,792	508,446
Río Negro	364,700	583,904	738,835	791,308	869,589	946,614
Salta	281,600	543,452	514,925	494,982	517,883	546,136
San Juan	281,100	426,014	439,877	373,742	405,093	399,602
San Luis	0	16,973	59,981	86,701	88,449	88,355
Santa Cruz	77,100	135,591	82,750	40,917	137,046	176,548
Santa Fe	397,000	510,919	496,633	579,685	938,950	1,021,739
Santiago del Estero	169,000	310,776	389,613	349,400	333,014	278,678
Tierra del Fuego	24,000	111,415	133,119	154,013	161,296	225,934
Tucumán	499,700	623,688	931,255	1,010,448	982,041	1,033,273

Fuente: Elaboración propia en base a información de la Subsecretaría de Programación Regional y calificadoras de riesgo
* A junio de 1999

Cuadro 7
Deuda provincial. Evolución 1994- 1999 por jurisdicción
(En porcentaje de los recursos totales)

Jurisdicción	1994	1995	1996	1997	1998	1999*
TOTAL	**40.2%**	**54.1%**	**53.3%**	**44.9%**	**47.1%**	**52.1%**
G.C.B.A.	50.4%	46.5%	40.2%	40.3%	34.5%	26.9%
Buenos Aires	37.8%	36.9%	40.3%	14.3%	16.3%	16.9%
Catamarca	78.8%	63.3%	79.9%	76.3%	77.6%	84.1%
Córdoba	46.7%	65.4%	50.0%	48.8%	44.0%	48.1%
Corrientes	89.3%	111.8%	114.8%	104.9%	128.5%	145.3%
Chaco	76.6%	80.6%	68.0%	94.5%	108.4%	129.3%
Chubut	14.4%	35.6%	44.6%	46.4%	50.4%	135.4%
Entre Ríos	41.7%	57.4%	50.2%	44.8%	50.7%	54.7%
Formosa	68.3%	132.9%	129.8%	116.9%	120.3%	127.8%
Jujuy	42.1%	86.0%	99.7%	113.9%	107.2%	120.1%
La Pampa	0.0%	7.9%	18.7%	16.6%	15.5%	15.1%
La Rioja	120.3%	90.7%	85.2%	72.3%	74.2%	74.1%
Mendoza	21.5%	103.5%	83.5%	111.1%	65.0%	82.4%
Misiones	42.6%	90.6%	74.3%	84.4%	88.0%	105.3%
Neuquén	7.5%	31.3%	33.9%	31.7%	40.7%	54.3%
Río Negro	61.1%	107.6%	108.2%	121.7%	126.3%	146.9%
Salta	37.9%	73.1%	63.1%	59.9%	61.9%	62.4%
San Juan	51.5%	79.8%	67.2%	53.6%	57.1%	57.9%
San Luis	0.0%	3.9%	12.4%	17.2%	16.8%	16.6%
Santa Cruz	16.3%	25.0%	11.9%	6.1%	21.4%	27.6%
Santa Fe	18.1%	24.8%	23.3%	23.8%	36.1%	42.4%
Santiago del Ester(	26.4%	49.9%	59.6%	45.1%	42.9%	34.9%
Tierra del Fuego	7.3%	36.2%	41.3%	43.4%	45.6%	62.8%
Tucumán	61.0%	74.3%	105.3%	105.5%	96.6%	105.0%

Fuente: Elaboración propia en base a información de la Subsecretaría de Programación Regional y calificadoras de riesgo
* A junio de 1999

El otro aspecto que merece ser destacado de la deuda provincial es su corta madurez. Al respecto, en el Cuadro 8 se presenta el stock de la deuda consolidada (sin deuda flotante) para el año 1998 y los vencimientos para dicho año. Del cuadro se desprende la importante concentración de los vencimientos de la deuda provincial. Otro indicador importante del perfil de la deuda provincial lo constituye el porcentaje de los recursos del régimen de coparticipación federal de impuestos afectados al pago de amortizaciones e intereses de préstamos con entidades financieras, organismos internacionales y el gobierno nacional. El cuadro 9 presenta dicha información, del cual se desprende que algunas provincias tienen afectada una alta proporción de estos recursos (Tucumán, Río Negro, Formosa, Corrientes y Chubut tienen afectado al pago de préstamos más del 50% de los recursos coparticipados).

Cuadro 8
Perfil de la deuda financiera provincial. Año 1998
(en miles de pesos corrientes)

	Stock de la deuda Consolidada (31/12/1998) (1)	Amortizaciones e intereses (2)	(2) / (1)
TOTAL	**13,244,844**	**2,644,931**	**20.0%**
G.C.B.A.	840,900	206,040	24.5%
Buenos Aires	1,270,100	343,891	27.1%
Catamarca	357,127	65,642	18.4%
Córdoba	828,440	135,084	16.3%
Corrientes	861,098	189,181	22.0%
Chaco	874,319	104,147	11.9%
Chubut	381,329	22,980	6.0%
Entre Ríos	533,897	94,185	17.6%
Formosa	710,721	93,152	13.1%
Jujuy	533,675	121,899	22.8%
La Pampa	81,415	2,877	3.5%
La Rioja	308,901	91,908	29.8%
Mendoza	978,240	143,000	14.6%
Misiones	705,979	76,229	10.8%
Neuquén	317,582	86,684	27.3%
Río Negro	799,097	170,087	21.3%
Salta	506,883	91,946	18.1%
San Juan	379,113	25,500	6.7%
San Luis	58,541	4,223	7.2%
Santa Cruz	117,965	2,456	2.1%
Santa Fe	515,190	53,508	10.4%
Santiago del Estero	304,327	199,996	65.7%
Tierra del Fuego	115,382	22,500	19.5%
Tucumán	864,623	297,818	34.4%

Fuente: Elaboración propia en base a información de la Secretaría de Programación Económica y Regional

Cuadro 9

Retenciones a los recursos de coparticipación federal de impuestos

(en % de los recursos coparticipados ley 23.548)

	1998		Ene/Oct 1999	
	total retenciones (1)	retenciones por préstamos (2)	total retenciones (1)	retenciones por préstamos (2)
TOTAL	**27.9%**	**17.3%**	**29.8%**	**19.7%**
G.C.B.A.				
Buenos Aires	0.8%	0.3%	0.8%	0.3%
Catamarca	52.4%	22.4%	46.3%	17.3%
Córdoba	14.8%	14.3%	3.1%	2.5%
Corrientes	48.3%	47.7%	57.9%	57.4%
Chaco	20.1%	19.6%	30.3%	29.7%
Chubut	14.2%	13.6%	52.1%	51.6%
Entre Ríos	18.6%	18.1%	21.5%	20.9%
Formosa	24.6%	24.0%	59.7%	59.2%
Jujuy	71.2%	40.3%	56.8%	42.8%
La Pampa	2.0%	1.4%	1.8%	1.3%
La Rioja	77.1%	41.6%	62.2%	24.2%
Mendoza	44.9%	6.8%	52.4%	10.2%
Misiones	22.2%	21.7%	37.6%	37.0%
Neuquén	2.0%	1.4%	2.5%	1.9%
Río Negro	96.5%	63.2%	98.7%	63.4%
Salta	53.9%	22.5%	65.6%	34.2%
San Juan	33.1%	3.4%	34.1%	4.6%
San Luis	22.4%	1.7%	21.3%	1.1%
Santa Cruz	2.0%	1.5%	6.1%	5.5%
Santa Fe	2.4%	1.8%	7.1%	6.6%
Santiago del Estero	67.3%	45.4%	50.1%	28.4%
Tierra del Fuego	32.8%	32.2%	43.4%	42.9%
Tucumán	95.8%	58.7%	91.6%	57.7%

Fuente: Elaboración propia en base a información de la Secretaría de Programación Económica y Regional

Nota: (1) Incluye las retenciones efectuadas por el Banco de la Nación Argentina en virtud del aporte al Consejo Federal de Inversiones, adelantos de coparticipación de la Secretaría de Hacienda, aportes y contribuciones al SIJP, amortizaciones e intereses de los préstamos en BOTESO 10, préstamos de entidades financieras públicas y privadas (FFDP, BHN, Banco Nación, BICE, etc.) y redescuentos del BCRA.

(2) Excluye las retenciones del Consejo Federal de Inversiones y aportes y contribuciones al SIJP.

VI. El marco regulatorio del endeudamiento subnacional en Argentina

A. Presupuestos y reglas de endeudamiento provincial

Las constituciones provinciales establecen, con alguna excepción, algún tipo de limitación o restricción a la capacidad otorgada al ejecutivo para contraer deuda pública[25]. Esta limitación incluye procedimientos específicos sobre los mecanismos para autorizar al poder ejecutivo a endeudarse (la exigencia de cierta mayoría especial para su autorización en la legislatura), restricciones en cuanto al destino y el uso de los fondos (en muchas jurisdicciones subnacionales esta vedado por la constitución provincial su uso para financiar gasto corriente) o limitaciones expresas sobre los montos de los servicios de la deuda[26].

Con respecto a los límites sobre la magnitud del endeudamiento provincial, las constituciones provinciales establecen, en general, que los servicios de la deuda no pueden superar el 25% de las rentas provinciales[27]. Los textos constitucionales no definen claramente el concepto de rentas generales, aún cuando se debería interpretar como servicios de la deuda el pago de amortizaciones e intereses. Algunas jurisdicciones tienen cláusulas más estrictas al considerar que para el cálculo de los recursos se tome en cuenta el menor de los ingresos de los últimos tres años (ver Anexo I: límites al endeudamiento subnacional).

No obstante la existencia de dichos límites al endeudamiento, en diferentes momentos, las provincias han superado estos límites constitucionales sin tener consecuencia alguna.

En el Cuadro 10 se exhiben, para 1995 y 1998, los servicios de la deuda provincial en relación con los ingresos provinciales y los límites al endeudamiento fijados por las constituciones provinciales. En el cuadro se puede observar de que manera las provincias de Córdoba, Corrientes, Formosa, Jujuy y Río Negro han superado los límites de endeudamiento establecidos por sus propias constituciones provinciales.

Adicionalmente a las cláusulas constitucionales que limitan el endeudamiento subnacional, algunas jurisdicciones han impulsado, en este último tiempo, leyes tendientes a restringir el gasto público y el nivel de déficit fiscal[28].

[25] San Juan constituye la única jurisdicción que en su constitución no establece límites expresos a la capacidad de endeudamiento.
[26] Para un análisis más exhaustivo, véase Jones, *et al* (1997).
[27] En el caso de las provincias de Catamarca, Córdoba y Jujuy el límite se establece en el 20% de los recursos provinciales. En la provincia de Buenos Aires no se fija un límite específico.
[28] Al respecto, la provincia de Salta sancionó en 1999 una ley de responsabilidad fiscal de similares características a la sancionada por el gobierno federal.

Cuadro 10
Servicios de la deuda y límites al endeudamiento subnacional
(en % de los recursos provinciales)

Concepto	Limites provinciales Constitucionales	Servicios de la deuda (1)	
		1995	1998
Total		**9.0%**	**12.5%**
G.C.B.A.	30%	9.4%	9.6%
Buenos Aires	s/l	4.4%	5.9%
Catamarca	20%	8.1%	13.5%
Córdoba	20%	19.3%	27.6%
Corrientes	25%	14.8%	24.9%
Chaco	25%	10.9%	11.3%
Chubut	s/l	16.0%	8.7%
Entre Ríos	25%	15.7%	14.5%
Formosa	25%	41.9%	25.7%
Jujuy	20%	9.6%	30.0%
La Pampa	25%	0.3%	1.3%
La Rioja	25%	7.7%	18.9%
Mendoza	s/l	13.7%	15.9%
Misiones	25%	7.4%	9.5%
Neuquén	s/l	5.2%	10.2%
Río Negro	25%	31.4%	39.5%
Salta	25%	6.6%	19.4%
San Juan	s/l	5.4%	8.2%
San Luis	25%	0.0%	1.2%
Santa Cruz	s/l	3.3%	0.8%
Santa Fe	25%	0.5%	3.1%
Santiago del Estero	25%	14.2%	20.1%
Tucumán	s/l	9.3%	31.0%
Tierra del Fuego	25%	1.8%	5.7%

Fuente: Elaboración propia en base a información de la Secretaría de Programación Económica y Regional

(1) Incluye amortizaciones e intereses

B. El control federal sobre el endeudamiento subnacional en la Argentina

Como anticipamos anteriormente, el control de los comportamientos fiscales provinciales en la Argentina no se encuadra en ninguna de las clasificaciones habitualmente abordadas en la literatura. Debido a ello se agregó una nueva clasificación denominada "control burocrático". Es menester destacar que el control burocrático no es utilizado monopólicamente por la Argentina, sino que muchos países emplean este sistema de control. Sin embargo, esta opción de control no ha sido considerada en la literatura como una alternativa en sí misma debido a que generalmente su uso es concomitante con algún otro método más restrictivo.

El control burocrático consiste en la necesidad de formalizar un conjunto de procedimientos administrativos para poder acceder al endeudamiento. Estos procedimientos involucran el cumplimiento de una serie de requerimientos formales que incluyen, entre otras cosas, la presentación de información acerca del estado de las finanzas subnacionales, el destino de dicho financiamiento -sea para financiar obra pública, para refinanciar deuda o para financiar el desequilibrio corriente-, el porcentaje o monto de afectación en garantía de los recursos provenientes del régimen de coparticipación federal de impuestos y la presentación de toda información que avala la legalidad de la operación sobre la base de las normas (constitucionales) de cada jurisdicción. En el Anexo II se presenta la información requerida por la Secretaría de Programación Económica y Regional para autorizar una operación de crédito de un gobierno subnacional.

En la Argentina el control burocrático encuentra su origen legal en la resolución del Ministerio de Economía 1.075 y en la comunicación A282 del Banco Central. La resolución 1075 asigna a la Secretaría de Programación Económica y Regional (SPEyR) la función de control del endeudamiento subnacional que utilice como colateral los recursos del régimen de coparticipación federal de impuestos y todo aquel endeudamiento en moneda extranjera. Por su parte, la comunicación A282 prohibe a la banca privada el otorgamiento de créditos al sector público con la única excepción –excepción que en los hechos resulta la regla- que la operación esté autorizada por el Ministerio de Economía.

Para el endeudamiento en moneda extranjera, la resolución 1.075 establece que "Las provincias, sus organismos o empresas, están sujetas a la supervisión, coordinación y aprobación del Ministerio de Economía y Obras y Servicios Públicos, respecto de todo acto, contrato, gestión o negociación de créditos a celebrarse por los que se originen, o puedan eventualmente originarse, obligaciones de pago en moneda extranjera."

Por su parte, para los casos de afectación de los recursos del régimen de coparticipación en garantía de endeudamiento provincial, la resolución 1.075 establece que "los importes que correspondan a cesiones de derechos sobre impuestos coparticipables o sobre la garantía otorgada por la Nación a las Provincias que suscribieron el Pacto Fiscal aprobado por la ley 24.130, serán retenidos por este Ministerio en una cuenta especial, hasta tanto los acreedores notifiquen la revocación de dichas cesiones".

En la práctica, en cumplimiento de estas normativas, las jurisdicciones que deseen afectar los recursos del régimen de coparticipación, o que pretendan tomar créditos en moneda extranjera, deben acudir a la SPEyR para que ésta autorice la operación. Es importante mencionar que la normativa señalada, tanto la 1075 como la comunicación A282 del BCRA, no establecen restricciones específicas en cuanto al grado de afectación de los recursos coparticipados que las provincias pueden ofrecer como colateral, o respecto a topes específicos en relación a los créditos tomados, sino que la autorización de la SPEyR constituye, en los hechos, un requisito más que las provincias deben cumplimentar para obtener un crédito en moneda extranjera o un crédito con afectación de recursos coparticipados, puesto que la autoridad de aplicación no tiene suficientes argumentos legales para no autorizar una operación de crédito de los gobiernos subnacionales.[29]

En función de los requisitos exigidos por la SPEyR para autorizar el endeudamiento subnacional (ver Anexo II), el gobierno federal cumple con dos roles principales. En primer lugar se asegura que la operación haya cumplimentado con todos los requisitos legales (constitucionales) establecidos en la provincia (ley autorizando el endeudamiento, ley autorizando la afectación de los recursos coparticipados, dictamen de la Fiscalía de Estado y el Contador General de la provincia autorizando la operación), a fin de resguardarse de eventuales denuncias por ilegalidad de la operación. En segundo lugar se asegura que los recursos afectados en garantía sean suficientes para cancelar los compromisos asumidos (intereses y amortizaciones), es decir, resguarda los intereses del prestatario.

[29] Por la Constitución nacional las provincias conservan todo el poder no delegado al gobierno nacional. En este aspecto las provincias mantienen plena autonomía para endeudarse.

Es necesario destacar que se han concretado algunas operaciones de crédito de la Banca privada con las provincias sin cumplir con la normativa vigente. Además, como se analizará con mayor detalle en la próxima sección, las entidades bancarias y financieras poseen un fuerte incentivo a exigir a la provincia la intervención del Ministerio de Economía debido a que de este modo se obtienen privilegios en cuanto a la determinación de los capitales mínimos y a las previsiones y clasificación de deudores.

Para concluir vale la pena argumentar porque este sistema de control no se encuadra en ninguno de las clasificaciones de control interno al sector público consideradas en la literatura. En primer lugar, es claro que no existe ninguna regla impersonal, ni de diseño presupuestario en el proceso de control. Es decir, no existe un marco de referencia explícito al cual el organismo de control –la SPEyR- deba controlar el cumplimiento de ciertos estándares o metas fiscales en la jurisdicción que requiere la autorización para endeudarse. Tampoco, el sistema se ajusta a un mecanismo de coordinación bilateral, ni multilateral, en el cual los distintos niveles de gobierno se ponen de acuerdo en cumplir cierto cronograma de financiamiento o un techo para la contratación de crédito público. Por último, el control no se ajusta a un sistema de control de endeudamiento directo. Aunque esta última alternativa parece la más cercana a la caracterización del caso argentino, el poder del gobierno nacional en el control de endeudamiento provincial en nuestro país no se acerca ni remotamente al poder de control que gozan los países generalmente considerados dentro de esta clasificación.

C. Los privilegios de las provincias en el acceso al crédito

En nuestro país existe un fuerte incentivo para que el sistema financiero conceda préstamos a las provincias. Esto se debe, no sólo a los costos asociados a evaluar a una gran cantidad de pequeños prestatarios que compiten con las provincias por los fondos, es decir a la existencia de economías de escala en la evaluación de los préstamos a las provincias, sino también a los menores requerimientos de capitales mínimos y previsiones para este tipo de operaciones de crédito.

En particular, la comunicación "A" 2253 de Banco Central establece que: "a los fines de la determinación de la exigencia de capitales mínimos, se ponderen al 0% los préstamos que se otorguen a las Provincias, a la Municipalidad de Buenos Aires y a los bancos oficiales de esas jurisdicciones, garantizados con la afectación especial de fondos de coparticipación federal de impuestos, en operaciones que cuenten con la pertinente intervención del Ministerio de Economía y Obras y Servicios Públicos de la Nación".

A su vez, la comunicación "A" 2216 del Banco Central establece que, a los efectos de las previsiones mínimas y clasificación de deudores, los préstamos con -"afectación en prenda de fondos de la coparticipación federal de impuestos, en operaciones que cuenten con la pertinente intervención del Ministerio de Economía y Obras y Servicios Públicos"- se incluyan en la categoría normal. Es decir, esta norma exige el mínimo del 1% de previsionamiento para este tipo de operaciones.

Estas normas legales generan grandes incentivos a que los bancos concedan préstamos a las provincias. Por otra parte, como se mencionó anteriormente, para obtener estos beneficios las entidades financieras demandan a las provincias que deseen endeudarse la intervención del Ministerio de Economía.

Recientemente la comunicación "A" 2793 del Banco Central redujo los beneficios a los préstamos provinciales. Esta comunicación establece la ponderación entre el 40% y el 60% para los créditos otorgados al sector público provincial que cuenten "con garantía de coparticipación de impuestos mediante la cesión directa o indirecta de los correspondientes derechos y que cuenten con la pertinente intervención del Ministerio de Obras y Servicios Públicos de la Nación." Esta medida obliga a los bancos que otorgan préstamos a las provincias con esta garantía a incrementar sustantivamente sus inmovilizaciones de fondos.

Sin embargo, debido a que esta medida ha desencadenado algunas protestas por parte de las entidades bancarias y financieras nacionales, que concentran el crédito provincial, se decidió prorrogar en dos oportunidades la entrada en vigencia de la norma. En una primera instancia la prórroga operaba hasta el 1/1/2000, pero recientemente la norma se prorrogó nuevamente[30].

D. Disciplina de mercado en el caso argentino

Como se indicó en apartados anteriores a partir de la estabilización macroeconómica, el endeudamiento con entidades bancarias y financieras ha constituido una importante fuente de financiamiento de los déficits presupuestarios provinciales. En este sentido, en el año 1999, la participación de la deuda bancaria en el stock total de la deuda para el consolidado de las 24 jurisdicciones subnacionales ha sido del 33%, alcanzando en junio de 1999 un nivel de aproximadamente $ 5.600 millones

En general este endeudamiento presenta como garantía (colateral) los recursos de libre disponibilidad de las provincias provenientes del régimen de coparticipación federal de impuestos.

El sistema de los préstamos con garantía de coparticipación funciona del siguiente modo: cuando una provincia toma un préstamo garantizado con recursos del régimen de coparticipación, afecta parte de los mismos al cumplimiento de las obligaciones contraídas. El Banco Nación, que cumple el rol de agente financiero del régimen, es el encargado de transferir diariamente los recursos de dicho régimen a las provincias. Al concretarse la operación de préstamo, el Banco Nación recibe la información referida a los plazos y pagos de amortizaciones e intereses, junto con las directivas de asignar parte de los recursos de la provincia prestataria al pago de sus obligaciones. De esta forma, del monto a transferir a la provincia, el Banco Nación retiene los importes correspondientes a los pagos de intereses y amortizaciones, que son girados automáticamente a la entidad que otorgó el crédito. Como queda explícito, las provincias no interfieren en este mecanismo

Con respecto a este tipo de operaciones de préstamos la calificadora Moody´s considera que el uso de garantías de coparticipación permite neutralizar el riesgo provincial sobre el instrumento financiero. Para Moody´s: "Los recursos provenientes de la coparticipación constituyen una importante herramienta de financiación, especialmente en combinación con técnicas de financiamientos estructuradas. Bajo la Ley de Coparticipación y la legislación sobre Fideicomiso" (ley 24.441) "el derecho a recibir el pago de recursos coparticipables futuros puede transferirse a un fideicomiso y de esta manera aislarlo del riesgo crediticio de la entidad que los transfiere" (provincia). "Además, se puede utilizar protección crediticia adicional para lograr una calificación de la entidad que realiza la transferencia (provincia), y en algunos casos, que exceda también "el techo" de la calificación soberana."

En este apartado se analiza que implicancias posee el hecho de que las provincias utilicen como garantía de sus préstamos un recurso cuya administración está fuera de su control. La hipótesis es que la disciplina fiscal no sería aplicable en el caso argentino debido a las distorsiones generadas por el marco institucional vigente en el mercado de préstamos a provincias. Es decir que no se espera encontrar una relación estadísticamente significativa entre el costo del crédito de las distintas jurisdicciones y las variables fiscales.

[30] La importancia de esta circular para las entidades financieras argentinas se pone de manifiesto en la inclusión en recientes operaciones de crédito de una corrección de la tasa de interés en función de los cambios de los requisitos mínimos de liquidez exigidos por el BCRA.

En el marco institucional vigente no se satisface una de las condiciones esenciales para que el mercado de crédito cumpla con el rol de disciplinador, que consiste en que los prestamistas internalicen el costo de cesación de pagos por parte de los gobiernos provinciales en caso de que estos no puedan afrontar la devolución de los créditos por encontrarse en dificultades financieras. Esta condición no es satisfecha en el caso de los préstamos con garantías de coparticipación ya que si una provincia atraviesa por dificultades financieras no tiene la posibilidad de declararse en cesación de pagos.

La utilización de recursos de coparticipación como garantía de los préstamos constituye una tecnología financiera[31] que, al asegurar la consistencia temporal de los compromisos asumidos por las provincias, levanta la restricción de liquidez que estas enfrentarían en caso de tener un comportamiento fiscal irresponsable.[32] Es decir, el Banco Nación retiene de los fondos que le corresponden a cada provincia en el marco del régimen de coparticipación federal de impuestos los importes correspondientes a los pagos de intereses y amortizaciones, los cuales son girados automáticamente a la entidad que otorgó el crédito sin que las provincias puedan interferir en este mecanismo.[33] Por lo tanto, puede argumentarse que este mecanismo constituye un sistema automático de pagos, y no sólo un colateral.

Una pregunta relevante es si esta tecnología financiera disciplina a los gobiernos subnacionales por sí misma. Esta pregunta es relevante por cuanto en el caso de los agentes privados una tecnología de este tipo, que hace creíbles las intenciones de honrar la deuda, evita el racionamiento del crédito y elimina el costo de monitoréo.

Sin embargo, en el caso de los gobiernos subnacionales, la alta tasa de descuento de los políticos y la posibilidad de salvatajes alteran este resultado. Es decir, la estrecha relación entre el gobierno nacional y los gobiernos subnacionales desalienta el control por parte de los prestamistas. Esto ablanda la restricción presupuestaria de los gobiernos subnacionales permitiendo comportamientos imprudentes y, de este modo, aumenta la probabilidad de que en el futuro se produzca un rescate por parte del gobierno nacional cuando el gobierno subnacional no tiene posibilidad de ajuste. Debe recordarse que la proposición original era si el mercado era capaz de sustituir las reglas explícitas.[34]

Esto es, la estructura de las relaciones financieras intergubernamentales vigente en la Argentina, junto al estrecho horizonte temporal internalizado por *los políticos, induce a un gasto excesivo. Sin* embargo, el control fiscal y la restricción de liquidez que el sistema financiero impondría a las provincias, en ausencia de una tecnología de este tipo, contrarrestaría la tendencia al comportamiento fiscal imprudente. Por lo tanto, esta innovación tecnológica, al eliminar el control y la restricción de liquidez, *posibilita que los funcionarios provinciales realicen sus ambiciones de corto plazo* y aumenta la probabilidad de un salvataje por parte del estado nacional.

Otro elemento que hay que destacar es que, como se analizó con anterioridad, en Argentina existe un fuerte incentivo para que el sistema financiero conceda préstamos a las provincias, lo que impide el cumplimiento de la segunda condición postulada para que el mercado funcione con eficacia.

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[31] Se debe mencionar que aun no existiendo una tecnología de este tipo los prestamistas pueden percibir una garantía implícita por parte del Gobierno Nacional, por lo cual la política propuesta debe ser más amplia que la eliminación de este mecanismo.

[32] Cabe mencionar que mientras el sector privado puede utilizar su riqueza total como colateral, no es común observar que los gobiernos comprometan más allá de sus recursos.

[33] Sin embargo, dada la estructura legal de este sistema, Standard & Poors argumenta que las provincias podrían alterar los términos y condiciones de su endeudamiento, de modo que no se eliminaría completamente la probabilidad de default. (Creditweek, 1997)

[34] Dillinger *et al.* (1998) argumentan que la garantía de coparticipación fuerza a las provincias a honrar su deuda y por lo tanto refuerza la restricción presupuestaria subnacional. Sin embargo, esta garantía hace que el mercado permita que las provincias realicen comportamientos imprudentes y riesgosos, que sólo sean sostenibles si la economía no sufre un shock negativo. Pero, en el caso que la economía sufra un shock negativo, las provincias se verán obligadas a solicitar un *bailout* por parte del Estado Nacional. Es decir, esta garantía hace que el mercado no controle a las provincias, y que por lo tanto vaya penalizando los comportamientos imprudentes sin saltos discretos.

En nuestro país no se cuenta con una fuente de información que permita testear acabadamente la hipótesis planteada. Sin embargo se dispone de la información de 64 operaciones de préstamos con garantía de coparticipación otorgados a 15 provincias, a partir de los cuales se puede intentar una aproximación. Estos préstamos están nominados en dólares y corresponden al período Julio de 1996-Julio de 1997. Las tasas de interés y las fechas de cada operación se exhiben en el gráfico A1 del anexo III.

A su vez, también se cuenta con un cálculo de la vida promedio para cada préstamo.[35] Dada la heterogeneidad de las distintas operaciones en cuanto a la estructura temporal de amortización del capital se procedió a estimar una regresión que vinculara estas variables.[36]

Luego se calculó el *spread* de cada operación en relación al valor de la curva de regresión estimada para la misma vida promedio. Por último se promediaron los *spreads* de las operaciones correspondientes a cada provincia. Los resultados expresados en puntos básicos se presentan en el Cuadro 11. En el cuadro también se exhiben indicadores fiscales que usualmente se consideran signos de una buena *performance* fiscal.

Es posible pensar que existe un problema de selección endógena a la muestra, lo cual probaría que las provincias que presentan peor situación fiscal no posean acceso al mercado financiero. En ese caso, no se podría testear con la muestra la hipótesis de racionamiento de crédito. Sin embargo, en el Cuadro 11 se puede observar que provincias que presentan una muy mala performance fiscal han tenido acceso al mercado financiero. Por ejemplo, Formosa es la provincia con mayor *ratio* entre la deuda y los recursos totales, presentó un déficit alto en 1996 y posee un gran desequilibrio vertical. Sin embargo, esta provincia tuvo acceso al crédito a una tasa reducida.

En el Cuadro 12 se presentan los resultados de las regresiones entre los spread y cada una de las variables fiscales tomadas individualmente.[37] En el Anexo III se exponen gráficos de dispersión que vinculan los spread con cada una de las variables fiscales consideradas.

De las regresiones se puede observar que en el caso de considerar todas las provincias de la muestra los signos de las regresiones son los esperados por la teoría de la disciplina de mercado. Sin embargo, sólo es significativa la variable "% de recursos afectados".

Cabe destacar que esta no es una de las variables fiscales que forma parte de la teoría de disciplina de mercado sino que se hace relevante debido al contexto institucional Argentino. Sin embargo, si el mercado penalizara la mayor proporción de recursos afectados, entonces esta innovación institucional podría ser de utilidad. Debido a ello resulta oportuno advertir que los gobiernos subnacionales no tienen la capacidad de declarar una cesación de pagos de estos préstamos aún cuando posean el total de recursos afectados.

Además, al extraer las provincias de Santa Fe y Córdoba de la muestra la afectación de coparticipación deja de ser una variable estadísticamente significativa y los resultados de todas las variables empeoran. En este caso, la deuda y el desequilibrio vertical poseen el signo contrario al esperado en la teoría del mercado disciplinador y ninguna de las variables es estadísticamente significativa.

[35] La vida promedio de un préstamo constituye una medida que informa acerca de la estructura temporal de la amortización del capital. Por ejemplo, una operación ha cinco años con amortización mensual posee una vida promedio de 2,5 años; y una operación a cinco años con una única amortización al final posee una vida promedio de 5 años. Si las operaciones poseen períodos de gracia entonces se alarga la vida promedio, dado que se retarda la amortización del capital.

[36] La relación entre el costo y el plazo de las operaciones generalmente se estiman con una relación en logaritmos. Kiguel y Lopetegui 1997. En este caso la elasticidad del spread a la vida promedio resultó de positiva y significativa. $\boxed{\text{Log(Tasa)}=-2{,}2995+0{,}04652\cdot\text{Log(vida promedio)};\ t=5{,}38,\ R^2=31{,}8\%}$

[37] Estas estimaciones están sujetas a serios problemas econométricos y sólo deben considerarse como una aproximación. Se regresan las variables tomadas individualmente debido a que sólo se cuenta con 15 observaciones. Parece adecuado tomar variables fiscales del año 1996 debido a que la mayor cantidad de préstamos corresponden al año 1997 y en ese año sólo se posee la información agregada del año anterior.

Cuadro 11
Préstamos de entidades financieras a provincias
Spread en puntos básicos e indicadores fiscales del año 1997

	Deuda/Rec. totales	Deficit/Rec. totales	Rec. Propios/Rec. totales	% de afectación	Spread
CATAMARCA	79.9%	17.8%	10.0%	59.4%	36
CORDOBA	51.5%	-8.2%	44.9%	37.5%	-87
CORRIENTES	114.8%	5.3%	13.1%	44.0%	11
CHACO	86.3%	8.7%	15.5%	18.7%	50
CHUBUT	70.1%	23.5%	35.6%	8.0%	15
ENTRE RIOS	50.1%	-12.5%	27.6%	24.6%	4
FORMOSA	129.8%	7.0%	8.9%	66.4%	-25
MENDOZA	82.2%	22.4%	38.4%	60.2%	58
MISIONES	74.3%	9.0%	18.5%	36.6%	22
RIO NEGRO	108.2%	12.2%	27.3%	90.6%	86
SALTA	63.0%	-3.4%	26.0%	49.9%	48
SAN JUAN	67.2%	-5.4%	15.0%	44.1%	42
SANTA FE	23.3%	2.0%	41.4%	3.1%	-164
TUCUMAN	105.3%	15.5%	20.4%	45.0%	134
TIERRA DEL FUEGO	41.3%	3.8%	29.4%	47.1%	87

Fuente: Elaboración propia en base a información de la Subsecretaría de Programación Regional

Cuadro 12
Regresión lineal de los spreads con variables fiscales

Variables Explicativas	Coeficiente	Estadistico t	R2	N° de observaciones
Deuda/Recursos totales	109.9	1.78	0.197	15
Déficit/Recursos totales	252.6	1.47	0.142	15
Recursos Propios/Recuros totales	-251.9	-1.58	0.161	15
% de afectación de recursos	157.1	2.04	0.243	15
Regresión sin Santa Fé y Córdoba	**Coeficiente**	**Estadistico t**	**R2**	**N° de observaciones**
Deuda/Recursos totales	-14.1	-0.29	0.007	13
Déficit/Recursos totales	93.5	0.82	0.057	13
Recursos Propios/Recuros totales	126.4	0.99	0.083	13
% de afectación de recursos	47	0.82	0.058	13

Fuente: elaboración propia

En suma, de la escasa información disponible no se encuentra que el mercado este disciplinando eficazmente a los gobiernos subnacionales mediante una penalización sobre el costo del endeudamiento. Esto es particularmente relevante cuando se extrae a las provincias de Córdoba y Santa Fe.[38]

Es decir, el mercado presenta una distorsión de tal magnitud que, ante el empeoramiento de la capacidad de repago de los prestatarios, ni siquiera se observan incrementos en las primas por default. Como mencionan Sanguinetti y Porto (1996) "puede ocurrir que la capacidad de endeudamiento de los gobiernos subnacionales no esté limitada por la performance actual o futura y que entonces el mercado no cumpla con su rol de disciplinador. Es el caso de por ejemplo, los préstamos bancarios con garantía de coparticipación."

[38] Debe notarse que en la Argentina los rescates han sido mas frecuentes en el caso de las provincias pequeñas. Sanguinetti J. (1999).

Cabe destacar que de este análisis no debe concluirse que una eliminación de la garantía de coparticipación permitiría sustituir las reglas explícitas de control fiscal de los gobiernos subnacionales por la disciplina de mercado. En numerosas oportunidades el gobierno nacional ha rescatado a provincias por deudas que no poseían esta garantía. La disciplina de mercado debe ser considerada mas un complemento que un sustituto de las reglas fiscales explícitas.

Sin embargo, aunque no se puede confiar plenamente en la disciplina de mercado para prevenir comportamientos no sostenibles, el mercado puede ser de gran ayuda si las instituciones fiscales son diseñadas de modo que el mercado participe en el control fiscal. Para ello, como línea de investigación, es relevante analizar como el mercado reacciona a las reglas fiscales.

VII. Síntesis y conclusiones

En este trabajo se ha analizado la cuestión del endeudamiento provincial en la Argentina y la necesidad de avanzar sobre un rediseño del marco institucional a fin de evitar los posibles costos externos que el comportamiento fiscal de una provincia puede ocasionar sobre las demás provincias y sobre la Nación. A su vez, se analizaron los distintos tipos de control de endeudamiento utilizados en la experiencia internacional a fin de evaluar que alternativas existen en la elección de un mecanismo de control que se ajuste a las necesidades y características de la Argentina.

Cabe puntualizar algunos resultados del trabajo:

- Las características de la economía Argentina, en el sentido de país chico y el hecho que los casos de *bailouts* han sido más frecuentes para las provincias de menor tamaño, hacen que la visión tradicional que asigna la política fiscal compensatoria al gobierno nacional sea más apropiada.
- En la experiencia internacional, aún los países grandes -para los cuales puede resultar oportuno que los gobiernos subnacionales posean una política fiscal autónoma- cuentan con algún mecanismo de coordinación de modo de impedir resultados ineficientes como consecuencia de comportamientos oportunistas (*free raider*).
- La disciplina de mercado no constituye para el caso de la Argentina un sustituto a los controles internos al sector público.
- El control del endeudamiento provincial en la Argentina resulta inefectivo, limitándose, en el caso del control federal un trámite burocrático. Además, existe una distorsión en la regulación financiera que alienta el acceso al crédito por parte de las provincias.
- El gobierno federal actuó reiteradamente como prestamista de última instancia, otorgado créditos a provincias con serias dificultades financieras mediante el uso del Banco de la Nación Argentina, el BICE, el Fondo Fiduciario, títulos de tesorería (BOTESO 10), anticipos de la coparticipación y Aportes del Tesoro Nacional.

Del menú de opciones de mecanismos para el control del endeudamiento subnacional utilizados en la experiencia internacional, los métodos más adecuados son las reglas y la coordinación en el ámbito de una institución fiscal federal.

En el caso de la instauración de reglas –tipo Maastricht- debe considerarse la gran heterogeneidad de las distintas provincias en cuanto a sus indicadores fiscales. Dicha heterogeneidad imposibilita la instauración de reglas generales para todas las provincias del tipo deuda sobre recursos, deuda sobre producto bruto geográfico, etc., ya que estas reglas serían inoperantes para algunas provincias e imposibles de cumplir para otras.

Por lo tanto, en el caso de las reglas, las opciones son instaurar reglas sobre algún flujo -déficit, por ejemplo-, lo cual implicaría en cierto sentido perdonar las malas *performances* fiscales pasadas, o diseñar un tratamiento asimétrico, instaurando una regla generalizada sobre el stock de deuda medida en relación, o bien a los recursos, o bien al producto, y dando un período de convergencia a las reglas generalizadas durante el cual se exige la amortización gradual de endeudamiento para las provincias que en el momento inicial no las satisfagan.

Paralelamente a la instauración de una regla sobre el endeudamiento subnacional será importante diseñar una instancia institucional de cooperación y negociación interjurisdiccional. El nuevo esquema de coparticipación federal de impuestos sería el instrumento más adecuado para introducir en el proceso de federalismo argentino esta nueva institución.

Por último, en el corto plazo será importante trabajar sobre la oferta de crédito, aprobando una circular que desaliente los préstamos a provincias con garantía de los recursos coparticipados incrementando las exigencias de capitales mínimos para estas operaciones. Por otra parte, sería recomendable penalizar con un nivel superior de requerimiento de capitales mínimos a las operaciones de préstamos con garantía de los recursos coparticipados que afecten una cierta proporción de estos recursos, por ejemplo, cuando un préstamo afecte un porcentaje superior al 50%.

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Anexo I
Límites a la capacidad de endeudamiento subnacional

Provincia	Autorización	Límite de los servicios	Prohibición de utilizarlo para	Otras especificaciones
GCBA	2/3 del consejo	30% de las rentas		
Buenos Aires	2/3 de los presentes de c/cámara			no dice nada sobre límites.
Catamarca	2/3 de los presentes de c/ cámara	20% de las rentas	gastos ordinarios	deben especificarse los recursos para los servicios y amortización
Cordoba	2/3 de los presentes de c/ cámara	20% de las rentas		como renta se considera la menor de los ultimos 3 años
Corrientes	2/3 del total de c/cámara	25% de la renta		
Chaco	2/3 legislatura	25% de la renta		los servicios no excederán *anualmente* el 25%
Chubut	½ +1 de los miembros		gastos ordinarios	
Entre Rios	½ +1 de los miembros	25% de la renta	gastos ordinarios	
Formosa	2/3 de los votos presentes	25% de las renta**		los servicios son sobre el stock y la nueva deuda.
Jujuy	2/3 legislatura	20% de las rentas	gastos ordinarios	
La Pampa	2/3 legislatura	25% de la renta	déficit	sólo para obras públicas y colonizacion
La Rioja	2/3 de los miembros de la cámara	25% de la renta		sólo para obras públicas.Para el computo de renta se utilizará el menor de los ultimos tres años. se debe epecificar los recursos que se utilizaran para los servicios de la deuda y su amortizacion.
Mendoza	2/3 de los presentes de c/cámara			la ley debe especificar los recursos para amortizaciones y servicios
Misiones	2/3 de los presentes	25% de la renta	gastos ordinarios	
Neuquén	2/3 de la totalidad de miembros			no dice nada sobre límites al endeudamiento.

Provincia	Autorización	Límite de los servicios	Prohibición de utilizarlo para	Otras especificaciones
Rio Negro	2/3 de los miembros de la legis.	25% de la renta*	déficit	la ley debe especificar los recursos para hacer frente a servicios y amort. y solo puede utilizarse paraobraspúbiicas, reforma agraria y calamidades.
Salta	2/3 de los presentes de c/cámara	25% de la renta*		
San Juan				no dice nada sobre límites ni mayoria especial.
San Luis	2/3 legislatura	25% de la renta		la renta se calcula como la menor de los 3 ultimos años
Santa Cruz	2/3 votos de los presentes			deben especificarse los recursos para su amortización y el objeto de su destino.
Santa Fe		25% de la renta		no dice nada sobre mayoría especiales.
Santiago del Estero	2/3 legislatura	25% de la renta	déficit	especificar los recursos para los servicios
Tucuman	2/3 legislatura			
Tierra del Fuego	2/3 de los miembros	25% de la renta	gastos de funcionamiento y servicios de adm.	prohibición de emisión de títulos públicos y privados que tengan como objeto el reemplazo de la moneda de curso legal.

* incluye las amortizaciones y servicios** se toma por renta el promedio de los recursos ordinarios Fuente: Jones *et al* (1997)

Anexo II
Los requerimientos pedidos por la Secretaría de Programación Económica y Regional para autorizar el endeudamiento subnacional

a) Objeto y destino del financiamiento, indicando en su caso si se trata de refinanciamiento de una deuda ya existente (Nota de la Provincia/Municipio solicitando el trámite a la Subsecretaría de Programación Regional).

b) Propuesta de la entidad financiera que especifique claramente montos, modalidades de pago y calendario de vencimientos de amortizaciones, intereses, gastos y garantías; debiendo acompañar asimismo el proyecto de contrato de mutuo -donde conste el porcentaje de coparticipación afectado en garantía- o prospectos de emisión en caso de bonos de deuda voluntaria.

c) Stock de deuda y perfil de vencimientos de capital e intereses actualizado.

d) Garantías. Informar el detalle (en porcentaje) de: a) Garantías sobre los recursos de Coparticipación de Impuestos Nacionales o Provinciales, b) Otras garantías.

e) Estado de ejecución presupuestaria de recursos y gastos.

f) En cumplimiento de lo requerido en el punto c) se solicita Informe descriptivo del estado de las operaciones acordadas con anterioridad en virtud de la Resolución MEyOSP N°1075/93, indicando el grado de desembolso de las mismas, así también el grado de cancelación de las obligaciones contraídas. Debiendo acompañar un detalle mes por mes, del total de las retenciones de los Recursos de Coparticipación Federal (con la aclaración de los montos reintegrados por las Instituciones Bancarias en los casos en que los porcentajes cedidos superen los servicios de amortización en intereses).

g) Planta de personal abierto por escalafón.

h) Leyes que autoricen a) el endeudamiento a contraer y/o reestructuración de la deuda tomada y b) la afectación de la coparticipación federal de los fondos que correspondan a la Provincia, en el caso de que la misma se otorgue en garantía de operación. Dichas normas legales deberán ser dictadas en el marco de la Constitución Provincial.

i) Autorización del Poder Ejecutivo Provincial para suscribir en representación de la Provincia la operación a contratar, en el momento de su dictado (usualmente posterior a la sanción de las leyes mencionadas).

j) Dictamen de la Fiscalía de Estado u organismo municipal competente.

k) Certificación del Contador General - u organismo municipal que corresponda- acerca de la procedencia del porcentaje afectado de los niveles de coparticipación federal y de la factibilidad de la operación conforme al régimen de administración financiera provincial (Ley de Contabilidad). Asimismo, dicho organismo deberá certificar la efectiva afectación de los fondos recibidos por las operaciones acordadas con anterioridad en virtud de la Resolución MEyOSP N° 1075/93, a los destinos para los cuales fueron autorizadas.

l) La información deberá ser certificada por el organismo de contralor que corresponda (ej: Contaduría y/o Tribunal de Cuentas y Escribanía General de Gobierno en su caso)

m) Asimismo deberá tenerse presente el inciso c) del Anexo a la Resolución MEyOSP N° 731/95, que textualmente expresa: "En el caso que las negociaciones de financiamiento no lleguen a ser incluidas de manera satisfactorias para las partes y por lo tanto no sea firmado el correspondiente contrato; las partes no podrán reclamarse recíprocamente suma alguna en concepto de gastos y comisiones".

SESION 2

INCENTIVOS TRIBUTARIOS PARA ATRAER INVERSION EXTRANJERA DIRECTA: EXPERIENCIAS RECIENTES Y EVALUACION DE DISEÑOS ALTERNATIVOS

GLOBALIZACION, IED Y NUEVAS ESTRATEGIAS EMPRESARIALES EN AMERICA LATINA

Michael Mortimore
CEPAL

Indice

El informe del presente año comienza mencionando los importantes obstáculos que entorpecen la comprensión cabal del fenómeno de la inversión extranjera, no sólo debido a las dificultades que se plantean por el uso de las diferentes metodologías, prácticas contables, definiciones, cobertura nacional y sectorial, etc. que aplican las distintas instituciones internacionales y nacionales que producen estadísticas de inversión extranjera directa (IED), lo que se indicó en la edición de 1998, sino también porque existe considerable confusión de carácter normativo o jurídico. Sin duda, la proliferación de tratados bilaterales de inversión, sumada a las obligaciones multilaterales concertadas en el marco del Acuerdo General sobre el Comercio de Servicios (GATS), el Acuerdo sobre las medidas de inversión relacionadas con el comercio (MIC), el Acuerdo sobre los aspectos de los derechos de propiedad intelectual relacionados con el comercio (ADPIC) y otros, y los capítulos sobre inversión de acuerdos de libre comercio, ya sea vigentes –como el Tratado de Libre Comercio de América del Norte (TLC), el Acuerdo de Libre Comercio entre Canadá y Chile, el Acuerdo de Complementación Económica entre Chile y México, el Tratado Bilateral de Garantía a las Inversiones suscrito entre Bolivia y los Estados Unidos, etc.-- o en etapa de negociación –como el Área de Libre Comercio de las Américas (ALCA)--, ha contribuido a aumentar significativamente los ingresos de IED a los países participantes. No obstante, estos instrumentos no han ayudado mucho a lograr una visión más clara del fenómeno de la IED en sí. De hecho, es muy posible que la plétora de nuevas obligaciones de carácter normativo o jurídico no coincida con ninguna iniciativa multilateral unificada sobre inversión extranjera que pudiera acordarse en el futuro en el seno de la Organización Mundial del Comercio (OMC), sobre todo si se trata de una iniciativa en que se reflejen mejor las necesidades específicas de los países en desarrollo. En consecuencia, parecería aconsejable que los países latinoamericanos ejercieran mayor cautela al contraer nuevas obligaciones hasta tanto se aclare la situación multilateral y se llegue a una mejor comprensión del fenómeno de la IED como tal. Quizá sea buen momento para que los encargados nacionales de adoptar decisiones se concentren en definir aquellas actividades prioritarias en que estiman que la IED puede contribuir sustancialmente a los objetivos nacionales de desarrollo, para luego trazar y aplicar políticas que favorezcan esos tipos de IED en particular.

Los desafíos estadístico y normativo vinculados a la IED no afectaron en absoluto la afluencia de inversión extranjera a América Latina y el Caribe, ya que los flujos netos correspondientes a 1998 (y las estimaciones disponibles para 1999) superaron a los de 1997 y ascendieron a más de 76 000 millones de dólares. En el capítulo titulado Panorama regional del presente informe se proporciona información más detallada sobre los ingresos de IED y demás aspectos estadísticos conexos de la IED en la región. Asimismo, se dedican capítulos separados al análisis exhaustivo del país receptor (México), el país inversionista (España) y la rama de actividad (el vestido) destacados en la edición de este año.

I. Panorama regional

En 1998 los flujos de inversión extranjera directa mundial superaron los 650 000 millones de dólares, lo que representó un incremento de casi 39% respecto del año anterior y más del doble del promedio correspondiente a 1991-1996. Estas cifras indican que continúa la aceleración de la expansión internacional de las empresas transnacionales en el contexto del proceso de globalización. Los ingresos de IED correspondientes a 1998 estuvieron mucho más concentrados que antes en los mismos países industrializados (más del 70% en comparación con alrededor del 60% durante todos los años noventa) que constituyeron los países de origen de cerca del 90% de las salidas de capital. De esta manera se invirtió la tendencia ascendente registrada hasta entonces, según la cual los ingresos a los países en desarrollo aumentaban, al recibir estos menos del 29% del total de los flujos, en comparación con el 40% que habían captado a mediados de los años noventa.

En términos absolutos, el nivel de los flujos de IED que ingresaron a los países en desarrollo se redujo ligeramente durante 1998, aunque en la distribución entre las regiones se aprecia que América Latina y el Caribe se puso casi a la par de Asia en desarrollo (40.6% frente a 44.3%) y se alejó mucho de otras regiones en desarrollo (15.1%). Indudablemente la crisis asiática que comenzó en 1997 afectó los ingresos de IED destinados a Asia oriental, meridional y sudoriental (que disminuyeron alrededor del 14%, al pasar de 88 366 a 76 292 millones de dólares), y especialmente los flujos dentro del continente asiático. Al mismo tiempo, la IED que ingresó a América Latina y el Caribe se mostró muy dinámica (con un aumento de casi 11%, al pasar de 69 404 a 76 727 millones de dólares). Así pues, si bien los países en desarrollo en general perdieron terreno frente a los países industrializados como destino de la IED durante 1998, la región de América Latina y el Caribe resultó ser la excepción y registró un sostenido dinamismo.

En 1998 los países de mayor tamaño de la región que pertenecen a la Asociación Latinoamericana de Integración (ALADI) recibieron 84% del total de ingresos de IED a la región, en tanto los centros financieros (8.5%) y el resto de los países (7.5%) de la Cuenca del Caribe captaron crecientes volúmenes en comparación con la tendencia de los años noventa. Entre los países más grandes, Brasil registró la mayor afluencia de IED (41.6%), seguido a gran distancia por México (13.3%), Argentina (8%), Chile (6%) y Venezuela (5.8%). Los flujos de IED que ingresaron a los centros financieros se concentraron en las Islas Caimán (4.6%), Bermuda (3.1%) y Panamá (1.6%). Los que se dirigieron a otros países de la Cuenca del Caribe tuvieron por principal destino El Salvador (1.1%), Trinidad y Tabago (1%), la República Dominicana (0.9%), Guatemala (0.9%) y Costa Rica (0.7%).

Según las cifras preliminares correspondientes a 1999, Brasil ha seguido siendo el foco principal de la IED en la región. Principalmente gracias a la venta de Yacimientos Petrolíferos Fiscales (YPF) a la empresa española de petróleo Repsol, Argentina superará a México y conquistará el segundo lugar entre los países de la ALADI. Entretanto, Chile duplicará aproximadamente sus ingresos de IED en 1999, en gran medida como consecuencia de la compra de Enersis y Endesa Chile por parte de la empresa española de electricidad, Endesa España. Así pues, las fusiones y adquisiciones, en particular a cargo de empresas españolas, han seguido siendo un factor muy dinámico en los ingresos de IED a los países más grandes de América Latina en 1999.

Habida cuenta de que los ingresos netos de IED a la región se concentraron en tal medida en Brasil, cabe puntualizar que cerca de la mitad de la IED que recibió ese país estaba dirigida a unos pocos sectores de servicios, en que se estaban vendiendo activos estatales como parte de los procesos de liberalización y desregulación de dichos sectores (telecomunicaciones y electricidad) o en que la venta de empresas privadas nacionales era un factor fundamental (servicios financieros y comercio al menudeo). En total, 37% de los ingresos generados por el proceso de privatización brasileño provino del sector de las telecomunicaciones y

33% del sector de la generación y distribución de electricidad. Las empresas europeas, sobre todo las españolas, tuvieron una participación muy activa en Brasil en estos ámbitos.

INGRESOS NETOS DE INVERSIÓN EXTRANJERA DIRECTA A AMÉRICA LATINA, POR SUBREGIÓN, 1990-1999
(En millones de dólares y porcentajes)

Subregión/País	1990-1994	1995	1996	1997	1998	Participación 1998 (%)	1999[a]
1. Centroamérica y el Caribe	1 397	2 005	2 108	4 251	5 776	7.5	5 500
2. Centros financieros del Caribe	2 506	2 427	3 119	4 513	6 486	8.5	5 000
3. Asociación Latinoamericana de Integración (ALADI)	14 238	27 750	41 416	60 640	64 465	84.0	75 420
Argentina	2 971	5 279	6 513	8 094	6 150	9.5	21 000
Bolivia	85	393	474	731	872	1.4	800
Brasil	1 703	4 859	11 200	19 650	31 913	49.5	31 000
Chile	1 219	2 957	4 637	5 219	4 638	7.2	8 900
Colombia	818	969	3 123	5 703	3 038	4.7	350
Ecuador	293	470	491	695	831	1.3	470
México	5 430	9 526	9 186	12 831	10 238	15.9	10 000
Paraguay	98	155	246	270	256	0.4	100
Perú	785	2 000	3 226	1 785	1 930	3.0	1 500
Uruguay	...	157	137	126	164	0.3	100
Venezuela	836	985	2 183	5 536	4 435	6.9	1 200
Total (1+2+3)	**18 220**	**32 182**	**46 643**	**69 404**	**76 727**	**100.0**	**85 920**

Fuente: CEPAL, Centro de Información de la Unidad de Inversiones y Estrategias Empresariales de la División de Desarrollo Productivo y Empresarial, sobre la base de información proporcionada por el Fondo Monetario Internacional, la Conferencia de las Naciones Unidas sobre Comercio y Desarrollo (UNCTAD) y los bancos centrales de cada país.
[a] Cálculos de la Unidad de Inversiones y Estrategias Empresariales, sobre la base de proyecciones de los bancos centrales de los países correspondientes u otras fuentes, a diciembre de 1999.

En la región en general, no cabe duda de que, como consecuencia del proceso de globalización y de las políticas nacionales tendientes a facilitar nuevas operaciones de las empresas transnacionales (liberalización comercial y financiera y desregulación de ciertos sectores), el papel que estas desempeñan ha cobrado enorme importancia. Este hecho queda claramente demostrado al comparar los activos y las actividades sectoriales de las 500 empresas más importantes en términos de ventas de América Latina durante la década de 1990. Al desglosar las ventas totales correspondientes a este grupo de grandes empresas, clasificadas en tres categorías –empresas transnacionales, empresas privadas locales y empresas estatales—, se advierte que la participación de las empresas transnacionales ha registrado un brusco aumento de 26.6% a 38.7%, la de las empresas privadas locales se mantuvo constante, en alrededor del 40%, y las ventas de las empresas estatales cayeron estrepitosamente, de 35% a 19.1%. En términos de sus actividades sectoriales, la manufactura se mantuvo estable, en cerca del 42% de las ventas totales, en tanto los servicios saltaron de 30% a 41.2% y las actividades primarias bajaron de 27.8% a 17.4%. Estas cifras confirman decididamente la idea de que la búsqueda de acceso a los mercados en materia de servicios ha sido una de las estrategias dominantes de las empresas transnacionales de la región durante los años noventa. El estudio de caso sobre Brasil que figura en la edición de 1998 también corrobora esta conclusión.

De acuerdo con información similar correspondiente a las 100 empresas *manufacutreras* más importantes en términos de ventas, se observa que la participación de las empresas transnacionales aumentó de 52.8% a 60.7%, que la de las empresas privadas locales se mantuvo estable en cerca del 40% y que la de las empresas estatales bajó de 5.2% a 1.2% de las ventas totales. Cabe señalar que la proporción de las ventas de las empresas transnacionales del sector automovilístico aumentó de 25.1% a 30.4%, lo que indica que alrededor de la mitad del total de las ventas de manufacturas de dichas empresas corresponde a esa única industria.

Los datos disponibles sobre el sector manufacturero se complementan con información sobre el valor de las ventas externas de los 200 principales exportadores de América Latina entre 1995 y 1998 (no se dispone de datos para años anteriores). Según las cifras, el sector manufacturero se mantuvo estable con el 50% del valor de las exportaciones de estas empresas, en tanto la participación de las actividades primarias declinó de 44.8% a 40.1% y la de los servicios aumentó de 5.3% a 9.2%. Las empresas transnacionales fueron con creces el componente más dinámico de este grupo de exportadores principales y su participación en el total de exportaciones trepó de 30.6% a 44.8% durante 1995-1998. Asimismo, la participación de las empresas transnacionales del sector automotor creció de 15.2% a 20.3%, lo que nuevamente subraya la importancia de esta industria en la región. Las empresas privadas locales mantuvieron una participación de alrededor del 33% de las exportaciones, en tanto la de las empresas estatales cayó abruptamente del 37% al 21.9% del total de exportaciones de estas empresas principales. Estas cifras ratifican innegablemente la idea de que el uso de la estrategia de búsqueda de eficiencia en América Latina para la exportación de manufacturas ha contribuido muchísimo a fortalecer la presencia de las empresas transnacionales en la región. El análisis de la industria automotriz mexicana que figura en el capítulo IV de la edición de 1998, el examen de la industria del vestido de México y la Cuenca del Caribe contenido en el capítulo IV de la presente edición y el estudio de caso sobre México que aparece en el capítulo II del informe de 1999 confirman dicha tesis.

El estudio de las ventas consolidadas de las 100 principales empresas transnacionales no financieras que operaban en seis países de América Latina en 1998 indica que se están produciendo cambios significativos. Las subsidiarias de las empresas transnacionales con base en Estados Unidos siguen siendo el grupo más numeroso (43.1% del total de las ventas consolidadas); sin embargo, varias empresas transnacionales europeas, procedentes de Alemania (10.6%), España (10%), Francia (9.2%) e Italia (5%), también han establecido una presencia destacable en la región. En el capítulo III del presente informe se examina en detalle la nueva relevancia de las filiales de empresas españolas. La industria automotriz (23.6% de las ventas consolidadas) es aún la rama de actividad donde se advierte la mayor presencia de las empresas transnacionales, en tanto el comercio (11.8%), la minería y el petróleo (10%), las telecomunicaciones (9.9%), la electrónica (9.5%) y la electricidad (8.1%) son dignos de mención en este sentido. Más del 70% de las ventas consolidadas de las 100 empresas transnacionales principales de la región correspondió a empresas que figuran entre las 500 clasificadas por la revista *Fortune*. No obstante, en términos de los activos externos, sólo algo más del 50% de las ventas consolidadas de estas 100 empresas transnacionales proviene de las principales empresas transnacionales que figuran en la clasificación de la UNCTAD, lo que sugiere que las recién llegadas contribuyen en gran medida a los flujos de IED que ingresan a América Latina. Las filiales de empresas europeas, sobre todo españolas, en el sector de los servicios representan un elemento dinámico de cambio respecto de los principales agentes económicos transnacionales que operan en la región.

La situación de los bancos extranjeros también ha cambiado drásticamente en América Latina. Aunque hay relativamente pocos bancos mundiales con redes extensas en la región, los activos del Banco

Santander Central Hispano (BSCH) en seis países latinoamericanos son casi tan cuantiosos como las redes de los dos bancos extranjeros que le siguen en tamaño, el Citibank y el Banco Bilbao Vizcaya Argentaria (BBVA), consideradas juntas. Los bancos españoles representan 32.5% de los activos totales de los 20 bancos extranjeros más grandes de América Latina, superando a los estadounidenses, cuya participación asciende a 29.7%. Nuevamente, las filiales de los bancos españoles actúan como elementos dinámicos de la expansión de los bancos transnacionales en la región.

En términos de modalidades, la IED que ingresó a la región durante 1998 y 1999 mantuvo su composición de alrededor de 60% para la creación de nuevos activos y 40% para la compra de activos existentes, si bien el volumen de la IED creció sensiblemente. Los datos de la CEPAL indican que las fusiones y adquisiciones aumentaron en gran medida durante 1998 y 1999, en tanto el valor de las privatizaciones bajó considerablemente en el mismo período. Las modalidades de la IED constituyen un aspecto importante del análisis de este tipo de inversión en la región.

Las fusiones y adquisiciones registradas en 1998 y 1999 en América Latina estuvieron sumamente concentradas en tres países: Argentina (45.6%), Brasil (26.4%) y Chile (16.5%). La mayor parte de la inversión extranjera tuvo su origen en España (53%) y algunos otros inversionistas extranjeros: Estados Unidos (15%), Francia (9%) y los Países Bajos (7.7%). Catorce operaciones en gran escala, por más de 500 millones de dólares cada una, representaron 63.9% del valor total de las fusiones y adquisiciones. De hecho, las cinco operaciones de mayor envergadura representaron casi la mitad (49%) del total. Sin duda la operación más cuantiosa fue la adquisición de la empresa argentina Yacimientos Petrolíferos Fiscales (YPF) por parte de la empresa petrolera española, Repsol, por más de 13 000 millones de dólares en 1999. Otras transacciones importantes fueron la compra de Endesa Chile y Enersis de Chile por parte de Endesa España, en dos operaciones separadas. También entre las cinco operaciones principales figuran la adquisición del Banco Real de Brasil por parte de ABN Amro de los Países Bajos y del Banco Excel de Brasil por parte de BBVA de España.

La mayoría de las privatizaciones que se realizaron en América Latina en 1998 y 1999 tuvieron lugar en sólo dos países: Brasil (62.4%) y Argentina (18%). La participación de países inversionistas fue mucho más diversificada que en el caso de las fusiones y adquisiciones. Los tres principales países inversionistas fueron los Estados Unidos (14.8%), España (8.7%) y Portugal (8.4%). No obstante, 24 operaciones por más de 500 millones de dólares cada una representaron más del 80% de todas las transacciones de este tipo. Las cinco privatizaciones más cuantiosas correspondieron al 39.5% del total. La concesión de aeropuertos en Argentina, otorgada a inversionistas de los Estados Unidos, Italia y Argentina fue avaluada en 5 134 millones de dólares, en tanto las otras cuatro privatizaciones se registraron en Brasil y entrañaron operaciones en los sectores de las telecomunicaciones y la electricidad: Telefónica de España y varios otros inversionistas compraron Telesp; Portugal Telecom adquirió Telesp Cellular; AES y Houston Energy de los Estados Unidos se unieron a Electricité de France para comprar Eletropaulo Metropolitana de Eletricidade, y EMBRATEL fue adquirida por MCI Worldcom.

En 1998, dos países –Costa Rica y Bolivia— habían logrado en gran medida elaborar y aplicar *nuevas* políticas destinadas a atraer un volumen de ingresos de IED mucho mayor hacia actividades prioritarias definidas en sus estrategias de desarrollo. En el caso de Costa Rica, cuya afluencia de IED aumentó a 531 millones de dólares en 1998 (equivalente al 6% del PIB) y donde 64% del acervo de IED existente había ingresado al país en los años noventa, la nueva política se basó en contactar directamente a las empresas transnacionales cuyas estrategias consistían en la búsqueda de eficiencia en actividades de alta tecnología, especialmente electrónica. Previamente Costa Rica había conseguido atraer IED a la industria del ensamblaje de prendas de vestir ofreciendo incentivos horizontales (fiscales) en zonas de procesamiento de exportaciones (ZPE); sin embargo, el impacto en términos de desarrollo del éxito de las ZPE fue un fracaso debido a la falta de progreso suficiente en cuanto a los niveles de los salarios, la capacitación de los recursos humanos y la falta de integración de tales actividades a la economía nacional, aparte del hecho de que hubo otros países de América Central que empezaron a ofrecer menores salarios y otros incentivos que a la larga hicieron perder dinamismo a la industria de ensamblaje de prendas de vestir de Costa Rica. No obstante, las autoridades nacionales dieron un golpe maestro al tomar medidas directas y utilizar incentivos selectivos, con lo cual consiguieron atraer un proyecto de inversión por un valor de 400 a 500 millones de dólares con el gigante de los microprocesadores, Intel, que instaló una planta de ensamblaje y ensayo en el país. Esa inversión por sí sola ascendió en 1999 a más del 40% del valor de las exportaciones totales y más del 90% del valor de las exportaciones de productos electrónicos de Costa Rica. Si bien el solo volumen e impacto económico de este proyecto de IED es formidable, la nueva política de Costa Rica no debiera considerarse consolidada hasta tanto se hayan conseguido varias inversiones de este tipo y el conglomerado nacional de electrónica esté mejor afianzado en el país.

Bolivia atrajo 900 millones de dólares de IED en 1998, lo que equivale a 10% de su PIB. Más del 70% del acervo de IED de ese país ingresó durante la década de 1990. Como parte de la estrategia de desarrollo denominada Plan de Todos, el Plan de Capitalización, que disponía la venta de activos estatales, y la Ley Corazón, que preveía beneficios especiales para las exportaciones de energía de zonas de frontera, se establecieron las bases de una nueva política tendiente a canalizar mayores volúmenes de IED hacia actividades prioritarias, convirtiendo así a Bolivia en un gran exportador de energía. La nueva política encaja bien en las estrategias de búsqueda de recursos naturales que aplican las principales empresas transnacionales, especialmente aquellas interesadas en establecer una red regional de energía. El programa de privatización captó más del 50% de las entradas de IED de 1995-1998. Lo más novedoso de la política de Bolivia fue el uso de la IED para la capitalización de empresas mixtas (el 50% de la propiedad quedó en manos de ciudadanos bolivianos). Entre las grandes empresas estatales que se vendieron figuran la empresa petrolera, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), con 55.2% del Plan, la refinería estatal de metales (Vinto), la Empresa Nacional de Electricidad (ENDE), la Empresa Nacional de Telecomunicaciones (ENTEL), la Empresa Nacional de Ferrocarriles (ENFE) y la línea aérea estatal, el Lloyd Aéreo Boliviano. No obstante, el éxito más saliente de la nueva política estuvo en el campo de la energía donde, además de los nuevos contratos de exploración y operación de pozos de petróleo, la Ley Corazón ofrecía considerables incentivos para crear condiciones parecidas a una zona de libre comercio (concesiones por 40 años, importaciones de bienes de capital libres de impuestos, eliminación del impuesto al valor agregado, etc.), a fin de fomentar las exportaciones de energía a países vecinos, especialmente Brasil. En 1999, las exportaciones de gas natural a Brasil constituyeron el 26% del valor total de las exportaciones bolivianas.

El hecho de que Costa Rica y Bolivia hayan logrado canalizar mayores volúmenes de IED hacia actividades prioritarias indica que la política de IED supone mucho más que la simple liberalización, desregulación y privatización sumadas a la mayor protección de los inversionistas extranjeros en el marco de acuerdos de inversión bilaterales, subregionales o multilaterales. Como primera medida, es preciso tener un plan, es decir, una estrategia de desarrollo en que se definan las actividades prioritarias.

II. México: fuente de eficiencia para las empresas transnacionales que operan en el mercado de América del Norte

En el siglo XX las autoridades mexicanas han tenido una relación extremadamente fluctuante con los inversionistas extranjeros. Durante la mayor parte del período posterior a la Revolución Mexicana, el Gobierno adoptó una postura nacionalista y restrictiva respecto de la IED, sobre todo cuando se nacionalizó la industria del petróleo en los años treinta y cuando se promulgó la Ley para Promover la Inversión

Mexicana y Regular la Inversión Extranjera, en 1973. Dicha postura cambió radicalmente a fines de los años ochenta, cuando en 1989 se agregaron nuevas regulaciones a la mencionada ley y luego, en 1993, se aprobó una ley completamente modificada. Esta última política daba gran impulso a la afluencia de IED y estaba en consonancia con el papel más prominente que tenían las operaciones de las empresas transnacionales como motores del crecimiento de la economía mexicana y la posibilidad de suscribir un Tratado de Libre Comercio de América del Norte.

El ingreso de México al Acuerdo General sobre Aranceles Aduaneros y Comercio (GATT) en 1986 probablemente marcó el principio del alejamiento del marco vigente de industrialización mediante la sustitución de importaciones con el fin de abordar una estrategia de crecimiento más orientada hacia afuera, basada en nuevas exportaciones y en la liberalización y desregulación de la economía mexicana. La IED habría de constituir un factor importante en esta nueva estrategia. El impacto que esta política tuvo en las empresas transnacionales se manifestó de tres maneras principales. Primero, las operaciones de maquila recibieron un fuerte espaldarazo de las políticas reactivadas, que facilitaron el uso más generalizado de mano de obra barata mexicana en el ensamblaje con insumos importados de productos finales (sobre todo autopartes, equipo electrónico y prendas de vestir) destinados al mercado de los Estados Unidos. Segundo, las subsidiarias existentes en el sector manufacturero que habían formado parte del anterior marco de política de industrialización mediante la sustitución de importaciones se vieron obligadas a reaccionar, retirándose del mercado interno cada vez más competitivo, racionalizando sus operaciones de producción en México (generalmente adoptando una estrategia defensiva de reducir su tamaño) o reestructurando su sistema de producción general (a menudo haciendo grandes inversiones nuevas para redefinir el papel de México en sus sistemas de producción internacionalmente integrados). La reestructuración de la industria automotriz fue un acontecimiento que marcó un hito en este sentido. En tercer lugar, el mayor acceso a los mercados atrajo a varias empresas transnacionales que constituían nuevos entrantes en el sector de los servicios de México (comercio al menudeo, telecomunicaciones, servicios financieros, etc.), así como en el sector manufacturero (alimentos, bebidas, tabaco, etc.). La firma del TLC, en virtud del cual Canadá, Estados Unidos y México se unieron en una economía de creciente corte continental, consolidó los cambios que ya se estaban produciendo en México. Durante el período comprendido entre 1990 y 1995, este país fue el principal receptor de IED de América Latina, y la mayor parte de esos flujos provinieron de sus socios en el Tratado.

Los resultados fundamentales de la explosión de ingresos de IED hacia México pueden comprenderse mejor en términos de las principales estrategias empresariales aplicadas por los inversionistas extranjeros, a saber, la búsqueda de eficiencia y la búsqueda de acceso a los mercados. Frente a la feroz competencia que planteaban las importaciones asiáticas de automóviles, computadoras y prendas de vestir en el mercado estadounidense, las empresas transnacionales de ese país han sido las que en mayor número han instalado plantas de producción y ensamblaje en México, utilizando la mano de obra nacional más barata y aprovechando el mecanismo de producción compartida de los Estados Unidos y el TLC con el fin de reducir los costos de producción y estar mejor preparadas para competir en el mercado de América del Norte. En consecuencia, México pasó a ser el tercer proveedor en orden de importancia en ese mercado y las exportaciones de las empresas transnacionales representan más de la mitad del total de exportaciones mexicanas con tal destino. México se ha especializado en los artículos de mayor dinamismo en el mercado de América del Norte (manufacturas), aumentando al mismo tiempo su participación en el mercado de importación. Dos tercios de la IED que recibe provienen de los Estados Unidos y Canadá, lo que revela el carácter continental de los sistemas de producción internacionalmente integrados que se están estableciendo. La creación de nuevos activos (plantas y equipos) ha predominado mucho más que la compra de activos existentes.

La estrategia de búsqueda de acceso a los mercados ha estado vinculada principalmente con la liberalización y desregulación de algunos sectores de servicios (comercio al menudeo, telecomunicaciones, servicios financieros, etc.), en que la IED se ha originado en empresas transnacionales europeas, así como estadounidenses y canadienses, y ha estado concentrada en la compra de activos existentes más que en la creación de nuevos. Si bien las exportaciones directas fueron escasas en los sectores de los servicios, esta IED ha acarreado una mejora en el aspecto sistémico de la competitividad internacional de la economía mexicana.

Algunos de los beneficios evidentes del papel más preponderante que ha tenido la IED en la economía mexicana se encuentran en su mayor integración a la economía internacional. Las exportaciones han registrado un fuerte aumento como proporción del PIB y también ha crecido la parte correspondiente a la IED en la formación bruta de capital fijo. Varias áreas del sector manufacturero se han visto fortalecidas y han adquirido competitividad internacional. Así pues, la competitividad sistémica de la economía mexicana ha mejorado gracias a la IED en los servicios.

No obstante, estos éxitos han estado acompañados por fracasos en otros ámbitos. El dinamismo del segmento de la economía mexicana dominado por la IED no bastó para aumentar significativamente la tasa de crecimiento global a largo plazo de la economía, que se polarizó cada vez más debido a la escasa integración de los sectores modernos y más tradicionales. El éxito de México en términos de lograr la competitividad internacional ha estado restringido a un solo mercado: América del Norte. El proceso de industrialización nacional se vio truncado en ciertas instancias porque las empresas transnacionales que buscaban eficiencia recurrieron sobre todo a insumos físicos importados y el mecanismo de producción compartida de los Estados Unidos castigaba a los insumos mexicanos. Además, en los sectores de las telecomunicaciones y los servicios financieros se tropezó con ciertos problemas de tipo regulatorio.

Este análisis indica que los encargados de formular políticas de México podrían aprovechar los éxitos alcanzados e intentar superar los problemas que existen. Es preciso hacer mayores esfuerzos para diversificar los mercados de exportación (como Europa y América Latina) y las fuentes de IED (Europa y Japón). La integración de los sectores modernos y tradicionales de la economía mexicana es vital para lograr un éxito completo. Este objetivo puede alcanzarse en parte sacando mejor partido de las normas de origen del TLC que, a diferencia del mecanismo de producción compartida de los Estados Unidos, permiten la incorporación de insumos mexicanos competitivos en los productos finales destinados a los mercados de exportación. De tal manera, es necesario aplicar un programa mucho más enérgico para alentar y apoyar a los proveedores mexicanos, además de aumentar los esfuerzos para mejorar los recursos humanos mediante la capacitación

III. España: unos pocos inversionistas audaces dominan algunos de los principales sectores de servicios de América Latina

La economía española rápidamente se ha puesto a tono en su integración al sistema internacional. Anteriormente el país hacía las veces de puerta de entrada al mercado europeo, al acoger las plataformas de exportación de los inversionistas extranjeros, pero ahora ha pasado a ser un inversionista extranjero en sí mismo, que además concentra cada vez más su IED en América Latina y, más especialmente, en el Mercado Común del Sur (Mercosur), Chile y los países andinos. La participación que le cupo a América Latina en el total de la IED española saltó de 29% a 72% entre 1990 y 1998. Una proporción muy considerable de esa inversión se destinó a los servicios, como las telecomunicaciones, la generación y distribución de electricidad (electricidad, gas, petróleo) y los servicios financieros. La mayor parte correspondió a unas pocas empresas transnacionales españolas.

El proceso de globalización, entendido como el desplazamiento en el largo plazo hacia un único mercado universal, parece ser el motor de la expansión internacional de estas empresas españolas. Tienen prisa por establecer sus sistemas internacionales y consideran una oportunidad estratégica el hecho de que los sectores en que operan estén atravesando por procesos de liberalización y desregulación en el marco del Acuerdo General sobre el Comercio de Servicios (telecomunicaciones y servicios financieros) o las Directrices de la Comisión Europea (electricidad) o por reestructuraciones mundiales a fuerza de megafusiones y megaadquisiciones (petróleo y banca). En estos sectores de servicios tanto los actores mundiales existentes como los aspirantes a actores utilizan actualmente la IED y las alianzas estratégicas como medio para posicionarse.

En el caso de las empresas transnacionales españolas que ingresan a la escena internacional, se han producido cambios muy significativos en las situaciones competitivas de los mercados internacional, europeo, español y latinoamericano, que han obligado a los aspirantes a actores mundiales a aplicar estrategias extremadamente audaces de expansión internacional. Algunas de las mayores empresas españolas en el área de las telecomunicaciones (Telefónica), los servicios financieros (BSCH y BBVA), la generación y distribución de energía (Endesa España, Iberdrola, Repsol) y otros sectores de servicios (Aguas de Barcelona, Iberia) están aprovechando los vínculos culturales y lingüísticos para lanzar sus campañas de expansión internacional *principalmente en América Latina.* La estrategia empresarial fundamental que utilizan es obtener acceso al mercado de los servicios que son objeto de liberalización, desregulación y privatización en la región.

Telefónica, la empresa de telecomunicaciones privatizada de España, ha pasado a ser la mayor empresa de telecomunicaciones en español del mundo, lo que ha logrado sobre todo al aprovechar la privatización de las empresas estatales de telecomunicaciones de América Latina. Por ejemplo, su clasificación entre las 500 empresas mundiales de la revista *Fortune* pasó del puesto 239 en 1997 al 193 en 1998. Tras invertir más de 10 000 millones de dólares en la región, principalmente mediante fusiones y adquisiciones, el 31% del total de sus activos es ahora extranjero y cuenta con 49 millones de clientes en Argentina, Brasil, Chile, Perú, América Central y Puerto Rico. La empresa proyecta invertir otros 20 000 millones de dólares en América Latina a fin de consolidar su posición predominante en el mundo de habla hispana y portuguesa y ha establecido alianzas estratégicas con MCI Worldcom y Portugal Telecom, así como otras empresas transnacionales españolas (Iberdrola y BBVA).

Los bancos españoles BSCH y BBVA, de por sí productos de fusiones ocurridas durante los años noventa, han estado a la vanguardia del proceso de consolidación que se está desarrollando en el sector financiero español. El 45% del total de activos del sector corresponde a los tres bancos más importantes de España y el 67% a los seis más importantes. En Europa, los bancos nacionales han recurrido al establecimiento de una sólida red nacional, con lo cual lograron evitar ser adquiridos por instituciones extranjeras. Estos dos bancos españoles han hecho justamente eso y, además, se han expandido hacia América Latina, donde junto con el Citicorp poseen las redes más extensas. En la clasificación internacional de los 1000 bancos principales publicada en *The Banker*, el BSCH y el BBVA pasaron del puesto 40 al 37 y del 50 al 47, respectivamente, entre 1997 y 1998. Ambos bancos invirtieron más de 10 000 millones de dólares en la región y, además de tener vastas redes regionales, con activos que superan los 20 000 millones de dólares y más de 16 millones de clientes, figuran entre los líderes en la administración de fondos de pensiones privados. No obstante, cabe señalar que, de los 50 grandes bancos europeos, estos bancos españoles se ubicaron entre los tres con clasificación de riesgo más alta en febrero de 1999.

Endesa España e Iberdrola han encabezado la campaña de expansión internacional de las empresas españolas de electricidad. Endesa es la principal empresa eléctrica de España y América Latina y figura en el tercer puesto en la Unión Europea. Invirtió más de 8 000 millones de dólares en 12 países durante el período 1992-1998 y adquirió grandes operaciones en siete países latinoamericanos; en la mayoría de los casos llevó a cabo estas transacciones participando en los procesos de privatización locales, aunque también ha establecido alianzas estratégicas, como fue originalmente el caso de Enersis de Chile. En total, el 40% de sus utilidades se genera en América Latina, donde posee 25 millones de clientes. Iberdrola, por su parte, ha invertido más de 2 000 millones de dólares en seis países de América Latina y tiene alrededor de 15 millones de clientes en esa región.

Repsol, la empresa petrolera española privatizada, ha invertido más de 19 000 millones de dólares en América Latina, siendo su adquisición más reciente la anteriormente privatizada empresa petrolífera argentina, Yacimientos Petrolíferos Fiscales (YPF). Ha participado en fusiones y adquisiciones de empresas petroleras o adquirido concesiones para la exploración de petróleo en otros ocho países de la región. En gran parte gracias a sus activos latinoamericanos, Repsol se está convirtiendo en un grupo petrolífero de creciente importancia en el mercado internacional, cuya clasificación entre las 500 empresas de *Fortune* ha pasado del puesto 257 en 1997 al puesto 224 en 1998.

De modo que, en conjunto, la IED española en América Latina y el Caribe durante la década de 1990 ha sido muy importante y ha tenido considerables repercusiones. Estos seis aspirantes a actores mundiales, muchos de los cuales son a su vez empresas privatizadas, han aprovechado los procesos de privatización aplicados en varios sectores de servicios de América Latina para expandirse internacionalmente. Han concentrado sus fusiones y adquisiciones en el Mercosur, Chile y los países andinos y, en algunos casos, han utilizado a su favor el hecho de que el Gobierno español sigue siendo un importante accionista de las empresas. Si bien en el ámbito local ha surgido cierta preocupación de que esta acelerada expansión forme parte de la "reconquista española" de sus antiguas colonias, las dificultades más serias que ha planteado este proceso tienen su origen en la fragilidad e imperfección de los marcos regulatorios de los países receptores, los efectos que produce en la competencia y el desafío financiero que entraña una campaña de tan gran escala para estas empresas españolas, dado el pobre desempeño de las economías en que se desarrolla su actividad.

IV. Las consecuencias para América Latina de la reestructuración de la industria del vestido de América del Norte

En general las importaciones de los países industriales han registrado gran dinamismo, y uno de los componentes más destacables han sido las prendas de vestir, cuyas importaciones al mercado de América del Norte han aumentado del 2.5% al 4.7% del valor de las importaciones totales de ese mercado entre 1980 y 1996. Actualmente las importaciones representan más de la mitad de las ventas de prendas de vestir en los Estados Unidos, pese al uso prolongado de cuotas unilaterales por parte de ese país en el marco del Acuerdo Multifibras y al hecho de que la industria del vestido está entre las que goza de mayor nivel de protección arancelaria en el mercado estadounidense (15.5% en 1997).

Los países asiáticos han estado a la vanguardia del auge de exportaciones de prendas de vestir en todo el mundo. Varias de las economías de reciente industrialización de Asia (la región administrativa especial de Hong Kong, la provincia china de Taiwán, la República de Corea) han podido desarrollar fuertes industrias textiles y al mismo tiempo desempeñarse como intermediarias de grandes compradores internacionales que se acostumbraron a recurrir a ellas para producir prendas de vestir "de paquete completo" sobre la base de los diseños del comprador, especialmente en los segmentos más dinámicos de la producción del vestido, como la alta costura. Algunas incluso han producido sus propias marcas originales. Otros países asiáticos han hecho las veces de sitios de ensamblaje para estos sistemas basados en intermediarios. En 1996 China ostentó una impresionante participación en las importaciones de todos los grandes mercados, que ascendió al 17.7% en el mercado de la Organización de Cooperación y Desarrollo Económicos (OCDE), 8.4% en el de Europa, 15.3% en el de América del Norte, y 58% en el de Japón. Sin embargo, este desafío asiático provocó una fuerte reacción de los productores del vestido y algunos compradores de los Estados Unidos, cuya consecuencia más evidente fue que la participación de los países asiáticos en las importaciones de prendas de vestir estadounidenses bajó de 80% en 1980 a 44% en 1996, mientras que la de los países de América Latina saltó de 6% a 28% en el mismo período. En efecto, lo que hicieron los productores y compradores de prendas de vestir de los Estados Unidos fue buscar mayor eficiencia para sus subsidiarias, filiales, asociados y proveedores de América Latina (principalmente México y la Cuenca del Caribe), aprovechando los bajos salarios a fin de competir mejor en el mercado de América del Norte.

Inicialmente las autoridades estadounidenses facilitaron el uso de esta estrategia por parte de las empresas locales del vestido mediante un mecanismo de producción compartida (partida 807 de la Lista de Aranceles de los Estados Unidos, posteriormente partida 9802 del Sistema Armonizado de Aranceles) que permitía la reimportación de productos finales ensamblados en países con regímenes de salarios más bajos a partir de componentes fabricados en los Estados Unidos y disponía la aplicación de derechos solamente sobre el valor agregado fuera de ese país. Los países proveedores de América Latina recibieron acceso preferencial al mercado estadounidense y los gobiernos de los demás países completaron la nueva situación competitiva ofreciendo incentivos tributarios y arancelarios en forma de zonas de libre comercio, así como otras ventajas. Entre 1993 y 1997, el total de importaciones de prendas de vestir que ingresó a los Estados Unidos gracias al mecanismo de producción compartida aumentó de 10% a 21% del total de importaciones de prendas de vestir y un 90% de las importaciones que ingresaron gracias a este mecanismo se originó en México (36.6% durante 1997) y los países de la Cuenca del Caribe (55.9%). Menos del 1% del valor de dichas importaciones procedía de los países asiáticos. Más del 80% de todas las prendas de vestir que México y los países de la Cuenca del Caribe exportaron a los Estados Unidos ingresó mediante el mecanismo de producción compartida.

Las disposiciones del TLC aplicables a las prendas de vestir produjeron una fisura en términos de las consecuencias que tuvo para América Latina la reestructuración de la industria del vestido de América del Norte, dado que el TLC otorga a México ventajas que no comparten los países de la Cuenca del Caribe. Primero, los derechos arancelarios implícitos con que se gravan las prendas de vestir mexicanas son notablemente inferiores (0.9%, comparado con 8.5% para los países del Caribe). En segundo lugar, se imponen menos cuotas para México, que puede realizar ciertos procesos de terminación que aportan valor agregado (blanqueado, tintura, lavado de desgaste con piedra, planchado permanente, etc.). Tercero, según las normas de origen, los insumos mexicanos se consideran insumos del TLC, lo que ha dado lugar al surgimiento de una industria textil y del vestido más integrada. En consecuencia, la participación de México en las importaciones de prendas de vestir de los Estados Unidos se disparó de 7.4% en 1995 a 15.3% en junio de 1999, en tanto la de los países de la Cuenca del Caribe sólo aumentó de 15.7% a 17.9% (y sólo Honduras y El Salvador alcanzaron logros destacables). Así pues, México ha desplazado a China como principal proveedor de prendas de vestir al mercado de los Estados Unidos. La nueva IED en materia de textiles y prendas de vestir ha generado un proceso incipiente de formación de cadenas productivas, tendencia que resulta particularmente notoria en productos como pantalones de algodón para hombre y mujer, especialmente pantalones vaqueros (rubro en que México tiene una participación superior al 50% en el mercado de importación de los Estados Unidos). Con las nuevas oportunidades que ofrece la producción de "paquete completo" se abre la perspectiva de que México se convierta en el "Hong Kong de América Latina".

Los países de la Cuenca del Caribe han estado atrapados en un modo de entrega al mercado de los Estados Unidos –basado en los bajos salarios, la producción compartida y las zonas de libre comercio– que no ofrece ninguna de las nuevas ventajas de que goza México en el marco del TLC. Al perder participación en el mercado de importación frente a México, dichos países reclamaron (sin éxito) al Congreso de los Estados Unidos para obtener la paridad con el TLC. Desgraciadamente, las ventajas que el TLC otorga a México no es más que uno de los nuevos desafíos que han de enfrentar los ensambladores de prendas de vestir de los países de la Cuenca del Caribe. El último tramo del Acuerdo sobre los Textiles y el Vestido, firmado en el seno del GATT en 1994, estará sujeto a una nueva disciplina comercial (en lugar de las cuotas del Acuerdo Multifibras) a partir del año 2005. A dicho tramo corresponde la mayor parte de las exportaciones de prendas de vestir de los países de la Cuenca del Caribe. Debido a tal liberalización, los ensambladores de dichos países deberán competir (sin zonas de procesamiento de exportaciones ni preferencias de mercado, y con salarios significativamente superiores) con potencias asiáticas, como China. Mientras México posee una industria textil y del vestido más integrada, en que están apareciendo opciones de paquete completo (aunque aún queda mucho por hacer para aprovechar plenamente las normas de origen del TLC), los ensambladores de prendas de vestir del Caribe muy probablemente enfrentarán una lucha sin cuartel en cuanto a los salarios y los incentivos de IED en esa industria.

TAX INCENTIVES FOR FOREIGN INVESTMENT IN LATIN AMERICA

by

Richard M. Bird and Duanjie Chen

International Tax Program

Joseph L. Rotman School of Management

University of Toronto

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Table of Contents

Abstract

This paper summarizes the debate on tax incentives over the last decade, analyzes the impact of taxes on foreign direct investment in Latin America in comparison with other emerging economies, and discusses the effects of incentives on competitiveness. The paper concludes that if there are to be any special tax incentives for investment at all, they should be few in number, simple in structure, and universally available.

Executive Summary

The lengthy debate over the efficacy of tax incentives is far from resolved. Tax incentives are clearly only; one, and often a minor, factor determining the magnitude of foreign direct investment (FDI) in any country. More important factors are political stability, a favorable legal framework (trade policy, labor policy, etc.), and of course economic conditions including natural resources, infrastructure, domestic market, and cost and quality of labor. When the non-tax environment is favorable, tax incentives may add to a country's attractiveness. When the environment is unfriendly, they may perhaps offer investors some needed compensation. In short, although tax incentives do not necessarily or always foster investment, a "good" tax system may indeed in some instances help attract capital investment.

Relative to Asia, Latin America as a rule has more complicated business tax systems. In particular, Latin America imposes more non-profit related taxes on business such as asset and payroll taxes. In addition, unlike the Asian countries in their initial growth period, most larger Latin American countries currently make little direct use of tax incentives to compete for foreign direct investment. Most tax incentives appear to be focused more on sectoral development (mining, agriculture) or to exporting or financial investment.

Detailed analysis of the tax regimes in five larger countries shows that, excluding the tax on dividends, Chile appears to have the most transparent tax system, with lower taxes and incentives more focused on new capital investment. Interestingly, Peru also appears to be relatively tax competitive, owing largely; to its relatively; generous tax depreciation allowance for machinery and equipment. In contrast, among the countries studied, Argentina and Brazil impose relatively higher taxes, with Brazil offsetting them with more conditional tax incentives that in principle seem likely to impair economic efficiency. Finally, Mexico lies in between these two groups in terms of both its general tax level and the simplicity of its tax system.

Recent FDI growth in Latin America is less impressive than in OECD countries owing largely to a significant decline in such major economies as Mexico and Argentina. Although corporate tax rates in Latin America – as distinct from all taxes on business – are relatively low, Latin America appears nonetheless to be the only region in which some important countries (Argentina, Brazil, Mexico) have recently raised corporate tax rates. These observations of course do not suggest any causal relationship between tax and FDI developments but they do suggest that further study might be warranted.

In any event, while academics may argue about the merits of tax incentives, in the real world some degree of fiscal competition appears to be an inevitable fact of life from the perspective of most governments, national and sub-national alike. The question of what tax structure may improve a country's competitiveness and still be consistent with non-predatory international economic behavior is therefore always of interest. Broadly, two fiscal approaches to attracting FDI are possible. The first is to apply standardized tax provisions to all investors with relatively low tax rates. The second is to tax different investment activities differently in order to achieve specific goals of economic policy such as promotion of exports or development of particular industries or regions. The latter approach is usually implemented through more finely-tuned incentives which, experience suggests, even if successful in the short run in attracting some investment are all too often likely to impinge on allocative efficiency (and to open the door to significant revenue erosion through evasion), thus providing a less sustainable basis for economic growth in the long run. On the whole, it thus seems likely; that the first – broad-based, low-rate approach with simple and generally available investment incentives (if any) – seems more suitable for the relatively more developed countries of Latin America.

I. Introduction

Many surveys have, over the years, reviewed with varying degrees of detail and rigor the effects of tax incentives on investment in developing countries.[1] On the whole, most such reviews have not been very favorable to tax incentives, finding them to be either redundant and ineffective -- forgoing revenue and complicating the fiscal system without adding to capital formation -- or distorting and inefficient -- directing investment into less than optimal channels. Indeed in some countries, incentives have been so badly designed and administered that they have, somewhat miraculously, managed to fall into both of these pitfalls at once.[2] Even in some of the fast-growing Asian countries which have made considerable use of tax incentives in the past, some recent analysts have condemned the tax incentive approach and urged the adoption of a more neutral system.[3] Nonetheless, with the exception of Hong Kong, almost all the high-growth Asian countries have made extensive and prolonged use of specific tax (and other) incentives in the past and indeed continue to do so.[4] Of course, many other factors were also important in explaining the Asian success stories such as macroeconomic stability, high and growing investment in human capital, and the market-driven (export) nature of growth (Summers and Pritchett, 1993). Nonetheless, high investment levels clearly played a critical part (Young, 1993). Are other countries mistaken in hoping for the same linkage?[5]

The history of investment incentives in the postwar period may be viewed from two quite different perspectives. One perspective sees this history as a more or less steady trend away from the extensive reliance on incentives that characterized the initial development efforts in many countries in the 1950s and early 1960s – not least in Latin America -- to the nirvana of "incentiveless" tax systems now commonly recommended by international experts (World Bank, 1991) and, to some extent, actually put into place in a few countries, notably Indonesia (Gillis, 1985).[6] Similar, if less drastic, moves away from fiscal incentives may be seen in a number of Latin American countries in recent years, including Argentina, Bolivia, Mexico, and Colombia (Bird, 1992).

1 Portions of this introductory section follow closely the more detailed discussion in Bird and Chen (1998). Early reviews of investment incentives still worth consulting include Heller and Kauffman (1963), Lent (1967), Shah and Toye (1978), and Gandhi (1987). The most recent detailed review is Shah (1995).

2 For an example, see the study of Belize by Bird and Chen (1997).

3 See, for instance, Ishi (1993) on Japan and Choi (1997) on Korea.

4 See, for example, Ishi (1993) on Japan, Trela and Whalley (1995) on Korea, Chang and Riew (1994) on Taiwan, and Asher (1988) on Singapore.

5 Even in Indonesia, frequently cited as an instance in which tax incentives have been abandoned (Gillis, 1985), a recent appraisal concluded that "generally, the promotion of investment through the use of incentives has been effective" (Sumantoro, 1993, p. 266).

6 As Goode (1993) noted, the attitude to tax incentives in the 1950s and 1960s was markedly different from that which now prevails . In the earlier period, reports and advisers frequently favored tax incentives to channel investment in one desired direction or another. Later, as skepticism grew both as to the efficacy of incentives and the wisdom of interventionist policies in general, attitudes changed, and tax incentives for investment fell into disfavor.

In this view, the palpable failure of central planning in Eastern Europe and elsewhere, the accumulated empirical evidence of the relative inefficiency and ineffectiveness of incentives, and the growth of economic knowledge all point in the same direction -- namely, away from the sort of interventionist policy represented by incentives and towards the ideal of a uniform "level playing field" in which market forces, rather than government officials, make investment decisions. The move away from incentives is thus seen as part of the general move towards market- rather than state-dominated allocative decisions.

The second perspective on recent changes in attitudes and actions on incentives is, however, quite different. Which ideas influence policy often depends as much on chance and circumstance as on their inherent merit. Over time both ideas and practices may change -- away from interventionism and towards the market, for example -- as may the country models viewed as exemplary -- witness the demise of the Soviet central planning dream a decade ago. As the recent disillusion with the so-called "East Asian Miracle" (World Bank, 1993) demonstrates, to the extent that the ideas that dominate at any point in time reflect less increments in knowledge than changes in fashion, they may well be reversed a few years down the road. The Asian currency crisis has, for example, clearly reduced the appeal in Asia and perhaps elsewhere in the world of the incentive approach to growth. Nonetheless, fiscal incentives are not only still to be found in many countries but recently seem to have become more attractive to some countries.[7]

The apparently sharp disparity between expert opinion and policy practice leads to several questions. Are the East Asian countries mistaken in thinking that tax incentives (and other policies fostering investment) had something to do with their growth success? Does the "Hong Kong model" of low and uniform taxes offer a surer path to success than what may perhaps be called the JKS (Japan-Korea-Singapore) model of fiscal (and other) interventionism? Would the East Asian "tigers" have done as well -- or better -- without the incentives? And, most important in the present context, does the apparent failure in the past of superficially similar incentive packages in many Latin American countries[8] reflect differences in political or social "culture,"[9] the macroeconomic context,[10] or simply differences in the design and implementation of the incentives?[11] To put the point at its simplest, would nothing have worked in Argentina in the 1980s-- and anything have worked in Korea in the same period?

Recent developments in economic theory have seemed to some to cast a slightly more favorable light on incentives. So-called "new trade theory", for instance, with its emphasis on imperfect markets and external economies has to some extent re-opened the case for selective government intervention in trade and factor markets. The relevance in the real world of these ideas remains doubtful, however, owing both to the unclear

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7 For example, Shah (1995) lists tax holidays in at least 14 developing countries, accelerated depreciation schemes in at least 28, and other investment incentives (credits, reinvestment allowances, etc.) in at least 21. Earlier surveys similarly found widespread use of a variety of tax incentives in all parts of the world. Chia and Whalley (1995) suggest that not only is the variety of tax incentives currently found in developing countries greater than that in developed countries but that such incentives are now more common in developing countries than they were a decade ago.

8 See, for example, the detailed studies of Argentina, Ecuador, and the Dominican Republic summarized in Gonzalez Cano (1994). Particularly notable for detail and rigor are studies of Argentina and Mexico by Sanchez Ugarte, who summarizes his finding in Sanchez Ugarte (1987).

9 Ishi (1993, p.156), for example, suggests that "socio-cultural" factors seem more likely than tax incentives to explain high savings rates in Japan.

10 See, for example, Weeks (1997), as well as Thirsk (1989) on the importance of this factor in evaluating incentives. Investment incentives are obviously less likely to be effective in countries with high variability in inflation and growth rates, just as export incentives are unlikely to be very effective in countries with substantial exchange rate instability.

11 As a recent study of incentives in Belize noted: "Apart from the question of its effects on economic incentive, there are two major problems with the present system of fiscal incentives in Belize. First, it is not and cannot be administered well for three related reasons: (i) it is far too complex; (ii) it is completely non-transparent and non-standardized; and (iii) it is, in the end, completely discretionary. Second, and perhaps more easily remediable, it is replete with statutory loopholes that make it both a revenue "sink" -- into which revenues flow but nothing necessarily comes out -- and a potential revenue "bomb" -- with the potential of devastating the normal revenue system in the long run" (Bird and Chen, 1997)..

importance in practice of external economies and the concern that governments may not be capable of implementing even beneficial interventions without opening the doors to dubious special interests and excessive rent-seeking.[12] The exacting practical demands of strategic trade theory make it an uncertain basis on which to base an argument for incentives, although the enthusiasm for such arguments of special interest groups that stand to gain from tax favors seems unlikely to be restrained by such considerations.

Much the same may be said of the new literature on "endogenous growth." Some scholars have demonstrated in this framework how incentives favoring research and development or machinery and investment may, under certain circumstances, accelerate growth.[13] The fact that a few empirical studies (notably DeLong and Summers, 1991, 1992) lend some support to such arguments makes the apparent case for interventionist policy stronger, even in the face of the many political and organizational constraints on implementing such policies in developing countries (Levy, 1993).

The partial shift in the ruling paradigm, with incentives to some extent moving back into favor, may be illustrated by contrasting two recent studies done under World Bank auspices. World Bank (1991) reflects the prevailing conventional wisdom with respect to tax incentives: they erode the tax base, reduce investment efficiency (because they mostly respond to pressure from special interests), are ineffective and often inequitable, and facilitate rent-seeking activities and tax evasion.[14] In contrast, Shah (1995) concludes his introduction to an impressive set of empirical studies of tax incentives recently carried out under World Bank auspices as follows: "Some tax preferences such as expensing, (refundable) investment tax credits for R&D and machinery and equipment that embody advanced technology have strong theoretical and empirical support."

Expert attitudes to tax incentives may thus again be changing, whether influenced by changes in theory (endogenous growth), in empirical results (for example, the production function studies reported in Shah, 1995), in real world experience (the East Asian "miracle"), in intellectual fashion, or in all these factors. Whatever the experts may say, however, incentives seem likely to be demanded, and supplied, in the future, much as they have been in the past. The design, implementation, and evaluation of tax incentives thus remains an important question.

As the continuing debate illustrates, it is by no means easy to assess the effects of tax incentives on investment in general, let alone on direct foreign investment. Many factors enter into the investment decision – economic conditions (rates of return, exchange rate risks, infrastructure, stability) and non-tax legal questions (labor policy, trade policy, investment restrictions) – in addition to tax issues. Many aspects of tax systems – tax structure, international tax rules, treaties, administration – in addition to incentives may affect investment decisions. Many forms of incentives (and disincentives) may play a role: tariffs, export taxes and subsidies, transfer pricing policy, price controls and subsidies, limits on repatriation, tax exemptions, deductions and credits, domestic content requirements, provision of infrastructure, and even direct cash or in-kind grants (for example, of land). Only a limited selection of these issues can be considered in the present paper. Specifically, our aim is simply to review briefly some recent experience with tax incentives in Latin America with particular attention to their potential effects on foreign direct investment.

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12 See, for example, the interesting papers by Krugman (1993), Krueger (1993) and Slemrod (1995). As Krugman (1993, p.364) puts it: "Free trade [read uniform factor taxation] is a pretty good if not perfect policy, while an effort to deviate from it in a sophisticated way will probably end up doing more harm than good."

13 See, for example, Barro and Sala-e-Martin (1992). Although there is no necessary implication in these models that increased growth results in increased welfare, policy-makers looking for a rationale for doing something they want to do have never worried about such refinements in the past, and they seem unlikely to do so in the future.

14 Despite these harsh words, the "reference set" of taxes proposed in World Bank (1991) recognized that there may still be tax preferences in some cases, although it argued any incentives should be both limited in duration and distributed more evenly across sectors and assets in order to avoid distorting investment decisions.

Section II of the paper presents a brief review of the major features of the tax and incentive systems in Latin America compared to those found in Asian countries, followed by a more detailed examination of the taxation of business in five specific countries – Argentina, Brazil, Chile, Mexico, and Peru. Section III then analyzes and discusses the impact of taxes in these five countries on foreign direct investment, utilizing the METR (marginal effective tax rate) approach. This analysis is coupled with a brief review of recent FDI flows and some comments on experience with tax incentives in the smaller Central American and Caribbean countries. Finally, Section IV discusses briefly the "competitiveness" dimension of incentives, and Section V concludes the paper with a brief discussion of an appropriate approach to tax incentives for foreign investment.

II. Taxes and Tax Incentives in Latin America

In this section, we first provide an overview of the major features of the tax and tax incentive systems in Latin America in comparison with those found in Asian countries.[15] We then outline some specific business tax provisions in Argentina, Brazil, Chile, Mexico and Peru.

A. Latin America and Asia Compared

Compared with Asia, Latin American taxes and incentives appear to have the following main features, as illustrated in Table 1.

- Corporate income tax rates in Latin America countries are relatively low. The regional average CIT rate is about 31 percent, which is similar to that in the South East Asia and not high compared to other regions over the world.

- It seems common in Latin America to impose non-profit-related taxes other than the property tax (e.g., turnover tax, and gross- or net-assets-based taxes). As we shall see, when these taxes are not collected as a minimum tax, they may increase significantly the effective tax burden on capital investment. Such taxes are uncommon in Asia.

- Reflecting past experience, many countries in Latin America take explicit account of the impact of inflation on taxation by imposing some monetary rule or tax indexation. Such provisions are rare elsewhere in the world.

- Employee profit sharing appears to be popular in some Latin American countries. When this plan is mandatory and even non-deductible for the income tax purpose, it may significantly reduce the net-of-tax profit and hence discourage foreign direct investment. Again, such schemes are unknown in Asia.

- Moreover, payroll taxes (including social security contributions payable by the employer) are rather high compared with most Asian countries. Although such taxes may not appear to be a significant burden to foreign investors in view of the relatively low labour cost, they may nonetheless -- particularly when imposed on total payroll without a ceiling – be perceived as an obstacle to hiring more highly-skilled workers and hence discourage potential foreign investment that might bring in advanced manufacturing and service techniques.

[15] For further discussion of taxes and tax incentives in Asian countries, see Bird and Chen (1998).

- Finally, unlike the Asian countries in their early stage of growth, most Latin American countries have not focused on using tax incentives to compete for foreign direct investment except that related to exporting and financial investment. Most tax incentives found in the region seem intended primarily to encourage sectoral (e.g., mining, farming, transportation, etc.) and regional development. That is, they appear to be more instruments of what might perhaps be called 'industrial policy" than of growth-oriented development policy. The principal tax incentives that encourage export and appear to be attractive to foreign investors are exemptions for transaction taxes levied on export-related inputs, which are generally applicable to free zones and assembly operations. In addition, tax incentives that promote financial investment often include an income tax reduction or exemption for the investment income.

B. Business Tax Provisions in Selected Countries

Below, we highlight the main differences in tax regimes among the five countries selected for more intensive study. A detailed discussion of the profit tax and incentive regimes in these countries is provided in Appendix 1, where Table A1 provides a summary of the key tax provisions for each of the five countries and Table A2 outlines their major tax incentives relevant to manufacturing and service sectors. (Despite the importance of mining and other natural resource sectors with respect to direct foreign investment in many countries, such investments are often subject to special tax rules that do not lend themselves to summary here.)

- *Corporate income tax rates*: The tax levied on the corporate income appears to be lowest in Chile, where the CIT rate is only 15%. However, distributed profit is subject to either the domestic personal income tax (up to above 33%) or a withholding tax to non-residents (20% as indicated below). In contrast, the CIT rate is 35% in Argentina and Mexico and 37% in Brazil[16] without differentiating the retained earnings from the distributed. It is noticeable that all these three higher taxed countries raised their income based tax rate in 1999[17]. Peru has a CIT of 30%, which, as in Chile, has been stable since the early 1990s.

- *Tax Depreciation*: All five countries adopt the straight-line depreciation method. Again, Chile and Peru appear to be more generous than the other three countries in allowing machinery and equipment to be depreciated at about 20% annually, which is double the rate allowed in other three countries. Peru also grants an accelerated depreciation allowance for buildings used for lodging in order to promote its tourism industry.

- *Loss carry-overs*: Chile allows operating losses to be first carried back to offset the retained earnings of previous years[18], and then carried forward indefinitely. Other countries allow only carry forward of tax losses for limited years, and Brazil imposes some restriction on the future taxable profit that can be used to write off losses.

- *Inventory Costs*: Most countries adopt the first-in-first-out method and other inventory accounting method. Only Argentina allows the last-in-first-out method.

[16] The rate in Chile is a combination of CIT and a social security levy with a taxable basis similar to that for CIT. Neither of these two taxes is deductible for the purpose of the other.

[17] In the case of Mexico, a portion of the CIT is deferrable. That is, the reinvested earnings will be taxed at a lower rate of 30% (32% in 1999), and the resultant difference in tax payable will be deferred until the profits are distributed.

[18] In this case, CIT paid in relation to the retained earnings is treated as an advance payment to be set off against future income tax liability or refunded under general rules.

- *Withholding tax on dividends*: It has been common in these five countries to exempt the after-tax distribution from further taxes, except that Chile imposes a withholding tax (20%) on dividends received by non-residents. However, effective in January 1999, dividends paid out of the after-tax profits in Mexico will be subject to a withholding tax of 5%.

- *Property Taxes:* All five countries levy property taxes based on appraised value and with tax rates varying by location.

- *Property Transfer Tax.* All countries except Chile collect tax from transfers of immovable property, with the rate ranging from 1.5% in Argentina to 3.3% in Mexico.

- *Social Security Taxes*: Argentina collects the highest social security contributions from the employer based on payrolls (33%) while Chile has the lowest (up to 3.4%). However, there are also compulsory profit sharing plans in Brazil, Chile, Mexico and Peru, which in effect impose an additional payroll cost on the employer. In the case of Chile, profit sharing (by option) may be equivalent to 25% of the total payroll up to 4.75 minimum monthly salaries.

- *Transaction Taxes*: All five countries impose the value-added tax at a general rate of around 20%, with Brazil having a complicated dual-VAT system. The main transaction tax that affects business activity in these countries is the import duty on capital goods and raw materials. As mentioned below, many tax incentives granted in these countries include import duty exemption.

- *Tax Incentives*: There are no tax incentives specifically designed for encouraging foreign direct investment in these countries. This report will therefore focus on those tax incentives targeted on export promotion that exist in all five countries and a priori appear to be attractive to foreign investors.

  As shown in Table A2, Argentina does not provide any tax incentives to promote specific sectors (except mining), or regions, or investment projects.

  In contrast, Brazil adopts numerous tax incentives to promote export production and regional development. These incentives vary greatly depending on the location, sector and the product involved. They are also very specific in terms of the tax to be exempted or reduced and, in the latter case, the magnitude of reduction.

  Chile, besides a generous tax depreciation allowance for all imported or new machinery and equipment as mentioned above, enacted an investment tax credit in 1999 to encourage investment in its extreme southern regions. The tax credit ranges from 10% to 40% depending mainly on the total value and type of investment.

  Mexico refunds import taxes paid by any taxpayers on inputs included in their exports[19].

  Peru introduced a generous tax incentive package to promote economic development to its Amazon region. The package includes exemptions for income tax, VAT, excise taxes and other taxes for a duration of 50 years (Byrne, 1999). Other Peruvian tax incentives for regional development are divided into two categories – for the Amazon and border

[19] Mexico also provides extensive tax incentives for the in-bound assembly operations (Maquiladoras). These incentives were supposed to be phased out in 1999 and are not further discussed here: for an outline, see Mexican Investment Board (1999).

regions. Industrial enterprises in the border region are exempted from all taxes except social security contribution, import duties and some municipal taxes.

In summary, excluding the tax on dividends, Chile appears to provide the most transparent tax system with lower taxes and rather focused tax incentives aimed at new capital investment. Peru also appears to be "tax-competitive," providing the most generous tax depreciation allowance for machinery and equipment In contrast, Argentina and Brazil appear to be on the higher end of business taxation among these five countries, with Brazil providing more conditional tax incentives that in principle impair economic efficiency. Mexico appears to be between these two groups in terms of both general tax level and the simplicity of its tax system. In addition to special fiscal advantages for exporting firms (mainly import duty exemption for inputs) in all but Argentina, like many other countries in Latin America – Bolivia, Uruguay, Paraguay, and Ecuador, for example – several of the countries studied in detail here (Brazil, Peru, and, to a lesser extent, Chile) provides special tax incentives to businesses operating in so-called "free zones."

III. An Effective Tax Rate Analysis

In this section, we undertake a quantitative assessment of the impact of the tax regimes in the five selected countries on foreign direct investment. The methodology used for this assessment is METR or marginal effective tax rate analysis (see Appendix 4 for a brief technical exposition). Assuming that a US multinational is the representative foreign investor, we ask the following simple question: How do the tax systems of the five Latin American countries impact on investment from the perspective of a US firm considering investing in the region? In this analysis, we consider only the impact of taxes on foreign capital investment in the manufacturing and service sectors. Despite their importance in terms of foreign investment in some countries other important sectors, such as resource-based industries and financial services, are excluded in part because these sectors are often subject to special administrative and tax regimes.

As mentioned earlier, taxes and tax incentives are of course only one factor affecting FDI inflows. Other major factors include political stability, transparency of policy and administration, market efficiency, soundness of infrastructure, quality of labor force, and domestic demand. A country which scores higher in terms of these non-tax factors may attract foreign investors even though it has higher taxes and fewer tax incentives. (An obvious example is of course the US.) Countries that do not perform as well in terms of these basic conditions may try to use favorable tax treatment in a sense as compensation for the potential investors. Of course, even if one confines oneself to fiscal measures there may be alternative measures that may be preferable-- for example, lower and simple taxation combined with fewer preferential tax- incentives. In addition to the already-cited case of Hong Kong, Ireland and Hungary to some extent illustrate the latter approach. We shall return briefly to this point in Section V below.

A. Calculating Effective Tax Burdens

To assess the impact of various taxes on investment decisions, we aggregate the impact of the relevant taxes on the rate of return on capital earned by the typical investment project. The typical foreign investment project – which, as mentioned above, is American in this model – is considered to be one in the manufacturing or service industries. The taxes considered in terms of their direct impact on investment include corporate income, withholding, gross receipts and other capital-related taxes such as import duty, property tax, and property transfer tax. Assets-based taxes are excluded when they are imposed as a minimum tax (as in Argentina, Mexico and Peru) which can be used to offset income tax liability and hence has no impact on tax-paying companies. Mandatory profit sharing plan have also been excluded owing to missing information. If such plans were taken into account, the estimate of effective tax rate for all but Argentina would be higher than those analyzed below.

The effective tax rate on capital is measured as the amount of tax paid as a proportion of the gross-of-tax rate of return on capital, taking into account all tax rates, bases, and incentives in a particular location. For example, if the gross-of-tax rate of return on capital is 10 per cent and the effective tax rate is 50 per cent, then the net-of-tax rate of return on capital is 5 per cent (50 per cent of 10 per cent). We estimate the effective tax rate for marginal investment projects. That is, the net-of-tax rate of return must be sufficiently high for the investor to be willing to invest in these Latin American countries compared to some other American investments in another country or another asset. Thus, in the example above, the marginal investment would need to earn a net-of-tax rate of return on capital at least equal to 5 per cent if project were to go ahead[20].

Three additional points about these estimates should perhaps be clarified. First, since our focus is on real rather than financial investment, only taxes affecting real capital investment decisions are relevant. Increasingly, some Latin American countries – such as Brazil –have negotiated tax treaties with various foreign countries. Arguably, the development of a network of such treaties may facilitate foreign investment both by signalling a country's interest and, more specifically, by removing barriers to profit repatriation. In some instances (for example, Canada), a treaty is necessary if foreign investors are to receive the benefit to tax relief for foreign investment (credits or exemptions) from their countries of residence. In other instances, such treaties may actually make tax incentives more effective to the extent the residence country allows what is called "tax sparing" (OECD, 1998). Tax treaties may thus be important determinants of repatriation decisions in some cases. Nonetheless, they do not need to be taken explicitly into account in the calculations reported here since they essentially affect only financial flows.

A second point relates to the less than perfect tax administration that unfortunately still prevails in some of the countries analyzed here. The METR analysis does not take administrative deficiencies into account because its intent is to evaluate the impact at the margin of the structural design features of tax systems. In effect, it estimates the effect of the tax system, if properly administered, on the present value of the accumulated cash flow that would be generated by an additional dollar of investment. It does not assess the efficiency with which tax laws are applied in practice.

Finally, the analysis considers only firms that are profitable and hence should in principle be tax-paying. In principle, it could be extended to loss firms by taking into account such features as loss carryovers and the interaction of (presumptive) asset taxes and income taxes. This calculation, however, requires information on the average length of period it takes for a tax-loss firm to write off its losses and become able to pay tax, which is not available to our study.

The analysis that we have carried out here begins with a comparison of the effective tax rate on foreign capital investment in the five countries, assuming no tax incentives for investment (see Table 2, "regular taxable case" under "manufacturing" and "services"). As Table 2 shows, there are two effective tax rates for Chile and the service sector of Peru. In the Chilean case, the lower rate corresponds to the general corporate income tax rate without taking into account the personal income tax or withholding tax on payable by the recipients which contributes to the higher effective tax rate. In the Peruvian service sector, the lower rate reflects the fast write-off allowed for lodging buildings used by the tourism industry

[20] The minimum rate of return needed for investments is measured using current interest rates and inflation rates for the various countries. The real rate of return on capital is obtained by subtracting inflation from the nominal interest rates.

while the higher rate is for other service industries. In terms of undistributed profit, Chile appears to be the lowest taxing country from a foreign investor's perspective. This results mainly from the combination of the low statutory corporate income tax rate (15%) and the generous tax depreciation allowance for buildings. However, Chile's tax advantage deteriorates when taxes on profit distribution are taken into account. In this case, Peru provides the most favorable tax system to foreign investors -- particularly in its tourism industry as a result of having the second lowest statutory corporate income tax rate and the most generous tax depreciation allowance for machinery and equipment.

In contrast, Brazil appears to provide the least favorable tax system for foreign direct investment in both manufacturing and service industry. This results from its rather high corporate income tax rate (37%), less generous tax depreciation allowance, and a rather high turnover tax (over 2.65 per cent). Argentina shares many of these features with Brazil. It has the second highest corporate rate (35%), a rather high turnover tax (average 2.55), and the least generous tax depreciation allowance (2% for buildings). The exemption of capital goods from import duties in Argentina, however, produces a lower effective tax rate for manufacturing in Argentina than in Brazil. The effective tax rate in Mexico is at the middle among the five countries, reflecting the combination of its "medium" income tax rate and the highest property transfer tax (3.3%).

The service sector is taxed more heavily than manufacturing in all five countries. This is mainly because buildings and land account for a higher share of capital invested in service sector compared to that invested in manufacturing sector (79% vs. 26%). Furthermore, property taxes on buildings and land, which do not apply to other type of assets (machinery and inventory), contribute to the higher effective tax rate on buildings and land compared to that on machinery and inventory. The higher effective tax rate on capital in service sector is a combination of these two factors.

For illustrative purposes, we have, as shown in Table 2, simulated the impact of the corporate income tax alone. .This simulation is done by excluding from our model all the non-profit-based taxes such as the gross-receipts tax in Argentina and Brazil, the assets tax in Brazil and Chile, the property-related taxes, and import duty on capital goods in all but Argentina. As this simulation shows, the effective tax rate reflecting the corporate income tax only was, unsurprisingly, lowest in Chile. On the other hand, the rate attributable to non-profit-based taxes was lowest in Mexico.

Although most attention in such studies is customarily paid to the corporate income tax alone, we suggest that more attention should be paid to non-profit based business taxes for at least three reasons. First, in many countries – including such developed countries as Canada (Mintz Committee, 1998) such taxes are becoming increasingly important. Second, non-profit taxes behave quite differently over cycles than profits-based taxes: this may be beneficial to governments from a revenue perspective, but the reduced cyclical sensitivity of taxes implies that the present value of future taxes impinging on investment decisions increases to the extent such taxes are not profits based. Third, METR analysis such as that carried out here frequently shows that the most important taxes impinging on business investment decisions are taxes on asset values (property taxes or gross receipts taxes) that may have low nominal rates but that may constitute major charges on potential profits.

. As is well known, inflation may have a significant impact on taxes paid. For example, inflation increases effective tax rates on capital when assets are depreciated at original cost rather than at the cost of replacing them, unless assets are re-valued periodically. On the other hand, inflation can also reduce taxes paid if firms are able to deduct interest expense, unadjusted for inflation, from income. The interest deduction shelters income from taxation and can more or less offset the impact of inflation on the value of fixed assets. This is particularly true in the case of land and buildings for which the cost of financing is the dominant factor in determining the cost of capital. Furthermore, for a high-inflationary economy, writing off inventory on its historical value can cause inflated tax burden to investors. In the case of the countries studied here, however, all except Argentina make some tax adjustment for inflation. In the case of Argentina, the inflation rate is very low (0.5%) and hence has little impact on the effective tax rate. As a result, the effective tax rates estimated for these countries in Table 2 can be seen as net of country-differentiated inflation impact.

In a second case reported in Table 2 (the "tax incentives for exporting" case), we have simulated the impact of existing tax incentives for export promotion. As described in Section 2 (and Appendix 1), these tax incentives are similar across countries except Argentina and consist mainly of exemptions from transaction taxes on export-related inputs. These taxes generally include import duty and value-added taxes. Since value-added taxes are designed to be refundable as input-tax credits, only import duties levied on capital and material inputs would affect the effective tax rate endured by investors using imported inputs. Therefore, compared to the effective tax rates for the "regular taxable case" as analyzed above, the effective tax rate for the "tax incentives for exporting case" reflects mainly the impact of import duty exemption for capital goods and raw materials. In Brazil, the incentive for export promotion also includes an exemption for a turnover-based social contribution of 0.65%. As the table shows, except for Argentina where no such incentives exist, the effective tax rate for manufacturing industry in all countries shows a reduction of 5 - 6 percentage points.

The third case reported in Table 2 simulates some tax incentives provided in free zones. "Free zones" cover a range of possibilities from bonded manufacturing warehouses to offshore financial centres and export processing zones. In their various guises, this approach has become very popular in Latin America in recent years and , in some countries (such as Honduras) such zones account for almost all FDI. Non-tax incentives, such as "one-stop shopping", easier regulatory procedures, and subsidized infrastructure may be included in some cases, but as a general rule the distinguishing feature of such zones is their exemption not only from transaction taxes but also from various direct taxes through devices such as tax holidays and reduced tax rates. These additional tax incentives include a 40% income tax reduction in Brazil, a full income tax exemption in Chile, and a complete tax exemption for 15 years in Peru. (In Mexico, tax incentives in free zones are generally the same as those available to the exporters outside the free zones.) As a result, the effective tax rate in free zones may fall by 7, 3 and 16 percentage points, respectively, in Brazil, Chile and Peru compared to the general tax incentives for export promotion.

With respect to manufacturing investment, following the earlier model of Mexico's maquiladoras, the principal form of FDI attracted initially to such zones is almost invariably labor-intensive manufacturing – for example, with respect to textiles, garments, toys, and sporting goods. Subsequently, more consumer durable investment (appliances, automobile parts) may be attracted, and in the best of all cases, as in some Asian countries, even the lower range of "high-tech" investment sectors such as electronics and precision engineering sectors. A critical factor in such development, however, appears to be the availability of high levels of local skills as, for example, in Ireland, Taiwan, and Korea – all countries which have long invested heavily in educating their populations in the skills and knowledge needed to compete successfully in the modern world. In the absence of such investment in human capital, even if the initial impact of FDI tends to raise employment and real wages, the inherently "foot-loose" lower end of the assembly and "low-tech" industries first attracted to such favored zones are likely to move on if an even lower-wage tax haven looms somewhere on the world horizon Mexico, for example, like Indonesia and the Philippines, appears to have gained some industry for this reason as countries such as Korea and Taiwan began to price themselves out of the low-wage market. Countries relying on tax-free zones to attract FDI thus to some extent face a dilemma since to develop a sustainable economic base over time they generally need to spend some of the very fiscal revenues they are forgoing. There is no easy answer to this problem, except to emphasize the need for countries utilizing this approach to attracting FDI to pay considerable attention to the need to forge linkages between "zone" activities and the development of their economies, and especially the knowledge and skills of their populations, more generally. In the end, unless the increased economic activity that may be initially attracted by tax incentives results in increased fiscal revenues that are then directed to such growth-inducing activities , it seems unlikely that any initial favorable effect will be long sustained.

B. Recent trends in FDI in Latin America

Taxes are often considered an important consideration in foreign direct investment and in cross-border portfolio investment decisions but the evidence connecting the two is seldom clear. Foreign direct investment (FDI) reached new levels in 1998 (UNCTAD, 1999). A recent OECD study (Miyake and Thomsen, 1999) summarizes FDI trends over the past three years.[21] This study shows that, for many of the OECD member countries, "recent inflows are not simply higher than before, they represent a different order of magnitude. For ten OECD Members[22] in 1998, inflows were roughly twice the level of 1997." This change was especially notable in the United States and United Kingdom, where the dramatic increment in FDI inflows was driven by cross-country mergers and acquisitions.

In Southeast Asia, where mergers and acquisitions were lower in the past two years due to the regional financial crisis, foreign investors were attracted by the growing possibilities offered through corporate restructuring and by the more liberal environment for such acquisitions. In particular, traditional intra-Asian investment has been replaced by large purchases of Asian firms by non-Asian foreign countries. Foreign investment inflow through mergers and acquisitions in 1998 was more than six times that in 1997 for Japan and 4.5 times for Korea.

In contrast to this phenomenon, Latin America as a whole had a small drop in the value of cross-border mergers and acquisitions. For example, Mexico's ranking in OECD inflows declined in 1998 as it participated less than other countries in the wave of cross-border mergers. Tax policies that do not specifically encourage fast-paced capital replacement may be one obstacle to modernizing industries in the region. Although there was a significant increase in FDI in Brazil, "the region's biggest target for foreign buyers,"[23] much of this may be related to resource industries.

Table 3 shows FDI inflow as a percentage of GDP in most Latin American countries in comparison with selected OECD member countries, Asian countries, and some transitional economies in the Central and East Europe. Of course, the FDI to GDP ratio does not necessarily indicate the magnitude of a country's success in attracting FDI. For example, while the average FDI to GDP ratio for Latin America as a whole was 4.8 in 1998, which is more than double that for the United States, the total FDI inflow for all Latin American countries accounted for only a third of that for the United States. What we are interested in is the trend in this ratio, which in a sense provides a useful indication of how countries are performing in the global competition for capital. Three observations can be drawn from Table 3.

- First, Latin America as a whole caught up with trends in terms of its rapid increment in FDI. Despite the growing pace of FDI in Latin America (17%), however, its performance was not as impressive as that in G7 countries (50%) and some other OECD countries such as Sweden and Czech Republic (90%) owing to a significant decline in some major economies including Argentina, Chile, Mexico and Venezuela.

[21] It should perhaps be noted that FDI numbers are often rather shaky and open to alternative interpretations. It is not uncommon, for example, for different sources to give quite different numbers, often varying by very large amounts: for Poland in 1998, for example, estimated FDI flows ranged from $5 to 11 billion (*Transition* (World Bank), October 1999, p. 7)

[22] These ten countries are Canada, Czech Republic, Denmark, Finland, Germany, Korea, Netherlands, Sweden, United Kingdom and United States.

[23] According to Miyake and Thomsen (1999), Brazil accounted for around 70 percent of total acquisitions in Latin America in 1998, compared with just 30 percent in 1997.

- Second, the significant increment in FDI inflow in Latin America occurred mainly, apart from Brazil, in some of the less developed economies such as Bolivia, El Salvador, and Guatemala. This recent performance may reflect a very low starting point in terms of FDI and a rather low level of GDP[24]. It may, nevertheless, offer an encouraging sign for future growth in these countries to the extent FDI inflow is accompanied by the introduction of more advanced technological, operational and management standards.

- Finally, among the Latin America countries, the FDI to GDP ratio varies significantly from a high of 12.9% in Panama to a low of 0.8% in Uruguay. The reasons for this wide variation deserve further study.

These observations on the FDI trend in Latin American countries compared with other regions do not suggest any very direct relationship between taxes and FDI. On the other hand, a recent tax rate survey conducted by KPMG (1999), does seem to suggest that tax reduction may to some extent at least go hand by hand with the trend in FDI growth. The major relevant findings of the KPMG survey are the following:

- Lower tax rates are emerging in both the Latin American and Asia-Pacific regions
- At the same time the trend toward lower corporate tax rates in developed countries continues
- And tax rates everywhere are under pressure from increasing business mobility
- On the other hand, as we emphasized earlier in our discussion of Table 2, corporate tax rates only part of the financial equation considered by investors – not least in Latin America where non-profit-based taxes account for over 50% of the effective tax burden in some countries.

C. Tax Incentives in Central America and the Caribbean

No country is an island in today's fiscal world, and an important rationale frequently offered in support of tax incentives is that they provide a needed tool in the competition to attract international investment. Given the growing importance of regional trading arrangements in the region,[25] it may be of interest to summarize briefly some of the results of a recent comparison of fiscal incentives in Belize to those in CARICOM countries. In addition, since all the countries included in this comparison are relatively small and make extensive use of "targeted" tax incentives, this section to some extent may offset the "large country" (and relatively non-incentive intensive) bias of the analysis reported earlier.

As Table 4 illustrates, Belize (which is classified as a less developed country -- LDC -- in CARICOM) essentially has in place a somewhat more generous and less transparent version of the basic CARICOM LDC incentive package. For example, the main criteria for tax holidays under the general CARICOM harmonization scheme are export potential and local value-added. Although the same criteria are frequently mentioned in Belize, in practice more emphasis appears to be put on job creation and the total value of the investment, and in any case the whole process is highly discretionary.[26] One of the few advantages of tax holidays is that they are in principle neutral as between capital and labor, unlike more directly investment-based incentives such as investment allowances. Relating the length of a tax holiday to the size of the investment on the one hand and the number of jobs created on the other makes little sense from this perspective. Questions may be raised about criteria such as local value-added, but in

[24] For example, El Salvador incurred a negative FDI inflow, or withdraws of FDI, in 1996 and received little FDI in 1997. In the meantime, although its GDP grew at an annual rate of 11% since 1993, the GDP per capita was below $2,000 in 1998.

[25] For an interesting recent review of the fiscal systems in the Mercosur countries, for example, see Macon (1999).

[26] In contrast, Thirsk (1991), p. 705, notes that in Jamaica the ratio of domestic value-added to sales and the ratio of exports to total sales are two of the three most important factors used to determine the length of the holiday period granted, and that there is relatively little discretion exercised with respect to such decisions.

general they seem both more relevant and easier to monitor than a criterion like job creation in relation to capital investment for which there can be no standard across industries and regions.[27]

In other respects too, the current incentives in Belize seem less well-structured than the general CARICOM package. For instance, the maximum duration of a tax-holiday in other CARICOM countries is 15 years. In Belize, the period can be as long as 25 years in law and even longer in practice. More importantly, the duration of import duty exemption in the CARICOM scheme is the same as that of tax holiday. In Belize, however, these two incentives can be applied separately, which obviously both complicates the process of application and approval and increases administration and compliance costs. Another problem arises from the fact that although the duration for carrying forward tax losses after the tax holiday in other CARICOM countries is limited to five years, it can be indefinite in Belize.[28] Finally, in contrast to the explicit provision with respect to depreciation allowances in the CARICOM package, there are no specific investment-related incentives in Belize.[29] On the whole, Table 4 certainly suggests that the existing Belizean system of incentives seems to be at least as generous, if not more so, than that in most of its neighboring countries. Recent detailed studies of fiscal incentives in Guatemala and Jamaica generally confirm this impression.

In Guatemala, for example, until recently a wide and varied set of tax incentives was available for many investors, including investment allowances (deduction of more than 100% of cost of assets), 8-10 year tax holidays for up to 90% of profits, duty exemptions, special exemptions for free trade zones, and a varied set of benefits for exporting firms. A tax reform in 1993, however, eliminated most of these incentives -- except those for exports -- although it "grandfathered" (left in force) benefits already granted. On the other hand, the new tax system introduced a new deduction for reinvested profits of up to 25% of taxable income.[30]

Similarly, Jamaica has had a regime of tax holidays and other incentives since at least 1944, although its current system largely reflects that permitted by the CARICOM agreement of 1974 as set out in Table 4 above. Apart from a proliferation of minor incentives, the most important change since then was the adoption of a more transparent and objective system of determining eligibility and the duration and amount of any benefits granted with the establishment of the Jamaican National Investment Promotion (JNIP) agency in 1981. Under the previous system -- as is still true in Belize -- in effect decisions were often made at ministerial discretion. Although JNIP recommendations are still subject to approval by a cabinet committee chaired by the Prime Minister, current practice is reportedly to limit tax holidays to a maximum of six years. A careful review of the workings of this program concluded that although it may not have been very effective in generating significant new investment per dollar of revenue forgone in the past, on the whole the incentives worked fairly well. In particular, it was concluded that "...Jamaica seems to have struck a reasonable balance between rules and discretion in its incentive program."[31]

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27 For example, local value-added is easily defined as ex-factory sales minus the purchase of factor services from non-resident sources.

28 As stated in Chapter 46 of Laws of Belize, Income Tax, Part I, article 15, losses may be carried forward "as long as the trade, business, profession or vocation is carried on by the person who incurred the loss". In contrast, the shorter carry-forward period more generally prevalent (in countries which have generally shorter holiday periods in any case) is presumably intended simply to provide for "hardship" cases in which it may take a year or two of full operation before potentially taxable profits are realized. But note also from Table 4 that Belize is not the only CARICOM country to permit indefinite loss carry-forward.

29 Of course, the indefinite loss carry-forward provision will eventually allow the full write-off of all capital costs incurred during the holiday period, but this is not the same as an incentive geared specifically to capital outlays such as an initial or investment allowance.

30 See Bahl, Martinez-Vazquez and Wallace (1996), pp. 107-08.

31 Thirsk (1991), p. 722.

IV. Tax Competition: A Few Remarks

As global corporate tax rates decline, the debate on the tax competition heats up. This debate raises several questions. First, does tax competition help some countries in terms of attracting capital investment and achieving economic growth? Second, is tax competition harmful to the global economy as a whole? And finally, what would an efficient and competitive tax structure look like?

A recent literature survey of inter-state tax competition in the US suggests that taxes have a small but statistically significant effect on interregional location behaviour (Wasylenko, 1997). More specifically, the effect of taxes in a specific jurisdiction depends not only on the tax elasticity of capital allocation, but also on the extent to which one jurisdiction's overall tax levels are significantly different from the average of the jurisdictions it competes against. A large deviation from the average tax level, multiplied by the tax elasticity, will yield a large location, employment, or investment effect. This finding seems relevant in Latin America given the range of apparent variation in effective tax rates. That is, there may indeed be some range within which tax influences may affect a country's attractiveness to foreign investment and hence its growth rate.

In 1998, OECD published a report by its Committee on Fiscal Affairs (CFA) on "harmful tax competition". This report has been critically received by business. For example, the Business and Industry Advisory Committee (BIAC) to the OECD released its response to the CFA report in June 1999 arguing that international tax competition is generally a healthy phenomenon from the viewpoints of both government and business. Its states: "Tax competition tends to keep tax burdens lower, which creates pressure for less wasteful, and, therefore, more efficient use of public funds. In addition, it fosters increased efficiency in the allocation of scarce resources. Lower tax burdens also translates into lower cost for multinationals operating within the territory and internationally." These conflicting views illustrate the very different ways in which the issue of tax competition, whether within or between states, may be viewed.[32]

Often, such competition has been attacked as wasteful and distorting, leading to such undesirable outcomes as "tax jungles" which impose high compliance costs on society and a "race to the bottom" as competing jurisdictions continually lower tax rates in an effort to retain tax base. Less frequently, fiscal competition between jurisdictions has been said to provide both a useful check on the propensity of governments to expand and a stimulus to more efficient use of scarce fiscal resources. Despite the fervor with which proponents of both "harmful" and "beneficial" intergovernmental competition often state their positions, in reality neither the theoretical nor the empirical literature on this issue is conducive to such certainty. While there is much still to be learned about intergovernmental competition between governments at the same level (horizontal competition) as well as between governments at different levels (vertical competition), what we know to date does not lend clear support to either extreme position in this debate. Neither the position that all intergovernmental competition is bad nor the position that all intergovernmental competition is good dominates. How one assesses these arguments depends upon a variety of factors that need to be specified carefully with respect to each particular setting in which the question is considered.

Whatever philosophers may argue, however, in the real world some degree of fiscal competition seems an inevitable fact of life. The question is then what tax structure would both improve a country's competitiveness and do so in a manner consistent with non-predatory international economic behavior? As noted earlier, there are broadly two fiscal approaches with respect to attracting foreign direct investment. One is to apply standardized tax provisions to all investors combined with low tax rates. The other is to tax various investment activities differently to achieve economic policy goals such as sectoral development or export promotion. The latter approach is typically implemented through fine-tuned

[32] For a classic example of these two views, see the debate in Buchanan and Musgrave (1999).

incentives which often cause severe tax distortion among different investor groups and impinge on economic efficiency. Although the second approach may attract foreign investment in the short run, particularly at an early stage of opening-up an economy to the world, on the whole it seems likely that the first approach is more conducive to sustainable FDI inflow in the long run and hence more suitable for the relatively more developed economies of Latin America.

If all taxes were levied on a strictly "benefit" basis, so that the taxes imposed on residents paid for the benefits they received from public services and any taxes "exported" to non-residents were similarly offset by cost-reducing benefits to such non-residents, both horizontal and vertical spillovers would be minimized.[33] In the real world, however, such perfection is not readily attained, and both forms of spillovers are often found. When there are horizontal spillovers between jurisdictions at the same level (whether between or within countries), the result may be that taxes will be unduly high, since non-residents (= non-voters) in effect end up paying for services enjoyed by residents (=voters) to the extent "excess" business taxes are exported. Alternatively, the result may be too low a level of taxation for fear of loss of tax base to other jurisdictions.

When governments can impose taxes that are, in effect, borne by other governments or nonresidents, the economic cost of taxation is lower than it should be, and the result is likely to be excessive government spending. On the other hand, if spillovers result in tax base moving to other jurisdictions, tax competition may make the perceived economic cost of taxation too high, thus resulting in "too little" government expenditure -- although, as already mentioned, some have suggested that such competition may provide a useful constraint on the taxing power of governments. Those who argue this way have generally been concerned about the possibility of excessive spending as a result of intergovernmental spillovers.

Experience supports the conclusion that intergovernmental tax competition exists and can in some instances constitute a real problem. These arguments are even more persuasive at the subnational than at the national level. Numerous empirical studies in the United States, for example, provide conflicting evidence on the extent to which differential state-local tax regimes affect competitive behavior as well as on the effectiveness of specific subnational tax incentives. With respect to the latter, as one recent balanced survey plausibly concluded, "studies exist to buttress almost any case about tax incentives" (Wasylenko, 1996). This confusing literature suggests few firm conclusions, but one that emerges clearly is that fiscal competitiveness is more likely to affect location choices within smaller areas than within larger areas. This suggests that fiscal differentials are likely to be more important factors in affecting location decisions within than between nations.

Tax levels and tax incentives are part of the "fiscal climate" which prospective investors have to take into account. At the subnational, as at the national, level a well-designed tax system -- one that levies a relatively uniform, stable, and "reasonable" burden on business -- seems more likely to encourage investment than an erratic and biased set of specific incentives. Nonetheless, the pressure on both national governments in the face of global economic pressures and also on the increasingly independent subnational governments in many countries to engage in incentive competition is likely to increase over time.

[33]Some of the following is based on Bird and Mintz (1999). Detailed references to the relevant literature may be found in this source.

V. Conclusion

The key to productive governmental competition, whether within or between nations, lies in making the relevant decision-makers accountable for their decisions. In turn, the key to effective accountability is to set out the rules clearly and to make relevant comparative information publicly available. At base, the ultimate mechanism driving "good" competition is, on one hand, the ability of citizens to compare governments in terms of the services they provide and the tax-prices they charge and, on the other, their ability to affect and alter the decisions of government. Democracy without good information is not enough to ensure that intergovernmental competition will be beneficial rather than harmful. Nor, of course, is information without democracy. Much of the recent decentralization in Latin America, for example, has been closely associated with the revival of democratic institutions throughout most of the region (IDB, 1997). But less attention has so far been paid to the need for good information systems in order to ensure that this democracy is exercised in a responsive and responsible way (Bird, 1999). Indeed, even in countries which do not have well-established democratic institutions good information is essential to ensuring enhanced service outcomes. Transparency is thus important in ensuring that the ultimate outcome of any fiscal incentives is socially beneficial

With respect to sub-national fiscal incentives, for example, a sound approach is to lay down some basic "rules of the game" and to enforce them by public accountability of the sort sketched above. Much the same seems true with respect to tax competition between nations, and one way of interpreting the OECD's recent initiative with respect to "harmful" competition is precisely along these lines.[34] In any case, one important rule with respect to tax incentives is simply: Keep it Simple. Complex provisions attempting to "fine tune" incentives to achieve detailed policy goals are likely to prove costly to administer and unlikely to produce the desired results at a reasonable cost. Few countries, and even fewer sub-national jurisdictions, have sufficient information to design narrowly-focused incentives in any case. If there are to be any tax incentives, they should therefore probably be few in number and as simple as possible in structure – not least to reduce the problems of enforcing tax systems effectively that are bound to be exacerbated in countries with less than perfect tax administration by the presence of, in effect "on-shore tax havens" in the form of "holiday" companies.

In this connection, it is of interest to note the evolution of investment incentives over the last decade or so in eastern and central Europe, for example. Initially, almost all the former communist countries introduced extensive tax holidays and other investment incentives. More recently, however, countries such as Estonia and Hungary, which have been among the most successful in attracting foreign investment have eliminated tax holidays and instead imposed relatively low and broad-based tax rates (for example, an 18% CIT in Hungary). Other countries in the region are similarly considering introducing more transparent and automatic forms of incentives such as accelerated depreciation and more generous loss offset provisions.[35]

Whatever the incentive chosen, the second rule for ensuring transparency and accountability is equally simple: Keep Records. Who gets what incentives? For how long? At what estimated cost in revenue forgone? And with what results in terms of investment, employment or whatever else is of interest? There will inevitably be problems in interpreting some of this information. Nonetheless, in the absence of information incentives are even less likely than usual to play a useful role in terms of promoting economic growth. Instead, they are likely to turn out to be at best a costly means of advertising

[34] A similar interpretation of the concern of the World Trade Organization (WTO) with certain aspects of members' tax policy in connection with WTO's Trade Policy Review Mechanism may be found in Daly (1999).

[35] See the discussion in Coolidge (1999).

for investment, or, more pejoratively, stealing it from one's neighbors, and at worst a way of rewarding those considered politically worthy of receiving such favors.

Thirdly, and combining some aspects of the first two rules, any sound incentives should be required to undergo periodic evaluations in as rigorous a way as possible. If they fail such tests they should be terminated. If a jurisdiction is unable, or unwilling, to put in place such a "sunset" test of the efficacy of incentives, it should probably not be in the incentive business at all. And incentives that cannot pass such tests should of course not exist.

Successful compliance with these apparently simple rules is clearly not easy, as experience around the world suggests. The complex legislation, poor implementation, and complete lack of accountability that presently characterizes most incentives in most national, regional, and local jurisdictions reflect political and institutional factors that are unlikely to be easily, or soon, changed in many countries. Nonetheless, in the absence of such changes, any new incentives that are put into place in response to the cost-benefit calculus of local politicians will likely soon come to resemble instead the sad and familiar world of most existing fiscal incentives rather than the Brave New World some proponents of incentives seem to have glimpsed in some of the recent empirical and theoretical literature on endogeneous growth, increasing returns, and all that.

Even if the present fiscal incentives in some countries were administered perfectly, they suffer from a number of potentially fatal structural faults. Belize, for instance, is one of the relatively few countries in the world that allows tax-holiday firms carry tax losses incurred in the holiday period forward after the holiday until they are used up.[36] For example, a firm may incur an operating loss during its holiday period and utilize this loss to offset otherwise taxable profits realized after the holiday has expired. Even if firms realize profits during the holiday and hence benefit once from the tax concession, they may "double dip" in the sense that investment carried out during the holiday may generate depreciation deductions that may be carried forward without limit and offset against subsequent profits. Other problems arise from the lack of clarity with respect to many critical points – for example, when, precisely, does production "start." In the absence of transparent and objective rules on matters which may significantly affect the fiscal benefits available, it is hard to believe that the present complex, discretionary, and opaque system of fiscal incentives found in countries such as Belize are optimal from any point of view.

Even if fiscal incentives in a country are well-designed and well-administered, experience suggests that they are seldom effective and often costly in terms of undermining the creation and operation of an effective, modern business tax system. As a rule, it often seems possible, in principle, to obtain more or less the same degree of stimulus to investment whether foreign or domestic through simpler measures that focus attention where it is most needed, namely, on strengthening, simplifying, and stabilizing, the basic tax system. Three examples – none of which, it may be noted, would distinguish between foreign and other investment [37]-- may be suggested:

1. ***Cut the corporate tax rate***. While obviously simple, and likely to be seen as strong sign that a country is "open for business," this policy is likely to be both costly in revenue terms and to provide less stimulus to investment than either of the next two alternatives.

2. ***Eliminate import duties on capital goods and, perhaps, raw materials (at least for exporters).*** The introduction of the VAT has of course already moved most Latin American countries well along this path, as has the generalized reduction of import tariffs. Nonetheless, it is far from clear

[36] Note that under the general CARICOM incentive scheme (see above) tax holiday firms are allowed to carry forward losses, but only for up to five years after the expiration of the holiday.

[37] One argument against such a distinction is the impossibility of telling what investors are really "foreign."

that confining the elimination of all input import taxes to firms operating in so-called "free zones" as is currently the rule in some countries is either a wise or a necessary policy. In most of the larger countries, the revenue effects of full elimination of duties on inputs are unlikely to be serious, but of course actions along these lines are as much a matter of trade as of tax policy and cannot be decided without a much closer examination of trade and development policy than is possible here. .

3. ***To the extent there is to be any special fiscal incentive for investment as such, it should likely take the form of a system of full or partial "expensing" of new capital investment***, that is, an initial write-off of 100% (or some smaller fraction) of the cost of depreciable capital. Although the rationale for this approach cannot be fully spelled out here, it is well-established in the literature.[38] In brief, such a system would (i) be relatively easy to administer, (ii) would remove all (or much) of the tax deterrent to such investment, and (iii) would provide more stimulus to investment per dollar of revenue forgone than either tax holidays or general reductions of corporate tax rates. Nonetheless, in at least two respects this approach too may give rise to questions, namely, its relative favoritism to capital-intensive investment and the greater burden it imposes on the administration of the corporate income tax. Moreover, this incentive may not benefit the new.firms which often incur operating losses and hence cannot utilize such tax allowances during their early years. Countries that wish to entice new firms to bring in capital intensive business may therefore find a reasonable investment tax credit to be a better choice.

Despite these problems, if some form of tax incentive to investment is considered necessary, on the whole some form of accelerated depreciation, preferably combined with improvement of the basic tax structure and administration in the direction of an effectively lower-rate and broader-based system, would appear to provide an adequate economic replacement for any benefits in terms of increased investment, growth, and job creation that may now be being realized from the various special fiscal incentives currently found in most countries of Latin America.

[38] For a useful early discussion, see Musgrave (1981).

Table 1
Main Features of the Latin American Business Tax System

	CIT rate 1999 (%)	Non-profit-based taxes[39]	Inflation adjustment	profit sharing	Payroll tax Rate (%)	Incentives for Exporting	Incentives for financial investment
Argentina	35	Yes	No	No	33	Yes	Yes
Bolivia*	25	NA	NA	NA	NA	NA	NA
Brazil	27 - 37	Yes	Yes	Yes	25.8	Yes	Yes
Chile	15 - 35	Yes	Yes	Yes	25.9	Yes	Yes
Colombia	35	Yes	NA	NA	27.1	NA	NA
Costa Rica	30 - 10	Yes	Yes	No	23.8	Yes	No
Dominican Rep.	25	NA	NA	NA	7.0	Yes	NA
Ecuador	25	NA	Yes	NA	NA	Yes	NA
El Salvador	25	Minor	No	No	14.5	Yes	No
Guatemala	25	Yes	NA	NA	12.0	NA	NA
Honduras	40.25	NA	NA	NA	NA	NA	NA
Mexico	32 - 35	Yes	Yes	Yes	20.5	Yes	Yes
Panama	30	NA	No	NA	12.3	Yes	NA
Paraguay	30	NA	NA	NA	16.5	NA	NA
Peru	30	Yes	Yes	Yes	Up to 26.2	Yes	No
Uruguay	30	Yes	No	NA	18.6	NA	NA
Venezuela	15 - 34	Yes	Yes	NA	Up to 15.5	NA	NA

Note: NA indicates information unavailable.

[39] Excluding the property tax.

Table 2
Effective Tax Rate on the Foreign Investment (%)

	Argentina	Brazil	Chile[40]	Mexico	Peru[41]
A. Manufacturing					
1. Regular taxable case	31.3	35.5	22.3/26.9	28.2	24.1
Impact of CIT only	20.8	19.1	4.0/10.6	19.3	11.5
Effect of non-profit-based taxes	10.5	16.4	18.3/16.3	8.9	12.6
2. Tax incentive for exporting	NA	29.3	15.1/20.4	21.8	16.7
3. Free zones	NA	22.3	12.0/17.0	21.8	0.9
B. Services					
1. Regular taxable case	38.8	39.1	28.0/31.8	29.2	24.5/29.2
Impact of CIT only	22.7	17.1	2.6/9.4	17.6	6.9/13.7
Effect of non-profit-based taxes	16.1	22.0	15.4/22.4	11.6	17.6/15.5
2. Tax incentive for exporting	NA	NA	NA	NA	NA
3. Free zones	NA	NA	NA	NA	NA

[40] The higher effective tax rate includes the withholding tax applicable only to the dividends received by non-residents.

[41] The lower effective tax rate is for the tourism sector where buildings used for lodging can be written off 10% annually for the first 5 operating years.

Table 3
Foreign Direct Investment as a percentage of GDP (%)

	1996	1997	1998		1996	1997	1998
Argentina	2.4	2.8	1.9	Canada	1.5	1.8	2.7
Bolivia	6.4	9.2	10.2	France	1.4	1.6	1.9
Brazil	1.4	2.4	4.1	Germany	0.2	0.5	0.8
Chile	6.8	6.9	6.4	U.K.	2.2	2.8	4.5
Colombia	3.6	NA	NA	U.S.	1.2	1.3	2.3
Costa Rica	4.7	0.6	NA	Italy	0.3	0.3	0.2
Dominican Rep.	0.7	2.8	NA	Japan	0.0	0.1	0.1
Ecuador	2.3	2.9	NA	**Group average**	**1.0**	**1.2**	**1.8**
El Salvador	-0.05	0.0	7.4	Korea	0.5	0.6	1.7
Guatemala	0.5	0.5	3.5	Malaysia	5.1	5.2	5.2
Honduras	2.2	2.6	1.6	Philippine	1.8	1.5	2.6
Mexico	2.8	3.2	2.5	Singapore	7.9	10.1	8.5
Panama	4.1	14.7	12.9	Thailand	0.1	1.6	6.2
Paraguay	NA	NA	NA	**Group average**	**3.1**	**3.8**	**3.8**
Peru	5.3	2.7	3.1	Ireland	3.8	3.7	NA
Uruguay	0.7	0.6	0.8	Sweden	2.2	4.5	8.6
Venezuela	3.1	5.8	4.0	Czech Rep	2.5	2.5	4.7
Group average	**2.9**	**4.1**	**4.8**	Hungary	4.4	4.5	NA
				Poland	3.3	3.6	NA
				Group average	**3.3**	**3.8**	**6.7**

Note: The average of the group is estimated excluding the countries for which the data is unavailable. Source: Based on International Monetary Fund, International Financial Statistics, October 1999.

Table 4
Incentives in Belize Compared to Central American and Caribbean Countries

	CIT	CCA	Other	Loss	WHT
Belize	35.0	no	Yes	Indef	0.0
Antigua	40.0	yes	IBC	6	
Barbados	40.0	yes	Export	9	0-15
Costa Rica	30.0	no	Reinvest	3-5	
Dominican Republic	26.0	no	No	3	18
El Salvador	25.0	no	Export	0	
Guatemala	34.0	no	Export	4	
Guyana	35.0	yes	Export	Indef	
Honduras	35.0	no	Export	3	
Jamaica	33.3	yes	No	Indef	15-22.5
Panama	34.0	no	Export		5-15
St. Lucia	33.3	yes		6	
Trinidad and Tobago	45.0	yes		Indef	15-20

Notes:CIT - standard statutory corporate income tax rate (1995)

CCA - some form of accelerated depreciation, initial allowance or investment allowance: Antigua has a 2% initial allowance on buildings, Barbados a 4% initial allowance on industrial buildings, St. Lucia a 20% initial allowance on industrial buildings and machinery, Guyana a 70% investment allowance on equipment, and Jamaica a 120% write-off of "market equipment cost" over time.

Other - various special incentives for export industries; for Costa Rica, 50% of reinvested profits are deductible from income; IBC = international base company; some minor incentives for specific industries and locations are not indicated.

Loss - Number of years loss-carryforward permitted; "indef" = indefinitely.

WHT -Withholding tax rate on dividends paid to treaty country; often different rates for royalties and interest, and generally higher rates for all forms of payments to nonresidents in nontreaty countries.

Source: Boadway and Shah (1995).

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Appendix 1
Business Tax Provisions by Country: an Overview

This appendix this appendix provides an overview of business taxation in each of five Latin American countries under our study: Argentina, Brazil, Chile, Mexico, and Peru. The business taxation means taxes that may affect business activities, particularly the real capital investment. The major business taxes include capital taxes, payroll taxes and transaction taxes on business inputs. The capital taxes in our context include the corporate income tax, personal income taxes on investment income[42], and the property tax on immovable properties and, in some countries, movable properties. A more comparative discussion is provided in the main text of the report. The description presented in this appendix is based on the publication of International Bureau of Fiscal Documentation, the 1999 Worldwide Corporate Tax Guide published by Ernst & Young, and various issues of Tax Note International published in 1999.

Table A1 summarizes the main features of each country's corporate tax system.

1. ARGENTINA

In response to its urgent need for additional revenue to balance its fiscal accounts, Argentina enacted a wide-ranging tax reform at the end of 1998. The reform, as stated by the government, was designed to improve vertical and horizontal equity in the tax system by means of a reduction of tax costs on labor and an increase in the tax burden of business[43]. The reform package contains a two-percentage-point increase in the corporate income tax rate, the elimination of certain exemptions, new thin-capitalization rules, new transfer-pricing rules, and increased effective withholding tax rates. It also includes changes to the value-added tax, a new minimum presumed income tax, a new tax on interest and other financial charges, and reductions in social security contributions

The capital tax provisions

The corporate income tax rate. The corporate income tax (CIT) rate is 35% in 1999. In early 1990s, the CIT rate was 20 and 36 percent respectively applicable to the domestic and foreign corporations. This discriminating dual rate system has been removed since 1992 and all corporations, regardless of the nationality, have been taxed identically. However, the CIT rate has been raised gradually from 30% in 1992 to 35% today. This trend appears to be in a direction opposite to most other countries that encourage the foreign direct investments by reducing the CIT rate.

There is also a minimum tax of 1% on assets held at the end of the tax period by the taxpayer. However, such minimum tax paid in a given period may be credited against the income tax payable for the same tax period. For a tax-loss company, or a company whose income tax payable is below the minimum tax paid for a giver period, the unused minimum tax credit may be carried forward for up to 4 years.

The thin capitalization rule. The 1998 tax reform established a thin capitalization rule for legal entities other than financial institutions. The rule limits the interest deductibility to the higher of a debt to equity ratio of 2.5 to 1 and 50% of taxable income (before the interest deducted). However, three types of

[42] As illustrated by the effective tax rate analysis, taxes on any personal investment income could affect the cost of capital investment through financing.

[43] McLees and Rosso Alba (1999).

interests are excluded from this limitation. They are interest paid to non-residents subject to a 35% final withholding tax, interest on loans from resident individuals, and 40% of any other interest.

The tax depreciation rule. The tax depreciation is based on the straight-line method. The depreciation rate is 2% for buildings and 10% for machinery and equipment.

Inventory accounting method. The valuation of inventory is based on the market cost at the end of the year, or last-in-first-out (LIFO).

Loss carry-overs. The loss may be carried forward for up to five years but may not be carried back.

The withholding tax rate on dividends. There is no withholding tax on dividends distributed from the after-tax profits. The 1998 tax reform introduced a new equalization tax on dividends. This tax is applied to those dividends for which the commercial profits as the distributing source exceeds the taxed profits[44], and the tax rate is 35%, equivalent to the corporate income tax rate.

The turnover tax. A turnover tax is levied at the provincial level. The tax rate varies by province and ranges from 1% to 5%. To avoid the cascading effect, some provinces and the city of Buenos Aires have enacted exemptions from the provincial turnover taxes for activities including manufacturing and certain intermediary services.

The property tax. The property tax is levied at the provincial level. Both taxable base and tax rate vary by location but subject to the federal government regulation. For example, under the Federal Fiscal Pact, the taxable base evaluated annually by local government is limited to 80% of the market value and tax rates are limited to 1.20% for rural property, 1.35% for suburban and 1.50% for urban.

The transaction taxes

There are mainly two transaction taxes that would affect the capital investment and business activities in Argentina. One is the property transfer tax of 1.5% levied on the transfer price of immovable properties. The other is the import duty on raw materials and parts ranged from 0 to 15%. New capital goods are exempted from the import duty.

The social security contributions

The social security contribution payable by an employer amounts to a total 33% of the employee's salary. However, there is a ceiling for certain contributions. For example, the taxable base for contribution to the retirement system and pension fund is limited to the salary under ARS 4,800 for 1999. The contribution rate may also be reduced depending on the location of the employment and the compliance record of the employer.

Tax incentives

As a general rule, most of the tax incentive schemes, especially the industrial promotion regimes have been suspended or abolished. In particular, there is no tax incentives designed for encouraging foreign direct investment.

[44] The "taxed profit" equals to the taxable income minus the income tax paid and plus the dividends (and other non-taxable profits) received by the distributing company.

2. BRAZIL

Brazil has introduced, recently, several new laws to increase certain tax rates aimed at collecting more tax revenues for coping with its budget crisis[45]. It should be noticed that Brazil uses a tax unit, know as UFIR, for the adjustment of certain amounts (???)[46] in its tax legislation. Currently, the UFIR is adjusted every 6 months in accordance with changes in the consumer price index.

The capital tax provisions

The corporate income tax rate. The Brazil adopts a two-tier rate in corporate income taxation: a basic corporate income tax and a corporate income surtax. Since 1996, the basic CIT rate has been 15%, and the corporate income surtax of 10% is levied on the *annual* taxable profits exceeding BRL 240,000. In other words, the marginal CIT rate on the annual taxable profits exceeding BRL 240,000 is 25%.

However, there is also a social contribution tax (SCT) levied on any CIT payers to finance the federal social security system. The tax rate for non-financial companies has been increased temporarily to 12% for 1999 from the original 8%. The tax is levied on the pre-CIT profits and is not deductible for CIT purposes. As a result, the aggregated tax rate on corporate income is 27% for the annual taxable profit under BRL 240,000 and 37% otherwise.

The gross-receipts tax. A social assistance contribution (COFINS) is levied on the monthly turnover, and the rate has been raised from the original 2% to 3% in 1999[47]. The new rules allow Brazilian companies to credit the additional amount of COFINS (i.e., the newly increased 1 percentage point COFINS) paid against the social contribution tax (SCT) on income. However, unused COFINS credit may not be carried forward to offset future SCT liabilities. An additional 0.65% of monthly turnover (PIS/PASEP) is also payable by the employer for a savings programme for employees administered by the *Caixa EconLmica Federal*. These levies, if paid and not used to offset the SCT as mentioned, are deductible for the income tax purpose.

There is also a business tax based on the value of assets although this tax is not significant (???)[48].

The tax depreciation rule. The tax depreciation is based on the straight-line method. The depreciation rate is 4% for buildings and 10% for most of the industrial machinery and equipment. Furniture and equipment are also allowed for 10% depreciation annually. The higher depreciation is allowed for companies with two or more operating shifts.

Inventory accounting method. The valuation of inventory is based on the acquisition cost, or First-in-first-out (FIFO). The weighted-average-cost method is also acceptable to the tax administration but LIFO is not. However, the acquisition cost or production cost of goods existing at the end of the tax period must be adjusted to the market value if this (???)[49] is lower.

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[45] Weiss and Wolf (1999).

[46] We need to know the content of the "certain amounts". In relation to this question, we would appreciate a more specific description of the tax unit in terms of its role in the tax adjustment for inflation. For example, whether the interest expense is deducted with an adjustment for inflation and, if so, how.

[47] The new rules allow Brazilian companies to credit the additional amount of COFINS (i.e., the newly increased 1 percentage point COFINS) paid against the social contribution tax (SCT) on income. However, unused COFINS credit may not be carried forward to offset future SCT liabilities.

[48] We need to know the tax rate of this assets-based business tax.

[49] This paragraph was adopted from the International Bureau for Fiscal Documentation. It is not clear on whether the word "this" here means the "acquisition cost" or the "market value".

Loss carry-overs. The loss may be carried forward indefinitely. However, the loss to be written off is limited to 30% of the taxable income during a tax period.

The withholding tax rate on dividends. There is no withholding tax on dividends distributed from the after-tax profits.

The property tax. A municipal real estate tax is levied on urban land and buildings. The tax base is the appraised value of the property, which varies by location, area, size, age, condition and use. Tax rates, therefore, vary considerably across municipalities. (???)[50]

The transaction taxes

The transaction taxes in Brazil include mainly a dual-VAT system, the import duty, and the taxes on transfers of immovable properties.

The dual-VAT system consists of the state VAT (ICMS) and the Industrialized Products Tax (IPI) levied by the federal government. The former is levied on all transactions while the latter only industrial goods at the manufacturing and import stages[51].

The import duty ranges from zero to 55%. Besides the full exemption given to the conventional export processing zones, there are many conditional exemptions up to 80% as incentives for encouraging sectoral or regional development.

The tax on transfers of immovable properties is imposed at the municipal level with different rate. In the state of Rio de Janeiro, the rate is 2%.

There is also a financial transaction tax of 0.38% on all banking transfers of currency.

The payroll taxes

There are several levies based on total payroll and payable by the employer. They includes the 12% federal social security fund (INSS), 2.5% educational fund, 1.2% for the national industrial training service and commercial training service fund (SENAI/SENAC), the 1.5% social service fund (SESI/SESC), the 8% severance payment, and the 0.6% SEBRAE contribution for promoting small enterprises. All the rates are based on the total payrolls and the aggregated payroll tax rate is 25.8%. As mentioned above, there are also other social security levies based on taxable profits and total turnover. The social security levy on the employee is progressive up to 9% and with a taxable ceiling of 516 BRL. Employees also have the right to share the employer's profit. The profit shared by the employees is deductible for the CIT purpose. (There is no information about specific rate and regulations.)

Tax incentives

Brazil has made an extensive use of incentives to promote development. The incentive scheme has been aimed at promoting export, encouraging sectoral and regional development.

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[50] For the purpose of effective tax rate calculation, we need a national average or a sample rate for a industrial region. In our current effective tax rate calculation, we are using an artificial property tax rate of 1.5%.

[51] According to the International Bureau of Fiscal Documentation, IPI is imposed on the supply and importation of any type of manufactured products or goods. The taxable amount is the customs value including duties for imported goods, or the supply value including incidental charges and VAT for manufactured products. The rates vary inversely with the necessity of the product from 356% (e.g., for manufactured tobacco and alcoholic beverages) to nil (e.g., for essential products). When the production phase is concluded, this excise tax ceases to arise and the accumulated excise taxes paid are incorporated in the cost. For detailed discussion on the problems with the Brazilian VAT system, refer to Silvani and Paul dos Santos (1995).

Incentive schemes for promoting exports, besides the one applicable to the conventional export processing zones[52], are mainly exemption from certain transaction taxes and payroll taxes. Exporting companies outside the EPZs are exempted from import duty on capital goods and other inputs for manufacturing goods for exporting. Furthermore, their export proceeds may be excluded from the gross receipts subject to the 0.65% tax for the savings programme for employees (PIS/PASEP). Finally, their financial transactions in relation to the exportation are exempted from the financial transaction related taxes.

Incentives for encouraging regional and sectoral development are mainly provided through the companies' investment in several investment funds and mostly valid until year 2010. More specifically, corporate enterprises, regardless of the business location, may invest up to 40% of their income tax liability through the government established investment funds. These funds are under the control and regulation of the National Securities Commission. Through this arrangement, firms in effect convert 40% of their income tax liability to their interest in those enterprises established in the regions entitled to use the investment funds. Furthermore, industrial, farming and construction enterprises operating in the listed regions may enjoy a 40% income tax reduction provided they invest this tax saving along with 50% of their own resources in an approved project within the region. There are also other tax incentives granted to qualifying enterprises established in the listed regions and engaged in the manufacturing and assembling specific items such as qualifying vehicles. These incentives includes mainly tax exemptions under the import duty, excise tax, financial transaction taxes, CIT and surtax (AIR).

Other tax incentives related to industrial development are mainly those targeted to the research and development activities[53]. These incentives include mainly a tax credit equal to 15% on R&D-related expenses (which is limited to 8% of the CIT liability), an exemption (with credit) from IPI for purchase of capital goods including tools, and a double-up in depreciation allowance for new equipment and instruments used for R&D activities. There are also certain tax credits or reductions in relation to income generated from the R&D activities and the related transactions.

3. CHILE

The Chilean income tax law contains provisions designed to prevent the taxation of profits created by inflation. These provisions, known as ***monetary correction***, require taxpayers to revalue certain assets and liabilities, such as fixed assets, inventory and debt financing, annually based on changes in the consumer price index (CPI) and in foreign exchange rate[54].

The capital tax provisions

The corporate income tax rate. The corporate income tax is 15% in Chile. There is no other taxes levied on the corporate income. Furthermore, income derived from certain regions of Chile (e.g., the extreme north and south) is exempt from corporate tax.

The foreign tax relief. The only treaty Chile has to avoid double income taxation is with Argentina. Foreign income tax up to a rate of 15% paid to countries other than Argentina may be credited against Chilean corporate income tax. Any additional foreign income tax is deductible as an expense.

[52] Companies operating in export processing zones (EPZs) are exempted from import-related taxes, excise tax, taxes on financial transactions, and social security contributions. Furthermore, profits of these companies are taxed under either the rules in force when an operation agreement is concluded with the government or a more favorable regime established at a later date.

[53] These activities include carrying out the Industrial Technological Development Programmes, developing integrated circuits and investing in research and development of software production technology besides their core business.

[54] For a detailed description of Chilean monetary correction rule, refer to the document on Chile published by the International Bureau of Fiscal Documentation.

Other capital based taxes. There is annual business tax, or business license fees levied by the municipalities. The tax is assessed on the registered capital of 31 December excluding the part invested in other firms subject to the same tax, taking into account the adjustments of inflation as mentioned above. The tax rate ranges from 0.25% to 0.5%.

The tax depreciation rule. The tax depreciation is based on the straight-line method and the useful life fixed by the tax authority. For example, the useful life for machinery in general is 20 years, and that for factory buildings of a permanent nature is 40 years. A higher depreciation allowance may be authorized in case of assets in use for two or more shifts. The taxpayer may use an accelerated depreciation system by directly reducing the useful life of the new or imported assets to one third of that fixed by the tax authority, provided that the normal useful life of the asset exceeds 5 years. As a result, the useful life for new machinery in general may be shortened to 6.6 years for the tax depreciation allowance and that for permanent factory buildings 13.3 years, and the corresponding depreciation allowance is 7.5% and 15% respectively. The aforementioned monetary correction should be applied to the calculation of tax depreciation allowance.

Inventory accounting method. For inventory valuation, the first-in-first-out (FIFO) method and the weighted-average-cost method are accepted. However, the corresponding monetary correction must be added to cost at the end of tax period.

Loss carry-overs. Losses must first be carried back to offset undistributed profits of prior years and then may be carried forward indefinitely.

The withholding tax rate on dividends. There is no withholding tax on dividends distributed from the after-tax profits. While dividends received by resident individuals are subject to personal income tax, the taxpayer may claim a tax credit equivalent to the corporate income tax paid in relation to the dividends received.

The property tax. The property tax is collected by the central government, from which the revenue is allocated to the municipalities. The tax is levied on the cadastral value of the immovable property, which must be revised every 3 to 5 years and adjusted for inflation every 6 months. The tax rate is 1.425% and 1.5%, respectively, for urban and rural properties.

The transaction taxes

The transaction taxes include mainly the VAT at a single rate of 18% and the import duty of 11% in general. There is no tax on transfers of immovable properties (although the related capital gains are subject to the normal personal income taxation).

The payroll taxes

There are no payroll taxes other than social security charges. Furthermore, social security contributions are basically payable by workers. Employers generally pay only 0.9% of the payroll to cover work accidents. This charge may be higher (up to 3.4%) in relation to the degree of risk in working environment. Furthermore, there is a mandatory profit sharing with employees in any enterprises. An employer can opt for either of the two methods. One is sharing 30% of adjusted taxable profit with employees. The other is paying 25% of annual salaries up to 4.75 times the minimum monthly wage at the end of the taxable period, adjusted for inflation. The total social security contributions payable by workers amount to about 20% of salaries with 10% for pensions, 7% for health services, and a minimum 2.55% for the disability and life insurance and the management fees for pension funds.

Tax incentives

Chile recently enacted tax incentives to encourage mainly small and medium-sized investments in its extreme southern regions. The main tax benefit granted under the new law is a tax credit corresponding to new equipment, machinery or related construction and installation. The tax credit is set as a progressive percentage, from 10 to 40 percent, of the investment value in fixed assets, depending on the amount invested, the type of project and the goods that qualify for the investment. The targeted sectors include tourism, transportation, and industrial and energy transmission projects. The qualified project invested through December 31, 2008 is entitled to this tax credit. Any unused credit may be carried forward to future years until the year 2030[55].

There is no tax incentives specifically aimed at encouraging the foreign investment[56]. There are several incentives designed for export promotion, general investment, and regional development.

4. MEXICO

Mexico adopts certain rules regarding inflation adjustment. The adjustment factor is the proportional difference in the consumer price index between the starting month and the ending month of a given period. The income tax law recognizes the effects of inflation on the following items and transactions: depreciation of fixed assets, cost on sales of fixed assets, sales of capital stock (shares), monetary gains and losses, and tax loss carried forward.

The capital tax provisions

The corporate income tax rate. The corporate income tax has been increased from 34% to 35% in 1999. There appears to be a tax deferral of 5 percentage points until the dividends are effectively distributed to shareholders[57]. The taxable income for a residential corporation is its worldwide income from all sources, while that for a non-residential corporation is its income derived from its Mexican source.

Minimum tax on net assets. There is a minimum tax of 1.8% on the net assets of corporations, which provides a credit for the CIT payable. Any minimum tax paid in excess of income tax for any tax year may be carried forward 10 years or back three years to offset CIT liabilities or CIT paid. More specifically, in the case of carrying back the minimum tax credit, a refund of tax paid in the last 10 years (-IBFD) up to that credit (and adjusted for inflation) is permitted.

The tax depreciation rule. The tax depreciation is based on the straight-line method. Depreciation is computed on original cost of fixed assets, with the amount of depreciation indexed for inflation as measured by price indices. The maximum annual deprecation rates are set by law. The rate is 5% for buildings, 10% for plant, machinery and office equipment, 30% for computers and related equipment, 100% for environmental machinery and equipment.

Inventory accounting method. For inventory valuation, the basic requirement is the adjustment for inflation, which is, in effect, equivalent to the average cost method.

Loss carry-overs. Business losses may be carried forward for 10 years.

[55] Larrain and Garcia (1999).

[56] A general restriction on foreign investment is the minimum amount of USD 1 million although any foreign investment exceeding USD 5 million requires an official approval.

[57] Refer to Zuniga (1999).

The withholding tax rate on dividends. There was no withholding tax on dividends distributed from the after-tax profits until 1999. Under the new tax laws effective January 1999, the dividends paid out of the after-tax profits must first be grossed up by the factor of 1.5385 and then subject to a withholding tax of 5%. As a result, the effective withholding tax rate is 7.7%. (The old regime, if the distributing corporation does not have sufficient accumulation in its "net tax profit" account to cover the dividend, then the dividends are taxed at the corporate level at the CIT rate of 34%. In this case, dividends distributed to foreigners subject to the lower of the treaty rate and the CIT rate. In its treaty with the US, the withholding tax is 5% or 10% with the lower rate applicable to the receipt owning at least of 10% of the payer. (E&Y)

The property tax. The property tax is levied at the municipal level. As a result, the tax rate varies by location. In the Federal District, the tax rate ranges from 0.131% to 0.647%.

The transaction taxes

The VAT is levied at a general rate of 15% with a lower rate of 10% in border regions. There is also a real estate acquisition tax, levied at the local or state level, on the market value of the transferred property. The approximate rate is 3.3%.

The payroll taxes

The social security contribution (covering pension, unemployment insurance, health insurance, etc.) is levied on salaries up to a specified amount[58]. A housing fund is also payable by the employer at 5% on salaries with a ceiling. Furthermore, the federal district and states levy a payroll tax on the total remuneration for dependent personal services at a rate up to 2%. The resultant gross rate payable by an employer is above 20% and that by the employee is 4%.

There is also a mandatory employee profit sharing plan, which accounts for 10% of the taxable profits excluding the inflation effect. However, losses of prior years are not deductible in computing profit to be shared. Furthermore, the portion of profits shared by employees is not deductible for the income tax purpose. However, new enterprises are exempt from profit sharing for the first year of operation and those engaged in manufacturing a new product are exempt for the first 2 years of operation.

Tax incentives

The government has offered many incentives promoting various economic activities, most of which are available almost exclusively to Mexican-controlled enterprises or to branches of those foreign companies that have formally committed themselves to shifting eventually to "Mexicanization." The most popular incentives available to foreign investors are in-bond-assembly industries, or maquiladoras, although there is no tax incentive designed specifically to encourage the foreign investment. The main tax incentive related to maquiladoras is the rather generous safe-harbor rule, which set the minimum taxable income as 5% of the total value of assets used in the operation. However, there is presently a clear trend towards treating maquiladoras for tax purposes in the same way as any other Mexican corporation.

[58] The maximum taxable amount is defined by specific times the minimum salaries, which varies from 15 to 25 minimum salaries depending on the category of contribution. The maximum amount will be set at 25 minimum salaries for all categories of contribution in year 2007 as some currently levies with lower taxable base being gradually reduced.

5. PERU

The capital tax provisions

The corporate income tax rate. The corporate income tax is 30% in Peru. The taxable income for a residential corporation is its worldwide income from all sources, while that for a non-residential corporation is its income derived from its Peruvian sources.

Minimum tax on net assets. A minimum tax of 0.5 % was levied (in 1998) on the net assets of corporations. The net assets are defined as total assets less depreciation and amortization allowed for the corporate income tax purpose with certain exclusions and exemptions[59]. The minimum tax paid can be used to as a credit against CIT liability. Unused minimum tax credit can be carried forward to offset CIT liability for the year 1999 - 2001.

There is also a mandatory profit sharing with employees. The sharing rate varies depending on a company's activities and is based on the pre-tax income. The profit shared with employees under this plan is deductible as an expense for the CIT purpose.

The tax depreciation rule. The tax depreciation is based on the straight-line method. Depreciation is computed on acquisition cost of fixed assets plus an inflation adjustment. The annual depreciation rate set by law is 3% for buildings in general[60], 20% for plant and machinery including data processing equipment, and 10% for other assets. A more generous depreciation rate may be authorized upon taxpayer's request, taking into account the characteristics of the business (e.g., more than one shift for the machinery utilization).

Inventory accounting method. Inventories must be carried at cost as adjusted for inflation. Cost may be determined specifically or by the FIFO, average, retail or basic inventory method, but the LIFO method is not permitted.

Loss carry-overs. Business losses from Peruvian sources may be carried forward for 4 years, beginning with the first subsequent year when taxable income arises. A carry-back of losses is not allowed. Losses carried forward must be adjusted for inflation.

The withholding tax rate on dividends.

The property tax. Urban property tax is levied at the municipal level. The tax rate is progressive from 0.2% to 1.0%.

[59] For example, a given firm's shares or participation in the capital of other enterprises that are subject to the minimum tax are excluded from this firm's taxable net assets. Refer to Ernst & Young (1999) for more details.

[60] For buildings and structure of new lodging enterprises, the rate is 10%.

The transaction taxes

VAT is levied at a single rate of 16%. A municipal sales tax of 2% is also applicable to any taxable amount under VAT. Since this tax is not creditable for VAT purposes and follows all the VAT rules, it virtually forms an additional VAT. As a result, the effective VAT rate is 18%.

A tax of 3% is levied on transfers of immovable property.

Imports are subject to customs duties. The general rate is 12%. Higher rates may apply to specific goods.

The payroll taxes

Social security contribution is charged based on the total salary. The contribution payable by the employer is 9% for health fund, 1% - 12.2% as a premium for work accidents depending on the degree of risk related to working condition, and a payroll tax of 5% under the former housing fund. The social security contribution to the national pension system is payable by the employee, and the rate is 11% of the total salary.

There is also a compulsory profit sharing with employees. The sharing basis is the annual pretax profits excluding previous years' losses. The share is 10% for manufacturing industry and 8% for service sector. The portion of profits shared with employees is deductible for the income tax purpose.

Tax incentives

Peru introduced a generous tax incentive package, known as "Amazon Law" to promote economic development to its Amazon region. The package includes exemptions for income tax, VAT, excise taxes and more. Most importantly, the law is stated to have a duration of 50 years, which most observers do not believe sustainable[61]. Other Peruvian tax incentives for regional development are for the border region. Industrial enterprises in the border region are exempted from all taxes except social security contribution, import duties and some municipal taxes.

[61] Byrne (1999).

Table A1
Business Tax Provisions Applicable to Manufacturing and Service Industries

	Argentina	Brazil	Chile	Mexico	Peru
1. The Capital Taxes					
Corporate income	*35*	*27 - 37*	*15*	*35*	*30*
Other tax on	1-5	2.65(turnover)/	EPS	10 (EPS)	10 (EPS)
Assets-based tax	1.0	Not available	0.25 - 0.5	1.8	0.5
Thin capitalization	Yes	None	None	None	None
Tax depreciation					
Buildings	2.0 SL	4.0 SL	7.5 SL	4.0 SL	3.0 - 10.0 SL
Machinery	10 SL	10 SL	15.2 SL	10 SL	20.0 SL
Inventory accounting	LIFO	FIFO	FIFO	average	FIFO/averag
Loss Carry-over[64]	5 years (F)	5 years (F/R)	Unlimited	10 years	4 years (F)
WH tax on dividends	0	0	20	5	0
Urban Property taxes	Max. 1.5	Not available	1.425	FD. 0.131-	Progr. 0.2 -
Property transfer	1.5	2	None	3.3	3.0
Tax incentives on	None	None	None	None	None
Other tax	Yes	Yes	Yes	Yes	Yes
2. The Indirect Tax					
VAT	21	Dual-VAT	18	15	18
Import duty	0 - 15	Up to 55	11 (general)	11 (average)	12 (general)
3. The Payroll Taxes (including payroll-based social security					
Employer	33	25.8	(0.9 - 3.4) +	20.52	15 - 26.2
Employee	Up to 9	12.5	19.6 - 20.4	18.71	9.0

62 Turnover = the turnover tax, and EPS = the mandatory employee's profit sharing on taxable income.

63 As the classification of depreciable assets varies by country, please refer to the text for details. Also note that DB = declining-balance method, and SL = straight-line method.

64 Following the number of years for loss carry over, the letters in brackets indicate the following: F = forward, B = backward, and R = certain restriction in the value of loss to be written off. Please refer to the text for details.

65 See Table A2 for detailed incentives provided by each of these countries.

Table A2: Tax Incentives in Relation to Manufacturing and Service Sectors

Target of the incentive	Description	Argentina	Brazil	Chile	Mexico	Peru
Assembly operation	favorable income tax treatment		Up to 20yr.		Yes	
	exemption from import-related taxes		Up to 20yr.		Yes	
	exemption from the social security contribution		Up to 20yr.		No	
Export promotion	transaction tax exemption for export-related inputs		Yes			Yes
	gross-receipts tax exemption		Yes			
	import duty refund for export-related inputs				Yes	
	refund of charges affecting export-related inputs			Yes		
Free Zone	complete tax exemption					15 years
	income tax reduction or exemption		by 40%	exemption		
	exemption from import-related taxes			Yes	Yes	
Regional development	reduction in income tax through direct or indirect investment		by 40%			
	exemption from income tax and assets tax					50 years
Tourism promotion	accelerated depreciation for lodging buildings					2 - 5 years
	exemption from property tax					2 - 5 years
Investment in new M&E	option for tax credit or accelerated depreciation allowance			Yes		
	fast write-off (62.5%) for annual increment in M&E investment				Yes	
Job creation tax credit	20% of annual minimum salary for each additional man-year				Yes	

APPENDIX 2
The United States: Tax and Economic Parameters

The combined corporate income tax rate in the United States is 38.9% with 35% at the federal level and an average 6% at the state level, and the state tax can be deducted for the federal tax purpose.

The expected inflation rate and interest rate is 2.3% and 8.4% respectively. Both are based on the International Financial Statistics, published by the IMF. The former is estimated based on the consumer price index for the period of 1995 – 1998, and the latter is based on the 1998 lending rate.

Table A3
The United States' Tax and Economic Parameters (%), 1999

CIT rate	Tax rate on interest income	Tax rate on equity income	Interest rate	Inflation rate
38.9	30	20	8.4	2.3

APPENDIX 3
Impact of Non-tax Parameters on the Estimate of Effective Tax Rate

Expected Inflation Rate

The expected inflation rate affects the effective tax rate on capital through its impact on the nominal interest rate. For a given real interest rate, the higher the inflation rate, the higher the nominal interest rate will be. *When there is no regulation for adjusting the inflation impact,* the nominal interest rate interacts with taxes mainly through the following three channels. Firstly, interest cost is deductible for income tax purposes at the nominal rate. As a result, the higher the nominal interest rate in relation to a fixed real interest rate, the lower the real after-tax financing cost, and hence the lower the METR. This effect is particularly favorable for leveraged land financing. Secondly, The accumulated present value of a given annual tax depreciation allowance decreases as the nominal interest rate rises. Since higher inflation lowers the present value of tax depreciation allowance, it increases METR on depreciable assets. And finally, if the first-in-first-out method is used for the inventory accounting, it may results in inflated taxable income and, hence, a higher METR on inventory when prices rise. Since inflation thus affects METR on different assets in different directions, its net impact will depend upon the capital structure. However, since all countries but Argentina under our study adopt a rule that is similar to tax indexation, the inflation impact described here would be largely avoided and hence is not reflected on our estimate of effective tax rate. The inflation rates shown in Table A3 are based on the consumer price indexes since 1995, published by the International Monetary Fund, *International Financial Statistics*.

Expected Real Interest Rate

The impact of the real interest rate on the effective tax rate is in part similar to the impact of inflation since as the real rate rises, so will the nominal rate, thus increasing the effective tax rate on depreciable assets. For a given debt-asset ratio, however, unless inflation is high, there is unlikely to be much of a distortion in effective tax rate arising from the deductibility of interest. The expected real interest rate used for our study is the expected real interest in the US assuming that the foreign investors, i.e., the US multinationals in our study, will borrow at the same real interest rate everywhere as that available at home. As shown in Table A4, Appendix 3, the real interest rate corresponding to the nominal interest rate of 8.4% and the inflation rate of 2.3% in the US is 6.1%.

Debt-asset Ratio

The ratio of debt to assets is sometimes referred to as the financing structure. As already noted, the impact of this ratio on the effective tax rate is related to the expected inflation rate and (real) interest rate. For a given inflation rate and real interest rate, the higher the debt-asset ratio, the more the potential benefit from the tax deductibility for debt financing cost, or interest expenses. A higher debt-asset ratio may thus reduce effective tax rate through lowering the real after-tax cost of financing.[66]

Economic Depreciation

The economic depreciation rate interacts with the tax depreciation allowance to affect the effective tax rate. Suppose, for example, under our assumption of fully mobile capital and technology that a given type of machinery is depreciated at the same economic rate everywhere around the world.

[66] For example, Argentina, like many countries around the world, imposes a thin capitalization rule to discourage tax-driven borrowing.

Countries with faster tax depreciation allowances for this type of machinery will then encourage this type of capital investment through a lower effective tax rate.

Capital Structure

A real capital investment generally involves two categories of capital: depreciable and non-depreciable assets. These two categories can be further divided into four types: buildings and machinery (both depreciable) and inventory and land (non-depreciable). Capital investments in different industries are as a rule structured differently. Moreover, under the same statutory tax rate(s), different types of assets may incur different effective tax rate due to the various interactions between tax provision and non-tax parameters discussed above. In the absence of other information, we use the same estimated capital structure to aggregate these differentiated effective tax rate on various type of capital for all countries, but of course different capital structure in different industries nonetheless result in different aggregated effective tax rate for different industries.

Table A4
Non-Tax Parameters
(in per cent)

	Argentina	Brazil	Chile	Mexico	Peru
Expected inflation rate	0.5	8.5	6.3	23.4	9.1
Expected real interest rate	6.1	6.1	6.1	6.1	6.1
Debt to assets ratio					
Debt raised abroad to home capital	40.0	40.0	40.0	40.0	40.0
Debt to assets ratio in home country					
Manufacturing	29.0	29.0	29.0	29.0	29.0
Services	38.0	38.0	38.0	38.0	38.0
Economic depreciation rate					
Manufacturing					
Buildings	4.0	5.3	3.5	4.2	3.6
Machinery	18.7	18.9	22.7	21.2	23.9
Services					
Buildings	5.0	5.0	5.0	5.0	5.0
Machinery	30.0	35.0	30.0	39.0	31.0
Capital structure by asset type					
Manufacturing					
Buildings	24.0	24.0	24.0	24.0	24.0
Machinery	38.1	38.1	38.1	38.1	38.1
Inventory	35.9	35.9	35.9	35.9	35.9
Land	2.0	2.0	2.0	2.0	2.0
Services					
Buildings	60.6	60.6	60.6	60.6	60.6
Machinery	11.7	11.7	11.7	11.7	11.7
Inventory	9.5	9.5	9.5	9.5	9.5
Land	18.2	18.2	18.2	18.2	18.2

APPENDIX 4
Methodology for Estimating Effective Tax Rate

The effective tax rate on capital calculated in our study is an effective ***corporate*** tax rate on capital, which combines all the taxes that would affect the capital investment at the corporate level in stead of personal level. Personal income taxes, however, may be incorporated into our calculation when they affect the capital investment at the corporate level. For example, the withholding tax on dividends certainly affects the cost of capital invested at the corporate level through its impact on the rate of return to equity required by shareholders.

Our estimates of the effective corporate tax rate are made mainly for the foreign capital investments, with the US multinationals as representative foreign direct investors in Latin America. Furthermore, our estimates are made for two major sectors: the manufacturing and service industries. The simulation for each sector is undertaken for both regular taxable case and tax-incentive case.

All the estimates of effective tax rates are based on 1999 tax regimes and the latest economic information available, unless specified otherwise.

1. The concept

The effective tax rate measures the impact of a tax system on an incremental unit of capital investment or business activity. It incorporates the effects of not only statutory tax rates and related tax treatments (e.g. tax depreciation, tax credit, tax deductibility, tax holidays, etc.) but also various economic factors interacting with these tax treatments (e.g. financial costs, the inflation rate, and the structure of investment, etc). In other words, the effective tax rate is a summary indicator of the overall tax burden imposed by a tax system on an investment within a certain economic environment.

The calculation of effective tax rate is based on the assumption of profit-maximization. Profit-maximizing firms base their investment/business decisions on the foreseeable incremental net revenue at the present value. Taxes reduce the portion of the profits accruing to the investor, while tax allowances mitigate such a reduction in accrued profits. Due to the interaction between these statutory tax provisions and the actual economic/industrial conditions (e.g., financing condition, capital structure, input structure of production, etc.), the effective tax rates can vary by industry even under the same tax regime. Furthermore, as mentioned above, for a cross-jurisdiction comparison, the difference in effective tax rate may reflect not only the variation in tax regimes but also the differentiated economic and financial climates.

For profit-maximizing firms, the gross rate of return on capital (net of economic depreciation) must be equal to the financing cost of capital, adjusted for taxes. The size of this adjustment for taxes on a new investment is the effective tax rate on capital. For example, if the gross-of-tax rate of return to capital is 20 per cent and the net-of-tax rate of return is 10 per cent, then the effective tax rate on capital is 50 per cent.

It should be noted that the analysis of effective tax rate provided in this study deals with only 'profitable' firms. By 'profitable' we mean those firms that have taxable income, if not granted a tax holiday. This assumption is important because that a tax holiday is irrelevant to an unprofitable firm that does not have to pay income taxes.

2. Methodology

The standard method used to estimate effective tax rates has been extensively documented[67]. The formula based on this method has been modified by incorporating some miscellaneous taxes such as capital tax, property tax, and tax on transfer of property[68]. The following are general formulas used in this study. It should be noticed that, for our study, all the formulas apply to foreign investors only.

i) Effective tax rate (t)

The effective tax rate on a given type of capital is defined as the proportional difference between the gross-of-tax rate of return required by a firm (r^G) and the net-of-tax rate of return required by an investor (r^N). r^G is the difference between the marginal revenue product (or user cost, in equilibrium) and economic depreciation. The after-tax rate of return is the weighted average of the return to debt and equity securities held by the investor. Thus, the effective tax rate (t) is defined as

$$t = (r^G - r^N)/r^G \qquad (1)$$

ii) The real cost of financing (r^f)

That is, the cost of financing for an investor is the weighted average cost of financing net of inflation rate.

For foreign investors, the real cost of financing (r^f) is defined by

$$r^{f\prime} = [\beta' i'(1 - U') + (1 - \beta')\rho']*(1 - \gamma)/(1 - x) + \gamma*[i(1-U) - \pi + \pi'] - \pi' \qquad (2)$$

with β' = debt to assets ratio in home country, i' = cost of debt in home country, U' = the statutory corporate income tax rate in home country, ρ' = cost of equity in home country, γ = the ratio of debt raised in host country to total investment fund, x = weighted average withholding tax rate in host country, i = cost of debt in host country, U = statutory corporate income tax rate in host country, π' = inflation rate in home country, and π = inflation rate in host country. That is, the cost of financing to a foreign investor is the weighted average of costs of its investment fund taken from home country and the debt raised abroad. The former is the weighted average cost of financing at home net of withholding tax payable in host country, and the latter is the cost of debt in host country adjusted by income tax deductibility and difference in inflation rate between home and host countries.

iii) The net-of-tax rate of return on capital (r^N)

A. Net-of-corporate-tax rate of return on capital

For a financial investor, or a supplier of the investment fund, the net-of-corporate-tax rate of return (r^N) can be estimated as

$$r^N = [\beta' i'(1-U') + (1 - \beta')\rho' - \pi'](1-\gamma) + \gamma(i-\pi) \qquad (3)$$

[67] Boadway, Bruce, and Mintz (1984, 1987) and Mintz (1990).
[68] Chen and Mintz (1993).

This is the net-of-tax rate of return on capital required by fund suppliers including foreign investor itself and creditors in host countries.

Applying equation (3) to equation (1) results in the effective tax rate on capital for foreign investors.

iv) The gross-of-tax rate of return (r^G) on capital

A. Depreciable assets

$$R^G = (1+tm)(r^{f'}+\delta)(1-k)(1-A)/[(1-U)(1-tg)] + tp/(1-tg) - \delta \tag{5}$$

with tm = tax on transfer of property, or sales tax on capital goods where is applicable, δ = economic depreciation rate, h = capital risk, k = investment tax credit rate, A = present tax value of the accumulated capital cost allowance, α = tax depreciation rate, tp = property tax rate and/or assets-based tax rate, and tg = gross receipts tax rate.

B. Inventory

$$r^G = (1+tm)(r^f + U\pi\zeta)/[(1-U)(1-tg)] \tag{6}$$

with tm = sales tax on inventory where it is applicable, and ζ= 1 for FIFO accounting method and 0 for LIFO.

C. Land

$$r^G = (1+tm)r^f/[(1-U)(1-tg)] + tp/(1-tg) \tag{7}$$

v) Aggregation

The effective tax rate for a given industry is the difference between the weighted average of gross-of-tax rate of return by asset type and the net-of-tax rate of return (which is the same across asset type within the industry) divided by the gross-of-tax rate of return on capital. That is, the marginal effective tax rate for industry i (t_i) is calculated as follows:

$$t_i = (\Sigma_j\, rG_{ij}w_{ij} - rN_i)/\Sigma_j\, rG_{ij}w_{ij} \tag{8}$$

where j denotes asset type (i.e. investments in buildings, machinery, inventories, and land), w_{ij} denotes the weight of asset type j in industry i.

The above are general format of formulas used in this study. Due to the variance among different jurisdictions, some variables in the formulas can be zero for some jurisdictions. For example, there is no gross-receipts tax in Chile, Mexico and Peru and hence tg = 0 in equation (5) - (7) for these countries.

GRAVACIÓN IMPOSITIVA E INCENTIVOS FISCALES A LA INVERSIÓN EXTRANJERA DIRECTA

LA OPINIÓN DEL SERVICIO DE ASESORÍA SOBRE INVERSIÓN EXTRANJERA

Joel Bergsman *

Muchos economistas rechazan los incentivos fiscales pues los consideran, en el mejor de los casos, medidas ineficaces que suponen pérdidas de ingresos para el erario público y, en el peor, costosas distorsiones que reducen el verdadero valor de la producción. Por otra parte, a la mayoría de los directores de los organismos de promoción de inversiones extranjeras prácticamente no hay incentivo que les parezca mal.

"No sirve de mucho desaconsejar el empleo de incentivos con el argumento de que causan distorsiones en los mercados de factores o productos, cuando estas distorsiones son, justamente, lo que el cliente busca."

"¡Sr. Bergsman, usted no sabe lo que dice!" (Funcionario del Ministerio de Finanzas húngaro, discutiendo sobre las treguas tributarias con un asesor del FIAS a comienzos del decenio de 1990).

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* El autor, uno de los creadores del FIAS, dejó el cargo que tenía en ese Servicio para acogerse a los beneficios de la jubilación en octubre de 1998, y ahora es un consultor independiente en St. Leonard (Maryland, Estados Unidos). Esta nota es un proyecto común, al que han hecho contribuciones muchos colegas, del FIAS y de otros organismos, a los que no nombro por temor a olvidarme de alguno. Con todo, Neda Pirnia merece un agradecimiento especial. Enero el 2000

Indice

I. Criterios tradicionales: coincidencias y discrepancias

¿Cumplen los incentivos fiscales eficazmente sus objetivos, es decir, atraen nuevas inversiones? De ser así, ¿los beneficios superan a los costos?

Según la experiencia recogida por el FIAS en el asesoramiento a decenas de países en desarrollo y en transición en los últimos 14 años, los sistemas de incentivos son, en su mayoría, ineficaces. Atraen muy pocas inversiones adicionales y tienen sus costos: constituyen un drenaje de fondos para las arcas fiscales de los países que los aplican, en algunos casos resultan contraproducentes porque complican demasiado los procedimientos para las inversiones y a veces dan origen a una corrupción mucho mayor. El analista de políticas no necesita más para recomendar algún tipo de cambio.

Una parte fundamental de la labor de asesoramiento del FIAS consiste en ayudar a la mayoría de los clientes a comprender que los incentivos demasiado generosos o, sencillamente, una escasa presión tributaria no atraen, por sí solos, inversión extranjera directa. (La carga fiscal elevada y/o la inestabilidad de las normas pueden ahuyentarla, de manera que si los impuestos pasan de muy elevados a moderados el ingreso de inversión extranjera directa podría aumentar.) Si alguien pone en duda esta afirmación, puede considerar el caso de la mayoría de los países de África al sur del Sahara, cuyos incentivos fiscales y generosas treguas tributarias reducen efectivamente la presión impositiva para los inversionistas extranjeros a niveles muy bajos y que, sin embargo, reciben muy pocas inversiones extranjeras directas. Nepal es otro caso detectado recientemente por el FIAS. Los motivos de la ineficacia de los incentivos en estos países son evidentes: con exclusión de algunas actividades basadas en recursos naturales, no ofrecen buenas oportunidades de hacer dinero en los tipos de actividades a los que se orienta la inversión extranjera directa; muchos de estos países también son inestables o presentan dificultades no económicas; sus mercados internos son pequeños y están alejados de las fuentes de producción y los mercados extranjeros. Es por ello que ni siquiera la ausencia de impuestos atraerá inversión extranjera directa hacia estos países o regiones, como no sea hacia los segmentos que despiertan especial interés, los cuales probablemente la seguirían recibiendo incluso con una moderada presión impositiva.

Estas conclusiones, a las que se ha llegado por simple observación y sentido común, están avaladas tanto por estudios econométricos como por las numerosas encuestas realizadas entre los inversionistas, que generalmente coinciden en que ni los incentivos fiscales ni siquiera la presión impositiva, a menos que sea excesiva, determinan, en la mayoría de los casos, la elección del lugar donde se asentará la inversión extranjera directa. Algunos de estos estudios y encuestas se mencionan en la bibliografía.

Sin embargo, el mundo no es así de simple. Muchos funcionarios públicos juran que sin incentivos no podrían atraer inversión extranjera directa. Esto ya era evidente hace casi 40 años, cuando Robinson (1961) presentó los resultados de una encuesta sobre 365 inversiones en 67 países, efectuada entre 205 compañías. Los resultados son, básicamente, los mismos a los que han llegado las numerosas encuestas realizadas desde entonces: los funcionarios públicos otorgan a los incentivos un alto grado de prioridad entre los factores decisivos, a diferencia de los ejecutivos de las empresas multinacionales.

El tema se pudo comprender mejor cuando la pregunta se formuló con mayor precisión. Reuber (1973) sostuvo que las empresas multinacionales no son todas iguales y reaccionan de distinta forma ante los diferentes tipos de incentivos, según sus motivaciones. Reuber estudió 80 proyectos de inversión; en los orientados a la exportación, los incentivos fiscales (incluyendo las treguas tributarias, la desgravación de derechos y la amortización acelerada) se mencionaron como importantes en el 48% de las decisiones sobre inversiones, mientras que, respecto de las inversiones dirigidas al mercado interno, en el 56% de las respuestas se afirmó que el factor de mayor importancia era la protección.

En un importante estudio financiado por el Comité para el Desarrollo y supervisado por la Corporación Financiera Internacional (CFI), Guisinger y sus colaboradores (1985) llegaron a la misma conclusión sobre la diferente pertinencia de los incentivos fiscales o la protección para los distintos tipos de inversión extranjera directa[1/]. En este último estudio también se presentó otro aspecto importante de la cuestión: por lo general, para los inversionistas los incentivos no son un factor determinante de la inversión si corren más o menos parejos con los de los países competidores. En las encuestas menos complejas simplemente se preguntaba si los incentivos habían influido en las decisiones sobre inversiones; cuando había incentivos similares en muchos países, la mayoría de los inversionistas respondía que no. Guisinger formuló una pregunta diferente: ¿habría sido distinto si el país no hubiera ofrecido incentivos y sí lo hubieran hecho los países competidores? Un número considerable de inversionistas contestó que sí. Finalmente, fue en el estudio de Guisinger donde quizás por primera vez se enunció de manera clara y explícita lo que la experiencia parece demostrar: los incentivos fiscales (o, para decirlo en términos más generales, aquellos encaminados a reducir los costos) suelen ser eficaces en dos situaciones aparentemente diferentes pero, en el fondo, similares, a saber, cuando la inversión debe decidirse entre:

- Plataformas que presentan atractivos semejantes para la producción destinada a la exportación a otros mercados, o

- Partes, de atractivo similar, integrantes de un gran mercado (como estados de los Estados Unidos o el Brasil, o países de la Unión Europea, entonces Mercado Común).

En otras palabras, cuando el inversionista está estudiando distintos lugares que ofrecen condiciones aceptables y bastante similares para la producción con destino a la exportación hacia un mercado mucho más grande que las jurisdicciones políticas en cuestión, enfrenta la competencia real o potencial de otros inversionistas que pueden elegir los mismos lugares, de modo que reducir los costos es muy importante. Los organismos de promoción de inversiones de Tailandia o Carolina del Norte o Irlanda lo saben y por ello ofrecen generosos incentivos fiscales, subvenciones en efectivo, tierras a precio reducido, incentivos a la capacitación del personal y otros estímulos, a pesar de que numerosos estudios econométricos, encuestas de inversionistas y economistas les aconsejan no hacerlo.

Ello también explica por qué la mayoría de los países grandes que despiertan interés no ofrecen incentivos en el orden nacional; por ejemplo, los gobiernos nacionales de los Estados Unidos, Brasil y México no proporcionan incentivos a las inversiones extranjeras (si bien Brasil y México, y los Estados Unidos hace un tiempo, otorgaban gran protección a sus mercados internos, y Brasil no ha abandonado por completo esta estrategia)[2/].

Rolfe y colaboradores (1993) señalaron que las preferencias son también función de factores como la etapa en que se encuentra la inversión (inicial o expansión) y el tipo de proceso (fabricación o servicios). Las firmas que recién se instalan prefieren los incentivos que reducen los gastos iniciales, mientras que las que se amplían prefieren los relacionados con los impuestos que inciden en las utilidades; las industrias manufactureras, que necesitan mayores inversiones en activos fijos, suelen inclinarse por los incentivos vinculados a los activos depreciables más que las empresas de servicios. Bergsman y Edisis

[1/] La presentación de Guisinger provocó un "debate innecesario" pues el autor subrayó reiteradamente que los resultados de su trabajo, según los cuales en muchas decisiones sobre inversiones influían los incentivos –entendidos como él los definía–, contradecían a otros de escaso efecto. En realidad, los resultados a los que arribó Guisinger fueron coherentes con los de los demás estudios; la diferencia principal consiste en que Guisinger incluyó la protección frente a las importaciones entre los incentivos, mientras que en pocos estudios se adoptó el mismo criterio. Guisinger efectuó un importante aporte a la comprensión de los incentivos, pero no modificó radicalmente los conceptos sobre el tema. Véase Wells (1986).

[2/] China constituye una excepción interesante. Cuando China abrió sus puertas a la inversión extranjera directa en 1979, puso en marcha tres medidas importantes que favorecieron a esta en relación con las empresas nacionales (prácticamente todas estatales): menores impuestos sobre las utilidades, libertad de retener el 100% de todos sus ingresos en divisas y mayor libertad para contratar y despedir trabajadores. Estas dos últimas no hicieron más que otorgar a las empresas extranjeras el tratamiento internacional corriente, lo cual equivale a admitir que las restricciones aplicadas a las empresas públicas chinas impedirían casi por completo la inversión extranjera directa. Haciendo un análisis retrospectivo, es probable que las menores tasas impositivas no generaran grandes inversiones adicionales y, por lo tanto, hayan representado meras pérdidas para la tesorería.

(1988), funcionarios del FIAS, en un estudio acerca de la eficacia de la capitalización de la deuda como incentivo para los inversionistas en América Latina en los años ochenta, confirmaron la importancia de reducir los gastos iniciales: el descuento de *swaps* reducía el costo de la inversión inicial y no dependía de las ganancias futuras. Este incentivo inmediato y seguro no sólo aumentaba los ingresos previstos sino que reducía el monto en riesgo; afectó la decisión sobre la inversión en más de la mitad de los casos estudiados. Este resultado coincide con el éxito logrado por Irlanda y otros países y regiones que, al parecer, atrajeron una buena cantidad de inversionistas ofreciendo generosos conjuntos de incentivos que incluían subvenciones iniciales.

Ahora comprendemos que la eficacia de los incentivos varía según el tipo de inversionista, la clase de incentivo, el grado de competencia para conseguir la inversión, la calidad del lugar y la reacción de otros países ante el aumento o la disminución de incentivos de sus competidores. Los incentivos fiscales u otros que reducen costos suelen ser eficaces:

- para inversiones sin vinculación permanente, orientadas a la exportación;
- en países o regiones similares a países o regiones vecinos;
- en lugares donde los demás aspectos económicos también son favorables, y
- donde los incentivos inciden en las etapas iniciales del proyecto y presentan mayor grado de certeza.

La oferta de un mercado protegido también puede resultar muy eficaz para atraer inversiones, en especial hacia una economía grande y en crecimiento, como lo demuestran claramente los principales ejemplos de América Latina en los decenios de 1950 y 1960 y China, últimamente. En realidad, la protección es aún más poderosa, como lo prueba el hecho de que también ha atraído un gran número de inversiones muy ineficientes hacia economías medianas e, incluso, pequeñas: desde plantas de montaje de automóviles en Chile (14 millones de habitantes) hasta plantas de laminado de acero en Togo. Pero en la actualidad esta práctica parece despertar menos interés y está cayendo en desuso en la mayoría de los lugares, debido a los perjuicios que ocasiona la constante protección contra la competencia y las prácticas del comercio mundial. Las propias empresas multinacionales se instalan cada vez más en sitios donde puedan producir según las normas de la competencia mundial, aun en aquellos casos en los cuales el principal objetivo estratégico en el momento de la inversión sea el mercado local.

Lo mismo se puede expresar diciendo que, al momento de decidir si efectuar o no una inversión, los inversionistas analizan el conjunto de características pertinentes del lugar. Son contados los casos en los que los incentivos fiscales o de otro tipo tendientes a reducir costos logran revocar una decisión negativa adoptada en razón de deficiencias graves del lugar. Los estímulos tales como los diferentes tipos de desgravación impositiva o las tierras a bajo precio inciden sólo cuando el lugar a) es aceptable y b) es similar a otros con los que compite. La protección puede tener más influencia si el mercado protegido parece lo suficientemente rentable.

En realidad, un número importante de compañías multinacionales tiene por norma tomar las decisiones sobre inversiones haciendo caso omiso de los impuestos y los incentivos fiscales. Sólo toman en cuenta los factores que consideran más esenciales. Por supuesto, una vez adoptada una decisión positiva, negocian cuanto sea posible para obtener todos los incentivos a su alcance.

Al estudiar los países en desarrollo y en transición, vemos que todavía hay varios que parecen ofrecer incentivos cuando, según los argumentos expuestos hasta ahora en este documento, lo más probable es que este tipo de incentivos atraiga muy poca inversión extranjera directa adicional y constituya, por consiguiente, una pérdida de dinero para la nación. Hay cuatro hechos que quizás expliquen, en la mayor parte de los casos, esta aparente anomalía.

En primer lugar, muchos de los funcionarios públicos que están convencidos de la eficacia de los estímulos para atraer inversiones basan su opinión en su experiencia cotidiana con los inversionistas, quienes negocian con ahínco para obtener todos los incentivos a su alcance. Estos funcionarios saben que los inversionistas quieren conseguir todo incentivo permitido por las leyes del país y harán todo lo posible para lograrlo; lo que ignoran es cuántos inversionistas no optarían por ese país si este les ofreciera una carga impositiva razonablemente reducida y condiciones relativamente satisfactorias, sin otro incentivo. Como asesores, creemos saber que, con excepción de los inversionistas orientados a la exportación y sin vinculación permanente, la falta de estímulos en situaciones que, por lo demás, sean ventajosas no desanimaría a muchos inversionistas. Pero, cuando el funcionario trata de lograr que una planta de Ford o de Siemens se instale en su país, se enfrenta con ejecutivos que exigen toda clase de exenciones fiscales y otros estímulos; la solución de ofrecer condiciones impositivas aceptables, sin incentivos, se encuentra entre las opciones que nos parecen más convenientes pero no entra en su marco analítico.

En segundo término, algunos de los gobiernos que continúan ofreciendo incentivos de dudosa eficacia procuran alcanzar un objetivo distinto de aquel al que alude nuestro trabajo. Singapur es el ejemplo clásico. Nosotros nos referimos a los incentivos para aumentar la cuantía de la inversión extranjera directa, pero la Junta de Desarrollo Económico de Singapur está tratando de poner en marcha una política industrial. No procura tanto aumentar el ingreso total de dichas inversiones como atraer determinadas actividades, incluso determinadas compañías, para modificar la <u>estructura</u> —no el <u>volumen total</u>— de la actividad económica del país. Si se trata o no de una buena idea es otra cuestión, pero el argumento de que Singapur obtendría cuantiosas inversiones incluso sin incentivos no es pertinente porque no se refiere al objetivo del país.

En tercer lugar, los incentivos pueden tener cierta utilidad como señal. La vida es muy compleja y no se la puede reducir a análisis económicos; incluso en las decisiones sobre inversiones influyen muchos factores diferentes. Especialmente en el caso de un país que desee transformar una imagen de hostilidad u oposición a los inversionistas y demostrar que está dispuesto a facilitar la actividad económica privada en general y la inversión extranjera directa en particular, el anuncio de una serie de incentivos puede resultar útil aunque más no sea por su efecto como medida de relaciones públicas. Si esos incentivos son la vía más eficaz en función de los costos para alcanzar dicho objetivo, es otra cuestión, pero su utilidad bien puede trascender el efecto estrictamente económico que se refleja en el estado de pérdidas y ganancias de las compañías. Se cree que esa finalidad es la que persigue la República Checa con los incentivos, cada vez mayores, que viene ofreciendo desde abril de 1998.

Por último, no olvidemos que, en su mayoría, aquellos funcionarios públicos que sostienen que los incentivos son eficaces y necesarios para su país o provincia son quienes los conceden o están encargados de atraer inversiones del exterior. Dejan en manos de otros la cuestión de la eficacia en función de los costos; tienen una misión que cumplir y para ello, naturalmente, desean utilizar todos los instrumentos a su disposición. Quieren tener atribuciones para otorgar incentivos y gran libertad para hacerlo. En estos casos es preciso analizar si lo mejor para el organismo de promoción de inversiones es también lo mejor para el país.

II. Consecuencias para el asesoramiento sobre políticas

Lo antedicho se puede resumir en la afirmación de que, siempre que los impuestos sean razonables, los incentivos no serán necesarios para atraer inversiones a) en la extracción de recursos naturales u otras actividades que generen renta, o b) en los proyectos encaminados a la venta en el mercado interno. El tipo principal de inversión extranjera directa no incluido en estas dos categorías es la industria manufacturera sin asiento fijo, dedicada a la exportación, que se puede atraer con mano de obra económica (y, en menor medida, con los cupos de importación, aplicados por los países ricos). Un país pequeño que desee atraer cuantiosas inversiones extranjeras directas y cuyo principal atractivo sea el que puede ofrecer a esas industrias manufactureras, seguramente necesitará reducir la presión tributaria (y probablemente también la tasa impositiva establecida por la ley) más que un país grande con un mercado interno interesante.

Hay numerosos conjuntos de medidas impositivas que no ahuyentan a la inversión extranjera directa. (Pueden variar de un país a otro). Al elegir entre ellos, algunos de los temas que un país —y los asesores del grupo del Banco Mundial— debe tener presentes son:

- La historia y la situación actual del país y los cambios que éste encuentra aceptables desde el punto de vista político y administrativo.

- Las cuestiones impositivas; no hay que olvidar que el propósito de un sistema tributario no es atraer inversión extranjera directa sino recaudar impuestos. En este sentido, no hay nada más triste que un país muy pobre, con unas pocas actividades especializadas de interés para la inversión extranjera directa, dispuesto a permitir que cualquier inversionista del exterior pague impuestos muy bajos o nulos, con la esperanza de atraer más inversiones. El resultado es que prácticamente todas las inversiones que lleguen se concentrarán en esas actividades especializadas que generan renta, y una carga impositiva razonable no las habría desalentado. Los incentivos casi no darán origen a nuevas inversiones extranjeras directas y constituirán una pérdida total para las arcas fiscales.

Hay gran cantidad de posibilidades aceptables. ¿Cuáles son sus límites? Actualmente, en muchos países en desarrollo competitivos las tasas, establecidas por la ley, de los impuestos sobre las utilidades superan apenas el 30% o el 35%[3/], según comparaciones de la carga impositiva real efectuadas recientemente por Jack Mintz, al parecer incluso en países que, por lo demás, resultan atractivos para los inversionistas, las tasas efectivas de los impuestos sobre las utilidades no deberían superar esos márgenes. Como se trata de recaudar algo, las tasas fijadas por ley probablemente no deberían ser inferiores al 10% o el 15%. Países como Brasil, México y (posiblemente) Rusia pueden aplicar las tasas impositivas más elevadas de esta escala. Los países mucho más pequeños y/o menos atractivos con potencial como plataforma de exportación necesitan tasas efectivas que no excedan el 10% o el 15%, o quizás aun menos para los exportadores, si quieren conseguir grandes inversiones extranjeras directas.

Cada opción dentro de esa escala presenta numerosos pros y contras y compensaciones recíprocas. Si una tasa efectiva próxima al extremo inferior de la escala se considera ventajosa, se podrá llegar a ella fijando por ley tasas bajas sin incentivos (como se definió anteriormente) o tasas elevadas junto con incentivos; determinar cuál de estas opciones es la mejor depende en gran medida de la situación particular del país, su capacidad administrativa, los efectos en la recaudación, etc.[4/]

Si el cliente utiliza o está analizando la posibilidad de aplicar incentivos, el FIAS siempre aconseja no conceder treguas tributarias. Suelen estar mal orientadas (porque premian la constitución de nuevas compañías en lugar del aumento de los bienes de producción, una mejor tecnología o la capacitación laboral, por ejemplo). Por lo general, no son eficaces en función de los costos (prácticamente en todos los estudios se señala que generan muy pocas inversiones adicionales). Inciden más que nada en las inversiones sin vinculación permanentes, a corto plazo, las cuales pueden irse o crear una nueva compañía una vez terminada la tregua, mientras que, para las inversiones a largo plazo, otros incentivos (véase el próximo párrafo) dan mejores resultados.

Los incentivos aconsejables serían combinaciones de disposiciones acertadas sobre traslado de pérdidas a ejercicios futuros, amortizaciones rápidas u otras cancelaciones, exenciones tributarias o créditos impositivos. Se pueden aplicar al gasto que el gobierno desee promover (por ejemplo, inversiones en capital

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3/ En la publicación KPMG Corporate Tax Rate Survey de 1999, obra del KPMG International Tax and Legal Center, con sede en los Países Bajos, se informa que las tasas, establecidas por la ley, de los impuestos sobre las utilidades se están reduciendo en todo el mundo debido a la presión de la competencia. En la encuesta se señala que la tasa media entre los países de la OCDE descendió casi tres puntos porcentuales en los últimos cuatro años, hasta llegar al 34,8% al 1 de enero de 1999. Las tasas en los países menos desarrollados son todavía más bajas; el promedio en la región de Asia y el Pacífico fue del orden del 32% y en América Latina, del 28,5%.

4/ Véase Mintz y Tsiopoulos (1992), donde se encontrará un buen análisis de las ventajas y los inconvenientes mencionados.

fijo, capacitación laboral) y por ello se focalizan mejor. Pueden incorporarse al código impositivo y actúan automáticamente; producen beneficios únicamente después de tomada una medida, no ante simples promesas. Si bien en muchos estudios se cuestiona la eficacia en función de los costos de algunos o de todos ellos, estos incentivos son preferibles a las treguas tributarias.

Reducir las tasas de interés establecidas por la ley es una práctica cada vez más difundida y parece ser al menos tan eficaz como los incentivos mencionados. Las tasas "reducidas" son, en la práctica, del orden del 20% o menos. La desventaja, naturalmente, es que se aplican a la totalidad del sector empresarial, lo que puede acarrear una fuerte pérdida fiscal. Sin embargo, en algunos países cuyo sistema consiste en imponer elevadas tasas impositivas, ofrecer incentivos generalizados y luchar poco o nada contra la corrupción, en realidad casi nadie paga los impuestos sobre las utilidades y la reducción de tasas puede formar parte de un plan que incluya medidas más acertadas y honestas para hacer cumplir las obligaciones tributarias (que quizás no funcionarían con las elevadas tasas y los numerosos incentivos discrecionales que imperaban anteriormente) y que, en la práctica, aumente los ingresos fiscales. Para muchos de los países que utilizan nuestros servicios este ejemplo optimista no es más que una esperanza para el futuro, pero al menos indica un buen camino.

Cualquiera sea el incentivo que el cliente insista en ofrecer, es importante que no lo otorgue únicamente a los inversionistas extranjeros. Excluir a los inversionistas locales no sólo sería cuestionable políticamente para cualquier gobierno sino que también daría lugar a la constitución de un gran número de empresas en común con extranjeros, que, en teoría, reúnen los requisitos legales para hacerse acreedoras a los incentivos pero que, en la práctica, no serían más que las mismas compañías nacionales a cuya lista de propietarios se ha añadido algún nombre extranjero. Ello ocurre en especial cuando se conceden treguas tributarias.

Es conveniente recordar a los clientes que son partidarios de los incentivos que la competencia basada exclusivamente en bajos costos no es el camino apropiado para alcanzar el desarrollo. Los países necesitan instruir a los trabajadores y mejorar la salud pública y la infraestructura e incluso si se puede recurrir al financiamiento privado para atender estas necesidades, los ingresos fiscales se precisarán para cubrir otras. El comportamiento internacional de la inversión extranjera directa indica bastante claramente que si los impuestos son razonables y la recaudación se utiliza para suministrar servicios, los inversionistas vendrán y pagarán los impuestos, y la productividad y los ingresos de toda la economía aumentarán con el tiempo. La inversión extranjera directa no es más que un medio para lograr este fin, y nuestros clientes son, en última instancia, los habitantes del país y sus descendientes.

Una de las dificultades con que tropezamos a menudo es el deseo de recibir asesoramiento <u>preciso</u> manifestado por muchos clientes. La diversidad de casos satisfactorios en todo el mundo indica que no hay una solución única. Sin haber estudiado exhaustivamente (nosotros u otros especialistas) la situación, las posibilidades y las preferencias de un país, enunciar a secas, por ejemplo, "El impuesto sobre las utilidades debería ser del 15%" puede ser algo arbitrario. De ser posible, deberíamos ayudar a los clientes a entender que cuentan con una variedad de opciones aceptables, en términos generales. Deberíamos explicar qué hace que una opción sea aceptable y otras no lo sean tanto. Tendríamos que señalar las ventajas y los inconvenientes de las diversas soluciones viables. Al tiempo que nos concentramos en los efectos para la inversión extranjera directa, también deberíamos señalar todos los otros criterios, incluso más importantes para los sistemas tributarios, como el aumento de la recaudación, la facilidad de administración, la reducción de las posibilidades de corrupción y fraude, etc. <u>No olvidemos que el punto de vista de la inversión extranjera directa es sólo una de las tantas voces que deberían escucharse para diseñar un buen sistema tributario</u>. Y, por supuesto, deberíamos hacer todo lo que esté a nuestro alcance para entender la situación del país en cuestión y, en la medida de lo posible, adecuar nuestro asesoramiento a ella.

<u>Otros impuestos</u>. Hasta ahora el análisis ha girado en torno al impuesto sobre las utilidades. A continuación presentaremos someramente otros impuestos pertinentes:

Derechos de importación de maquinaria y equipo: Estos impuestos pueden tener importancia si son considerables, puesto que representan un aumento de los costos para el inversionista, mientras que su eliminación los reduce. Es difícil entender la conveniencia de que un país imponga elevados derechos de importación de maquinaria y equipo, independientemente de que los importadores sean empresas con inversión extranjera o nuevas compañías que instalan capacidad o antiguas compañías que quieren ampliar o actualizar sus equipos. Si bien no está referido estrictamente a la manera de atraer inversión extranjera directa, nuestro consejo para la mayoría de los países, si no todos, es que los impuestos sobre la importación de maquinaria y equipo probablemente no deberían superar los niveles de "ingreso" de aproximadamente el 5% al 10% como máximo, y que todos, excepto los exportadores, deberían pagarlos. Si en el país existe el impuesto al valor agregado (IVA), que se aplica tanto a las importaciones como a la producción nacional (como debería ser), entonces los derechos de importación que superen el IVA sobre maquinaria y equipo podría, y probablemente debería, ser nulo. Cualquiera sea su nivel, esos derechos y el IVA deberían reintegrarse (o no cobrarse) a los exportadores. (Naturalmente, se presenta el problema del reintegro de impuestos sobre bienes de capital a los exportadores indirectos. Nada es perfecto.) En la mayor parte de los países que recurren a nuestros servicios, la mayoría de los inversionistas no paga, en la práctica, impuesto alguno a la importación de maquinaria pero, en muchos de ellos, hay que recurrir a halagos o sobornos. En este tema, como en otros, el consejo de adoptar un sistema simple y automático es, a menudo, uno en los que más se debe insistir.

IVA o impuestos a los insumos que graven materias primas y bienes intermedios; rebajas para los exportadores: en estos casos, el consejo estándar es que deben ofrecerse a los exportadores condiciones semejantes al libre comercio. El tipo de sistema puede ser muy importante, desde el punto de vista administrativo; los sistemas de reintegro de derechos requieren una administración competente y orientada al cliente que, en muchos países, no existe. Los países que utilizan nuestros servicios no deben dejar de lado ningún sistema práctico satisfactorio para los exportadores por aplicar algún otro que es teóricamente óptimo para un país desarrollado, con capital humano, instituciones y procedimientos tributarios avanzados.

Impuestos y otras cargas sobre los costos salariales: suelen ser altos y varían notablemente de un país a otro. Cuando son muy elevados, pueden constituir un serio obstáculo para la competitividad de las exportaciones, a menos que se los traslade por completo a los empleados. En las economías más pequeñas y orientadas a la exportación, habrá inversión extranjera directa cuando las condiciones sean favorables a la exportación; para que lleguen al país cuantiosas inversiones de este tipo debemos recomendar sistemas impositivos viables que faciliten la exportación[5/].

También deben analizarse las contribuciones territoriales, los impuestos sobre los activos fijos, los impuestos sobre la repatriación de utilidades u otros ingresos, etc., pues pueden desalentar la inversión extranjera directa.

<u>Los beneficios automáticos en comparación con los beneficios discrecionales</u>. La palabra utilizada *normalmente en este trabajo* es "*incentivos*"; *hemos empleado* "*beneficios*" *para incluir no sólo* los incentivos impositivos en el sentido más estricto usado anteriormente sino también otros como la reducción de tasas establecidas por la ley, las subvenciones iniciales, los servicios de contrapartida para los socios y cualquier otro instrumento que una persona encargada de promoción de inversiones quisiera tener autorización para otorgar o considerara necesaria para persuadir a un inversionista de efectuar una inversión.

La mayoría de los promotores de inversión extranjera directa quisieran tener atribuciones para otorgar incentivos u otros beneficios. Sólo dos motivos justifican estas atribuciones, incluso en principio: a) impedir que los incentivos "se desperdicien" en inversiones que se efectuarían de todos modos, y b) concentrarlos en

[5/] Los impuestos e incentivos vinculados a los costos de maquinaria o mano de obra pueden provocar sesgos. Los altos impuestos sobre los salarios pueden inclinar la industria hacia métodos de uso intensivo de capital; lo mismo puede suceder, por ejemplo, con la rapidez de las amortizaciones o los créditos impositivos por inversiones. En las publicaciones sobre el tema no se señalan efectos apreciables en las proporciones de los factores de estos cambios en los precios relativos; no revisten importancia en la práctica. No han sido motivo de gran preocupación en ningún trabajo de asesoría sobre incentivos a la inversión extranjera directa en que haya intervenido el FIAS.

actividades de especial interés, por ejemplo, poner en marcha una política industrial. El primer motivo no es estrictamente verdadero; pocos promotores de inversiones tienen los conocimientos especializados o la integridad y "tacañería" necesarias para aplicarlos si los tuvieran. En el caso de sectores donde los beneficios son elevados y es obvio que los incentivos son innecesarios, la ley o las normas pueden excluir a la inversión extranjera directa de los incentivos que se ofrecen en general. El segundo motivo, la aplicación de una política industrial, puede tener más aplicación práctica. Sin embargo, escapa en parte al objetivo de este trabajo, pues no se relaciona con la forma de atraer inversión extranjera directa. En realidad, en muchos de los países que solicitan nuestros servicios, la principal razón por la cual los clientes desean conservar las atribuciones mencionadas es tener la oportunidad de recibir sobornos.

Las inversiones cuantiosas e interesantes reciben, al parecer, algún tipo de aliciente discrecional prácticamente en todos los lugares del mundo. Si no lo hace el gobierno nacional (y en ocasiones incluso si lo hace), las autoridades provinciales y/o municipales pelean por atraer las grandes plantas de automotores o máquinas herramientas o circuitos integrados para computadoras. Cuando un equipo de Intel llega a un país, no pasa desapercibido[6/]. Sin negar esta realidad, podemos recomendar con seguridad un conjunto de a) tasas impositivas y normas sobre amortización racionales, dentro de un sistema tributario estable y mínimamente honesto; b) beneficios automáticos que operen a través del sistema tributario, si alguna otra medida se considera necesaria; y c) inevitablemente, algún tipo de tasas impositivas muy bajas si se busca que las plataformas de exportación atraigan gran cantidad de inversión extranjera directa.

Según la experiencia del FIAS, para que las autoridades atiendan sus consejos, el asesor normalmente debe presentar al menos algún análisis cuantitativo que compare la presión tributaria del país con la de sus vecinos u otros supuestos competidores. Hasta el gobierno ruso, a comienzos de los años noventa, pidió un análisis de esta índole, aun cuando el país no competía por obtener inversiones que actuaran como plataforma para la exportación. La amplia experiencia adquirida nos indica que, en muchos casos, los argumentos basados exclusivamente en análisis cualitativos se rechazan o ni siquiera se estudian con seriedad. Probablemente habría que suministrar cifras diferenciadas en función de los sectores y mercados pertinentes, y también analizar las distintas opciones en materia de políticas con que cuenta el país que solicita nuestros servicios.

<u>Los beneficios mínimos frente a los beneficios considerables</u>. En la práctica suele haber una importante relación de correspondencia entre los diferentes efectos que producen estos dos tipos de beneficios: los primeros ocasionan menos distorsiones y menos pérdidas en quienes se aprovechan de la situación sin asumir carga alguna, pero probablemente no alteren ninguna decisión (o no muchas); en un caso extremo, pueden producir pocos de los efectos buscados, o ninguno, y pueden tener un costo bajo, pero no nulo. Los beneficios considerables pueden provocar mayores distorsiones (si bien la distorsión quizás sea exactamente lo que la política busca) y acarrear mayores gastos en quienes se benefician sin contrapartida, pero alcanzan en gran medida sus objetivos. Ello plantea un dilema para el asesor sobre políticas. Es obvio que no debe recomendar un sistema complejo de beneficios mínimos, pero si el cliente está estudiando la posibilidad de aplicar un plan más sencillo y sólido que produzca verdaderamente los resultados que desea, requerirá una evaluación detenida que permita analizar y sopesar las ventajas y los inconvenientes de las diferentes opciones, las cuales, probablemente, incluirán resultados imprevisibles ("manzanas y naranjas") sobre los cuales corresponde al cliente decidir. Para citar un ejemplo extremo (pero real, que le tocó vivir al FIAS): si un cliente desea diseñar un conjunto de medidas para sustituir la tierra y la mano de obra actualmente destinadas al cultivo de coca por otras actividades agrícolas, de poco sirve aconsejar no hacerlo por las distorsiones que provocarían los importantes beneficios que habría que ofrecer para cumplir este objetivo.

6/ Véase en Spar (1998) un informe acerca del plan empleado por Costa Rica para atraer una planta de Intel sin infringir las normas ni regalar el negocio.

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SESION 3

ADMINISTRACION DE RIESGOS Y MANEJO DE PASIVOS CONTINGENTES DEL SECTOR PUBLICO: ¿COMO INCORPORAR EL TEMA DE LAS GARANTIAS GUBERNAMENTALES --EXPLICITAS E IMPLICITAS-- A LA PROGRAMACION PRESUPUESTARIA ANUAL Y PLURIANUAL?

GOVERNMENT CONTINGENT LIABILITIES:

A HIDDEN RISK TO FISCAL STABILITY

by

Hana Polackova

The World Bank

The findings, interpretations, and conclusions expressed in this volume are those of the author and should not be attributed to the World Bank, affiliated organizations, or members of its Board of Directors or the countries they represent. The author thanks Hafez Ghanem, Sanjay Pradhan, Allen Schick, and Sergei Shatalov for their helpful comments and suggestions. The paper is a short version of a forthcoming, more comprehensive study that further elaborates the policy and institutional aspects of fiscal risks and includes several country case studies of direct and contingent fiscal risks and the quality of fiscal adjustment.

Table of Contents

Summary

i. Governments are facing increasing fiscal risks and uncertainties. Most recently, the Asian crisis revealed how contingent forms of government support create major moral hazard in the markets and severe fiscal instabilities. The main reasons for this situation are: (a) the increasing volumes and volatility of international private capital flows, (b) a shift in the role of the state from directly financing and providing services to guaranteeing that the private sector will accomplish particular outcomes, (c) biases in policy decisionmaking under fiscal constraints, and (d) the existence of moral hazard in the markets because of a perception that the government has some residual responsibilities.

ii. Since off-budget government programs increasingly cause fiscal instabilities, a string of years with a balanced budget and low public debt figures does not necessarily suggest either past fiscal prudence or a good fiscal outlook. Thus, a study of government fiscal position must also examine the obligations taken by the government outside the budgetary system. The fiscal risks governments face are of four types: either direct or contingent, both of which in turn are either explicit or implicit. Governments that want to avoid the danger of sudden fiscal instability and accomplish their long-term policy objectives must have a good understanding of both their direct and contingent liabilities and must be able to handle them appropriately. But do governments have adequate incentives and capacities to deal with not only budgetary but also with all significant fiscal risks? Assistance and even coercion by international institutions may be required.

iii. There are four main ways governments can address fiscal risks: (a) control the contingent as well as direct, and implicit as well as explicit fiscal risks and orient policies toward good quality rather than rapid fiscal adjustment; (b) publicly recognize the limits of the state's responsibilities so as to deter moral hazard in the markets; (c) ensure that institutional arrangements for public finance and standards for budgeting, accounting, financial planning, reporting, and auditing address both contingent and direct liabilities and promote fiscal prudence and equity in all contingent as well as directly financed public programs; and (d) develop and employ institutional capacities to evaluate, regulate, control, and prevent financial risks in both the public and private sectors.

I. Introduction

Governments are facing increasing fiscal risks and uncertainties. Two of the reasons for this situation are: first, the international integration of financial markets, which has meant greater volumes and volatility of cross-border flows of private capital; and, second, the privatization of state functions, accompanied by implicit or explicit state guarantees. State guarantees and insurance schemes, as opposed to budgetary subsidies and direct provision and financing of public services, have become a common method of government support. These off-budget programs and obligations involve hidden fiscal costs, with implicit and contingent liabilities that may result into excessive requirements for public financing in the medium and long term.

The third reason is that policymakers pursuing a balanced budget or some deficit target tend to favor off-budget forms of state support that do not require immediate cash and that, at least for some time, hide the underlying fiscal cost. Fiscal adjustment that concentrates on deficit reduction may overlook or elevate the fiscal risks associated with structural policies affecting pensions and health care. Major fiscal risks outside the budget derive from explicit promises and implicit expectations that government will help when various failures occur. The subsequent emergence of moral hazard in the markets can exacerbate these risks. Usually the support governments offer to large weak banks, enterprises, and subnational governments in troubles is outside the budget.

Although it is impossible for governments in a market environment to avoid all fiscal risk, they can control and reduce the risks, but only if they recognize and fully consider them in their policy debates. Whether governments have the incentives and capacities to reflect fiscal risks in their policy choices and to carry out appropriate fiscal adjustment is an important question. The incentives will reflect how well policymakers understand the issues and the pressures they face in dealing with them. The fiscal risks become apparent only when the institutions conducting fiscal analyses look beyond the government's budget and debt to include the contingent and implicit liabilities. The extent of the incentives governments have to make direct and contingent fiscal risks transparent is linked mainly to the definition and measurement of internationally recognized fiscal indicators, to the quality of public awareness, external monitoring, and to the sanctions imposed for concealing relevant data and exposing the state to excessive fiscal risk.

This paper first classifies and analyzes the potential obligations and fiscal risks governments face and their sources. It next outlines the options for reducing fiscal risks in the context of fiscal adjustment, with particular attention to the typology and analysis of specific fiscal risks, the high risk exposure of governments of transition and emerging-market economies, and the quality and bias in government decisionmaking at the time of fiscal adjustment. Several questions are addressed. How can policymakers be made accountable for recognizing the long-term cost of all forms of government activities? How can the moral hazard induced by government interventions be reduced? What standards for public sector accounting, budgeting, reporting, and risk management would foster sound fiscal performance in the long term? A forthcoming, more comprehensive study presents a framework for including direct and contingent fiscal risks in fiscal analysis and applies it to selected countries.

II. Possible Financing Pressures on the Central Government

A. The Fiscal Risk Matrix

Governments face four types of fiscal risk, each of which is a broadly defined liability that combines two of the following four characteristics: explicit versus implicit and direct versus contingent.[1]

- *Explicit liabilities* are specific obligations of the government established by a particular law or contract. The government is legally mandated to settle the obligation when it comes due. Common examples are the repayment of sovereign debt and repayment of nonperforming loans the state has guaranteed.
- *Implicit liabilities* involve a moral obligation or expected responsibility of the government that is not established by law or contract but instead is based on public expectations, political pressures, and the overall role of the state as society understands it. Examples of implicit liabilities are future public

[1] The international accounting standards for governments proposed by the International Federation of Accountants define a liability as a present obligation of the government that entails a form of economic benefits and that arises from past events whose settlement is expected to result in an outflow of government resources (International Federation of Accountants 1998).

pension benefits that are not specified by law, disaster relief for uninsured victims, and default of a large bank on nonguaranteed obligations.

- *Direct liabilities* are obligations that will arise in any event and are therefore certain. They are predictable based on some specific underlying factors; they do not depend (are not contingent) on any discrete event. For example, future public pensions specified by law are a direct liability whose size reflects the expected amount of the benefit, eligibility factors, and future demographic and economic developments.

- *Contingent liabilities* are obligations triggered by a discrete event that may or may not occur.[2] The probability of the contingency occurring and the magnitude of the government outlay required to settle the ensuing obligation are difficult to forecast. Probability and magnitude depend on some exogenous conditions, such as the occurrence of a particular event (for example, a natural disaster or banking crisis) and some endogenous conditions, such as the design of government programs (an example being the contracts for state guarantees and insurance), as well as on the quality and enforcement of regulations and supervision. The fiscal risk matrix in table 1 provides a typology of the sources of the potential financial requirements central governments face. Under each category are examples of government programs and promises that can create fiscal pressures. Some of the examples apply across all countries (such as sovereign debt), whereas others are more country-specific (such as crop insurance).

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[2] International accounting standards define a contingency as a condition or situation whose ultimate outcome is determined only by the occurrence, or nonoccurrence, of one or more future events (International Accounting Standards Committee 1997).

TABLE 1
THE FISCAL RISK MATRIX

Liabilities[a]	Direct (obligation in any event)	Contingent (obligation if a particular event occurs)
Explicit Government liability is recognized by law or contract	• Foreign and domestic sovereign borrowing (loans contracted and securities issued by the central government) • Expenditures by budget law • Budget expenditures legally binding in the long term (civil service salaries, civil service pensions)	• State guarantees for nonsovereign borrowing and obligations issued to subnational governments and public and private sector entities (development banks) • Umbrella state guarantees for various types of loans (such as for mortgages, students studying agriculture, and small businesses) • State guarantees (for trade and the exchange rate, borrowing by a foreign sovereign state, private investments) • State insurance schemes (for deposits, minimum returns from private pension funds, crops, floods, war risk)
Implicit A "moral" obligation of the government that mainly reflects public expectations and pressures by interest groups	• Future recurrent costs of public investment projects • Future public pensions (as opposed to civil service pensions) if not required by law • Social security schemes if not required by law • Future health care financing if not specified by law	• Default of a subnational government and public or private entity on nonguaranteed debt and other liabilities • Cleanup of the liabilities of privatized entities • Bank failure (beyond state insurance) • Investment failure of a nonguaranteed pension fund, employment fund, or social security fund (social protection of small investors) • Default of the central bank on its obligations (foreign exchange contracts, currency defense, balance of payments stability) • Bailouts following a reversal in private capital flows • Residual environmental damage, disaster relief, military financing, and the like

[a] Of fiscal authorities, not the central bank.

B. Direct Explicit Liabilities

In most countries, the central government commonly recognizes, quantifies, and discloses direct explicit liabilities. Even so, estimating the size of the government outlays related to these obligations in the medium term is not a simple task.

- Governments usually specify *obligations to settle direct foreign and domestic sovereign debt* in their loan contracts and securities. The future financing requirements mainly relate to the maturity, currencies, and interest rate of the debt instruments. Using these specifications, governments forecast their debt service profile, simulate the tradeoff between risk exposure and the cost of borrowing, and build debt service scenarios for alternative portfolio and macroeconomic developments. Denmark, Ireland, and the United Kingdom provide excellent examples of how to analyze and disclose sovereign borrowing risks.

- *Budgetary outlays* are normally embedded in an annual budget law, which contains the approved activities and policies of the government. In principle, the budget is legally binding, and outlays are to comply with the budgeted figures throughout the fiscal year. In practice, the budget is viable only if it is based on good macroeconomic analysis and if the government employs institutional mechanisms for fiscal discipline and control.

- Governments in many countries extend *legal entitlements to a salary and pension* at a specified retirement age to public employees. It is certain these legal entitlements will be a spending item in future state budgets. Their magnitude is based on forecasts of the numbers of public employees and their expected remuneration, pension benefit, and retirement age. Under New Zealand's Fiscal Responsibility Act, the government is required to analyze and disclose such forecasts in budget documents. (Where a government plans to downsize the civil service, it may be obligated to pay redundancy packages, whose overall cost would be contingent on the actual downsizing.)

In contrast to the environment depicted in the fiscal risk matrix (table 1), countries with legal provisions that the government finance future social security benefits, such as public pensions, universal health care, and education, list these as direct explicit rather than implicit items.

C. Direct Implicit Liabilities

Direct implicit government liabilities often arise as presumed, rather than as legal or contractual, obligations established by public expenditure policies in the medium term. Only governments that are committed to transparent medium-term expenditure planning and long-term fiscal discipline recognize and quantify these obligations. Assuming no policy changes, the implicit cost of demographically driven public expenditures is what in particular poses a danger to fiscal stability in the long term.

- *The completion of public investment projects and maintenance* are only expected, not mandated, by law. Governments analyze and quantify, and are accountable for, the ex-ante estimates and actual multiyear investment and ensuing long-term recurrent costs. Countries such as Australia and South Africa use a medium-term expenditure framework that automatically includes the financing requirements for operations and maintenance in the fiscal outlook and future budgets. Thus, government obligations to sustain the benefits of public investments are explicit.

- In many countries, *future public pension benefits* are not grounded in any legal document and therefore are not explicit but rather are implicit government liabilities. Assuming that a given pension policy will continue, it is certain that the overall obligation of the government will occur (there are economic, social, and political reasons for assuming that a government would not stop paying the benefits unless it first reformed its pension system). Hence future public pension benefits are a direct liability, even though not in the strict accounting sense. Since the provision of public pensions is recognized as the most striking problem for fiscal sustainability in aging societies, many governments have been analyzing the long-term fiscal implications of their pension policies and of alternative reforms using long-term fiscal and pension models. (A point discussed below is that pension reforms often encourage private sector involvement in saving for retirement because the government provides indirect forms of support, such as guarantees of minimum pension benefits. These guarantees are an explicit contingent liability of the government.)

- Similarly, *future health care and social security* financing can be analyzed as a direct implicit government liability (even if not accounted as such). Research shows that the dynamics of the financing requirement for health care in an aging society is often even more explosive than that for public pensions. Modeling and recognition of the long-term fiscal implications of health care policies and their reforms are critically important for fiscal stability and equity in the long term.

D. Contingent Explicit Liabilities

Contingent explicit liabilities are a legal obligation of the government to make a payment if a particular event occurs; they are not directly associated with any existing budgetary program. A government's commitment to accept obligations contingent on future events amounts to a hidden subsidy and may cause immediate distortions in the markets and result in a major unexpected drain on government finances in the future.

Although governments recognize each contingent explicit liability in some formal documentation, many have yet to consolidate all these obligations and their total magnitude in one place and to include them in their overall fiscal analysis and expenditure planning. In contrast, many corporations, commercial banks, and insurance companies have made considerable progress in dealing with contingent liabilities in the past 10 years. Similarly, governments have not yet recognized the importance of good design, monitoring, and management of their programs to control fiscal risks. At the policy level, ex-ante analysis of the risks and future financial implications associated with the contingent forms of government support contribute to better policy choices on equity and long-term fiscal stability.

- Governments often issue *guarantees* to cover part or all of the risk that a borrower will fail to repay a loan or other guaranteed asset or that an institution will fail to fulfill its obligations. Common examples include state guarantees of debt and other obligations of subnational governments and various public and private entities, such as budgetary institutions, credit and guarantee funds, development banks, and enterprises. Guarantees and credit issued through a state-guaranteed intermediary are particularly risky because they allow the government to pursue unannounced policy decisions, involve a problem of management incentives, and are difficult for governments to monitor and control. The hidden subsidy to the beneficiary of a guarantee, and the subsequent potential cost to the government, are positively correlated with the risk, size, and duration of the underlying asset. In addition, the probability of a default may be very high if the guarantee contract does not specify risk-sharing by both the government and the other parties in terms of both the financial coverage (part versus all of the loan) and risk coverage (specific political or commercial, versus all risks). Government guarantees routinely cover all risks fully. Such guarantees distort the markets and are called with high probability. The risk a government assumes can be estimated based on the experience of governments of different capacities, simple rules, and, where appropriate, more sophisticated methodologies such as actuarial, econometric, loss estimate, and option pricing models.[3] Assessment of risks allows governments to reflect the potential fiscal cost associated with guarantees in their choices of policies and forms of support and in the design of a guarantee contract. Since passage of the Credit Reform Act, the United States provides good examples of government analysis and the design of credit guarantees.
- Governments extend *umbrella guarantees* to eligible persons or entities borrowing for a specific purpose, such as university studies, a mortgage, farming, and small business development. The rationale for these guarantees and the assessment of their risks and potential long-term cost are similar to those for the individual guarantees discussed above (and are also true for *trade and exchange rate guarantees* and *guarantees on foreign sovereign borrowing and private investments).*
- *State insurance schemes* often constitute a major risk to future fiscal balances. Common state insurance programs cover bank deposits, crops, war risks, minimum returns from pension funds, and floods, earthquakes, and other natural disasters. Although most of these programs cover losses that occur very infrequently, when the losses do occur, their total magnitude may be enormous. The risk

[3] For a detailed discussion of the valuation methodologies for loan guarantees and other contingent liabilities, see Mody and Patro (1996) and Mody and Lewis (1997).

pool under these programs, particularly in small markets, is very limited, one justification for government's involvement. State insurance schemes rely on net government financing from general taxes, rather than on insurance fees, and thus redistribute wealth. The analysis of risks and potential fiscal burdens associated with state insurance schemes requires sector data and sophisticated models (such as the hydrologic model used to estimate the probabilities of floods in a given year), and loss estimation methodologies and options pricing models to assess the riskiness of the returns of a pension fund. A qualitative analysis of the risk factors is, however, sufficient for the government both to design a sound insurance scheme that would not seriously distort market behaviors and to make a rough estimate of its potential fiscal cost. The United States may take the lead in this area as its government adopts the analytical and budgeting method for federal insurance programs proposed by the General Accounting Office (United States, General Accounting Office 1997).

E. Contingent Implicit Liabilities

Contingent implicit liabilities are not officially recognized and may be the product of declared policy objectives. Governments accept these liabilities only *after* a failure in the public sector or market and as a result of pressure by the public, possibly interest groups, or just too high an opportunity cost for not acting.

Contingent implicit liabilities often pose the greatest fiscal risk to governments. The event triggering the liability is uncertain, the value at risk difficult to evaluate, and the extent of government involvement difficult to predict. In short, it is very hard to identify and estimate the size of contingent implicit liabilities. They are particularly large if the macroeconomic framework in the country is weak, the financial sector vulnerable, regulatory and supervisory systems inefficient, and disclosure of information in the markets limited.

In addition, expectations of government involvement generate moral hazard in the markets. The scope for moral hazard is particularly large in economies in which the government significantly minimizes the pain of past failures of market agents and in which the government and investors do not have a good capacity to monitor the risk exposure of market agents. Governments can constrain moral hazard if, in advance and through their actions, they decide on and signal the limits of their potential intervention to the markets. To reduce rather than expand the moral hazard, the signals have to make clear that the government will be responsible for minimum public goods only and that there will be significant pain for agents that fail. The government needs to assess the costs and benefits and reveal its responsibility for each contingent implicit liability separately.

- In most countries, *the financial system* is government's most serious contingent implicit liability. International experience indicates that the markets expect the government to help financially if the stability of the financial system is at risk. In case of a failure in the financial sector, governments are compelled to intervene financially far beyond their legal obligation either to secure some critical functions of the financial system or to protect depositors and specific market agents beyond the limits of state insurance schemes.[4] Such practice further exacerbates the moral hazard problem in the financial and corporate sectors.

- Uncovered losses and defaults on nonguaranteed debt and obligations by a *subnational government, state-owned or large private enterprise, budgetary or extrabudgetary agency*, or any other institution of political significance may induce the government to provide financing. Governments also accept various obligations of parastatal and public entities subject to privatization. (The government is often liable for the obligations, including contingent explicit ones, of state-owned financial institutions.) The contingent implicit government liability associated with both the financial system and nonguaranteed corporate debt increases with rising amounts and less efficient allocation of private capital.

- Depending on social preferences, some critical *social and welfare functions*, even when the government has contracted them out, are believed to be the ultimate responsibility of government. For example, where there is an investment failure of a nonguaranteed pension, employment, or social security fund, the government has to finance the social services from the budget. Thus, nonguaranteed private provision of social and welfare services poses a contingent implicit financial risk for governments (Heller 1997).

- The fiscal authorities also have ultimate responsibility for *currency stability* and *the balance of payments*, and therefore also for unmet obligations of the central bank. Most recently, Thailand and other Asian countries have shown that fiscal obligations may arise from a fixed exchange rate regime or the foreign exchange contracts of the central bank and, ultimately, are connected to international bailout packages. As in most of the instances listed above, the risk escalates with the macroeconomic vulnerability and moral hazard in the markets.

- *Private capital flows* entail contingent implicit risks to the government in four areas: (a) policy (the risks include exchange rate overvaluation and sterilization), (b) domestic assets valuation (an asset bubble for real estate, productive and intangible assets, financial instruments, and domestic currency), (c) intermediation (interest rate differential and weakness of the domestic financial system), and (d) borrowing (incentives for corporations, banks, and governments to overborrow and borrow short-term).

- Ultimately, *environmental damage* and *natural disasters* create a high demand for public monies, beyond explicit state insurance programs and guarantees. Many countries face the financial risk of operating and dismantling nuclear plants, disposing of nuclear and toxic wastes, and the residual cost of environmental recovery. In the absence of developed private insurance industries, particularly in countries with a history of caretaking, disasters such as floods, earthquakes, and droughts create major political pressures for government action.

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4 Standard & Poor's estimated the contingent fiscal cost of the domestic banking system in 1997 (the level of direct and indirect costs to the government under the worst-case scenario) in Argentina, Hungary, Italy, Poland, and Sweden to be less than 10 percent of gross domestic product (GDP), in Greece, the Philippines, Singapore, the Slovak Republic, the United Kingdom, and the United States to be about 10 to 20 percent, and in China, the Czech Republic, Hong Kong (China), Japan, the Republic of Korea, Malaysia, Thailand, and Taiwan (China) to be over 30 percent (Standard & Poor's, 1997).

III. The Increasing Problem of Fiscal Risks

A. Trend, Bias, and Moral Hazard

As noted, recent trends show that governments are exposed to expanding fiscal risks. First, the high volumes and volatility of private capital flows and increasing economic dependence of countries on foreign capital have exacerbated the vulnerability of their domestic financial and corporate sectors and, implicitly, of the government. Particularly in transition and emerging market economies, domestic assets are subject to the rapidly changing preferences of foreign investors. An interplay of risks—policy (high exchange and interest rates), valuation of domestic assets (asset bubble), intermediation (interest rate differential and weak domestic financial system), and borrowing (overborrowing and short-term borrowing by government and market institutions)—may lead to a sudden dumping of domestic equity, bonds, and currency by investors. Such instances, which occurred recently in Mexico, Asia, and Russia, cause a crisis that is solved partly at taxpayers' expense.

Second, states have been transforming their role, moving from directly providing and financing services to guaranteeing that the private sector will accomplish certain outcomes. Privatization of state responsibilities and attempts to encourage private sector initiative through explicit or implicit government guarantees have left governments with increasing uncertainty about future public financing requirements. *Will a guarantee be called? What will the outlays of state insurance programs be?* Will reserve funds be sufficient to cover the contingent losses? Several governments have incurred expenditures above envisaged limits following a massive failure of projects covered by state guarantees, busted deposit insurance schemes, banking crises, and excessive private credit. In such instances, many transition and emerging-market countries have faced capital flight and plunged into fiscal crisis, whereas developed countries such as France absorbed the fiscal shock by issuing more public debt.

Third, governments may be biased toward off-budget policies, which pose more financial risk but require less immediate financing. Often, particularly in times of deficit reduction and a short-term political horizon, policymakers exploit the fact that off-budget commitments and obligations are not necessarily reported so that the cost of government policies is hidden. Under these conditions, decisionmakers favor off-budget forms of government support such as state guarantees, direct credit, and absorption of private liabilities and bad assets. There are many examples of fiscal opportunism, for example, in countries in the European Monetary Union's (EMU) subject to the fiscal ceilings of Maastricht as well as World Bank and International Monetary Fund (IMF) adjustment programs.[5] Such forms of government support give rise to government contingent fiscal risks whose costs and cash consequences perhaps will not be seen for many years.

Finally, explicit state guarantees and insurance schemes, or any implicit understanding that a government will come to the rescue in the case of various market failures, generate serious moral hazard problems in the markets. Loans and investments with a full guarantee suffer from insufficient analysis and supervision by creditors. Beneficiaries of poorly designed state insurance schemes tend to expose themselves to excessive risks. For instance, in the United States, the generous benefits of the federal flood insurance program have resulted in excessive construction of houses in flood-prone areas (United

[5] The 1992 Treaty of Maastricht sets the following fiscal limits: general government deficit as a net borrowing requirement, 3 percent of GDP and total gross debt at nominal value outstanding at the end of the year and consolidated within general government, 60 percent of GDP. Both deficit and debt are calculated according to the European System of National Accounts ESA78. ESA78 only roughly defines the general government and does not require the recording of government transactions on an accrual basis and of assets at market value. For a description of the opportunistic fiscal behaviors of governments under fiscal constraints see Easterly (1998) and Forte (1997).

States, General Accounting Office 1997). Given this market behavior, it is more likely the government will be called on to provide financial support later on.

B. Fiscal Risks and the Challenge of Transition and Emerging Markets

The implicit and explicit fiscal risks that both governments in transition and in emerging- market economies face are particularly large. Dependence on foreign financing, vague ownership structures in the economy, underdeveloped regulatory frameworks, and weak enforcement exacerbate the scope for failure in the financial and corporate sectors. Failures in turn often generate political pressures on governments to intervene, ad hoc and ex post, through various financial bailouts. The recent history of repeated bailouts, coupled with the lengthy tradition of a central plan, has produced enormous moral hazard in the markets. The Hungarian and Czech Republic governments were willing to repeat their bailouts and recapitalize banks while accumulating public liabilities. The public liabilities that the Czech Republic amassed outside the budgetary system outweighed its low sovereign debt levels (Czech Republic, Ministry of Finance 1998).

The weak disciplinary effects of the international financial markets exacerbate the fiscal risks that governments in transition and emerging-market economies face. Markets that are small in size and have a short history and limited disclosure of information limit the understanding that investors have of the risks. This factor in part explains why in many emerging-market economies creditors have tolerated excessive risk exposure by domestic financial institutions and enterprises before fleeing. As economies integrate with the international markets, more reliable data become available for statistical analysis, a shift that enhances the ability of both governments and investors to estimate risks with standard methodologies. These countries also have insufficient capacity to manage risk, a capacity that is expensive to build (for instance, it is costly for governments to replace low-paid bureaucrats with financial analysts).

C. Hidden Fiscal Risks and the Value of Transparency and Certainty

Government commitments and promises outside the budgetary system blur the analysis of past fiscal performance and future fiscal developments. Contingent fiscal risks surface only after a delay and in the form of unexpected requirements for public financing. Usually governments lack information on particular fiscal risks and overall risk exposure. Often they are not held accountable for the outcomes and cost of their off-budget commitments. As a result, contingent fiscal risks may accumulate and require substantial government financing in the future. In only a few countries are the governments required to assess and compare the full cost of alternative budgetary and off-budget programs and to report all contingent liabilities and other fiscal risks. The United States and Italy provide some good examples of risk assessment of state guarantees, and New Zealand and Australia do the same for the reporting of contingent fiscal risks.

In making policy decisions, governments often face a tradeoff between directly providing and financing services or guaranteeing their provision by the private sector. The former requires higher budget outlays in the short term. Provision by the private sector, with the state guaranteeing certain outcomes, means minimal budget outlays in the short term but exposure to higher fiscal risks and uncertainty about future public financing requirements in the longer term. If a government is trying to reduce the deficit and achieve certain short-term results, provision by the private sector looks attractive. Once a contingent liability falls due and requires government financing, however, the government has limited choices: it can increase the deficit, incur additional public liabilities without reporting any increases in the deficit, cut some envisaged expenditures, levy more taxes, sell state assets, default on some obligations, or engage in some combination of these activities. Each of these actions challenges government performance and credibility, with an attendant reduction in the effectiveness of future policies, compromises political stability, and impairs future performance and growth in the overall economy.

In this respect, the positive value of certainty (the cost of uncertainty) about future public financing requirements is an important factor for government decisionmaking. Alternative forms of government support can be prioritized, not only based on their contribution to the desired policy objectives and long-term cost, but also to reflect the volatility of the financing requirement and contribution to the government's overall risk exposure.[6]

Certainty in public financing is particularly valuable to governments that have restricted or unreliable access to borrowing, low risk management capacities, low risk preferences, and strategic cash and debt management. Contingent liabilities are potentially very harmful for governments that cannot rely on continued favorable access to borrowing. Large reserve funds may reduce the potential harm from contingent liabilities when they fall due, but those funds come with an opportunity cost. Governments with low capacity to analyze and manage risks, and in economies where outcomes are less predictable and the asymmetry in information is greater, are ill-prepared to cope with the potential moral hazard and financial uncertainties.[7] Ideally government risk preference reflects the risk preference of the median voter. A risk-averse government chooses direct provision, whose expected financing requirement is less volatile, over a guarantee, even if both involve equal risk-adjusted net present fiscal costs and both would deliver equal policy outcomes. Finally, for governments with sophisticated and efficiently managed borrowing and financing strategies, an ad hoc financing requirement involves costly disruptions and efficiency losses.

D. Fiscal Opportunism Under Debt and Deficit Ceilings

As yet there are no internationally accepted criteria for fiscal performance to address contingent government outlays and encourage truly sound fiscal performance by governments and their fiscal stability in the long term. Meanwhile, the tradeoff between long-term fiscal stability and the target level for the budget deficit and debt, and between the quality of fiscal adjustment and the speed of deficit reduction, may surface through fiscal opportunism (a bias toward excessive accumulation of contingent fiscal risks) and nonsustainable policies.

Opportunistic behaviors by countries under IMF and World Bank programs and, more recently, by countries bidding for European Monetary Union membership indicate that a narrow focus on budget deficit and debt compels governments to delay structural reforms and investments, conceal the cost and financing of programs outside their budgets, and raise temporary revenues. Such behaviors generate

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6 In a multipillar pension system, the adequacy of government guarantees for returns from private pension funds depends on the analysis and assessment of the risks of guarantees and on the government's capacity to regulate and supervise private pension funds and to cope with the problem of asymmetric information without incurring high transaction costs. Where the government provides pension benefits directly, it can predict total government outlays, and it seeks mainly to balance the size of the benefits, retirement age, and contributions to make the pension provision fiscally sustainable. In the guaranteed portion of the pension system, citizens save for their retirement privately. However, the government faces a high level of uncertainty about the amounts and timing of public financing that would be required should the pension guarantees fall due.

7 Consistent with the conclusion in the 1997 *World Development Report*, that governments should adjust the extent of their interventions to the level of their institutional capacities, this paper argues that governments should adjust their overall risk exposure to the level of their risk management capacities.

uncertainties about future public financing requirements and may endanger future fiscal stability. A focus on a cash-based budget, deficits, and debt also distorts government decisions about spending priorities and the timing and form of government support.

Governments may employ a number of opportunistic budgetary and accounting behaviors to meet their deficit and debt targets (table 2). The behaviors involve any or all of three types of imprudent actions: assumption of excessive liabilities for cash payment, a running down of public assets, and excessive use of off-budget support in public policies. Governments doing their accounting on a cash basis have wide scope to apply the first two actions. In cash-based accounting, expenses and liabilities are accounted not when the obligation is incurred, but only when the government makes the actual cash transfer. Thus governments collecting a fee for assuming a liability (for example, when it issues a guarantee or accepts the pension liability of an enterprise under privatization) report the income as a net revenue gain. The third action occurs under both cash- and accrual-based accounting standards but is eschewed in well-designed accrual budgeting rules.

An accrual-based accounting system without accrual budgeting is neither necessary nor sufficient to ensure that governments adequately consider contingent fiscal risks in policy. Although this system encourages governments to prepare a statement of contingent liabilities and financial risks, it generally does not require that the liabilities be included in the balance sheet and that the associated risks be evaluated and quantified. International accrual accounting standards require that liabilities be accounted only when the obligation is due with certainty.[8]

Policymakers are encouraged to make choices consistent with the risk-adjusted net present costs of alternative policies and forms of government support in an accrual-based budgeting system that is built on an accrual-based accounting platform. Accrual-based budgeting requires that the net present fiscal cost associated with various government programs and contingent liabilities be included in budget documents. This way, contingent liabilities enter the fiscal analyses and public accountability frameworks from the moment government recognizes them.[9]

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[8] For a discussion of the rules of probability and risk assessment see International Federation of Accountants (1998).

[9] Accrual-based accounting in the public sector is the trend in countries in the Organisation for Economic Co-operation and Development. The International Federation of Accountants has proposed and elaborated accrual accounting standards for the public sector, and the proposed update of the IMF's Government Financial Statistics methodology implies accrual-based accounting. New Zealand and Iceland both have implemented accrual-based budgeting, and the United Kingdom, Sweden, the Netherlands, Canada, and Australia are doing so.

Table 2
Opportunistic Government Behaviors to Meet the Maastricht Deficit and Debt Ceilings

Behaviors	On the Revenue Side	On the Expenditure Side
That increase future payables and liabilities of the government	***To meet the deficit rule:*** • Introduce an ad hoc tax to be reimbursed in the future • Accept cash for a promise of future benefits • Record revenues gross rather than net of the reimbursements, which are due later • Exchange some existing public debt instruments for indexed bonds sold at a premium *To meet the debt rule:* • Transform indebted government agencies into autonomous legal entities outside the general government while granting them a state guarantee • Enter repurchase contracts with public debt	***To meet the deficit rule:*** • Postpone inescapable expenditures, such as infrastructure investment and maintenance • Favor off-budget forms of government support versus direct financing • Delay legal recognition and financing of government purchases and transfers • Postpone legal recognition and quantification of rebates due taxpayers • Record subsidies as purchases of (bad) assets from corporations and banks at face value • Record the deficits of state-owned and municipal agencies providing nonmarket public services outside general government figures ***To meet the debt rule:*** • Omit the existing net liabilities of public enterprises and agencies that are outside the sphere of general government but that benefit from government guarantees • Favor trade credit as a form of support • Exclude contingent liabilities from debt reports
That reduce future receivables	***To meet the deficit rule:*** • Withhold revenues due in the following fiscal year • Accept cash in exchange for future tax exemptions	
That dilute the value of state assets	***To meet the deficit rule:*** • Record the capital gains from a sale of property, possibly with a subsequent renting or lease-back arrangement • Charge a dividend from revaluation of the gold reserves of the central bank • Charge a higher dividend from public holdings ***To meet the debt rule:*** • Sell gold of the central bank • Sell state assets	***To meet the deficit rule:*** • Cut operations and maintenance expenditures • Reduce expenditures on complementary inputs into the service provided by the asset

IV. Understanding, Incentives, and Capacities to Reduce and Control Fiscal Risks

Contingent fiscal risks may significantly affect the results of a country's fiscal analysis. They may also be an important factor in assessing allocative efficiency in the use of public monies (the implicit subsidies and risk exposures relative to policy priorities). Finally, contingent and implicit forms of government support may not only be risky, but may also lessen the government's operational efficiency because they are unnecessarily costly compared to a direct, budgetary provision.

A first necessary condition for fiscally prudent policies is for policymakers to identify, classify, and understand the fiscal risks facing the government. Comprehension of the fiscal risks and their consequences will at least encourage the government to avoid risks that are bound to surface in a politically meaningful time horizon. For risks that extend beyond that timeframe, achievement of fiscally sound behavior may depend on coercion. In particular, policymakers are more likely to gravitate to fiscally sound decisions if the media, the public, investors, credit-rating agencies, and multilateral institutions understand the government's fiscal performance in its entirety and if there are sanctions when the government exposes the state to excessive risks and conceals those risks. (See the annex for a questionnaire to use in evaluating the problem of government fiscal risks and risk management in a country.)

Coercion as a means to discipline a government's fiscal behavior beyond the budget deficit and debt can be applied internally and externally. Internally, the principal audit institution can assess the direct and contingent fiscal risks of each government agency and of government as a whole and make the information public. Although voters do not necessarily care about government fiscal risk, public explanation of the fiscal risks by an independent State Audit Office would also empower the external forces of coercion. To be effective, external coercion should be used to ensure that the government applies the international rules for fiscal analysis not only to the budget and debt, but also to its contingent liabilities, and that it overcome the problem of asymmetric information. Specifically, external coercion would pressure the government to meet certain quality standards: the government must define, measure, and monitor fiscal performance in full, using sound indicators and methods as defined by international authorities such as the IMF, World Bank, European Commission, or sovereign credit rating agencies and investors, and it must develop adequate public finance institutions and disclose relevant information. Governments attempting to conceal data would be subject to sanctions.

The following sections discuss measures that a government can take to reduce its risk exposure and improve the quality of its fiscal performance. These measures apply at the policy and institutional levels, both systemically and at the various stages of government decisionmaking.[10]

[10] For policies and fiscal institutions to reduce public risks see Schick (1998) and Irwin (1997).

A. Systemic Measures to Reduce Fiscal Risks

The main aim of systemic measures (table 3) to encourage sound fiscal behavior is to improve the understanding of policymakers, the public, and the markets of the fiscal risks.

TABLE 3
SYSTEMIC MEASURES TO REDUCE FISCAL RISKS

Fiscal Policy	*Public Finance Institutions*
• Consider full fiscal performance beyond the budget and debt • Identify, classify, and analyze all fiscal risks in a single portfolio • Determine the government's optimal risk exposure and reserve policy according to its risk preference and risk management capacity	• Internalize and disclose the full fiscal picture • Monitor, regulate, and disclose the risks in the public and private sectors

1) Policy

To achieve sound fiscal performance, the government needs to include in its fiscal analysis and decisionmaking the fiscal risks relating to future possible obligations of the state and to consider those fiscal risks in the context of its risk preference, risk financing, and risk management capacities. The following steps are critical.

Consider fiscal performance in full, that is, beyond the budget and debt. Fiscal analysis, especially of the quality of fiscal adjustment, is complete only if it factors in the cost of the implicit subsidies in the government's contingent support programs. In particular, the government cannot separate the analysis of its fiscal position from the obligations it has undertaken outside the budget system. The arrears and other obligations of state-owned and guaranteed institutions, for example, may claim significant public resources in the future. Moreover, the government may have mismanaged some institutions to finance and implement its policies outside the budget system. A string of years with a balanced budget and low public debt suggests neither that the government has been fiscally prudent nor that there will be fiscal stability.

In deciding between alternative forms of support, the government needs to consider the medium-term fiscal impact and allocative and operational efficiency of programs pursued outside the budget to the same extent as with the budget. Medium-term fiscal forecasts, the budget itself, and government financing and borrowing plans are truly viable only if they provide for contingent and other fiscal risks.

For international institutions, such as the IMF and World Bank, it is time to extend the scope of their fiscal policy and institutional analysis to address contingent and implicit fiscal risks. Also, international institutions should assist countries to develop adequate analytical and institutional capacities, require countries to disclose information regarding their fiscal risks, and enforce limits on the countries' exposure to fiscal risks according to the countries' analytical and institutional capacities.

Identify, classify, and analyze all fiscal risks in a single portfolio. To understand and prepare for the entire range of potential fiscal pressures, policymakers will have to take stock of all programs and promises and identify and classify the main sources of fiscal risks, as shown in the fiscal risk matrix (table 1). For each item of the fiscal risk matrix and in order of significance, the government needs to analyze the risk factors and ways to control and reduce its exposure to the risks. Qualitative analysis of risks would help the government formulate and design sound new programs and promises.

The government should consolidate the stock of contingent liabilities into a single portfolio, along with state debt and other public liabilities, so that it can evaluate correlations, sensitivity to macroeconomic and policy scenarios, and overall risk exposure. A single portfolio allows the government to relate its contingent liabilities to its comprehensive risk strategy and guidelines regarding risk exposure, asset and liability management, hedging, and benchmarking. As an input into the analysis of risk exposure, the government would also analyze information about budget arrears, state guarantees, state insurance programs, subnational government borrowing, obligations of state-owned and state-guaranteed institutions, effects of private capital flows, and similar factors. In contrast to the deficit and debt constraints, indicators reflecting a comprehensive analysis of the government's exposure to fiscal risks would have greater predictive value for fiscal stability. (The forthcoming, more detailed version of this paper includes a fiscal risk analysis for several countries.)

Determine the government's optimal risk exposure and reserve policy based on its risk preference and risk management capacity. The government needs to base its risk and reserve strategy on its overall risk exposure, risk preference, and ability to manage risk and absorb contingent losses. Ideally, the risk strategy would be tied to the risk preference of the median voter. Similarly, the government would assess new programs based on their marginal impact on overall risk exposure and fiscal outlook. It would agree to further contingent and implicit forms of financial support only to the extent it is able to evaluate, regulate, control, and prevent the risks. If the government has a low capacity to evaluate and manage risks, the best approach is to favor direct subsidies and provision of services rather than guarantees. That is, assuming that the government's intervention in a particular area is justifiable, the government would opt for budgetary financing of its intervention rather than ensuring that particular outcomes will be delivered by the private sector. To this end the government has to enact guidelines for prudent and sound fiscal management (as discussed in the institutional section below).

Reserve funds provide liquidity for guarantees and other contingent liabilities and thereby protect the government against pressures to increase the deficit and debt, cut envisaged expenditures, or default on its obligations if a contingent liability falls due. There is a tradeoff between the opportunity cost of withholding resources instead of spending them or cutting taxes, on the one hand, and the benefits of a reserve fund in promoting fiscal stability and government credibility, on the other hand. A reserve fund offers the government more financial flexibility to deal with unexpected loss profiles if it sets the whole portfolio of fiscal risks centrally, rather than assigning a risk to each risk separately.[11]

2) Institutions

An institutional framework for public finance will encourage the government to pursue sound fiscal performance only if it encompasses both direct and contingent fiscal risks. A framework for public finance management that ignores the future fiscal implications of contingent liabilities and other off-

[11] Recently, Australia, Canada, and the United Kingdom have moved toward a central pool of unallocated, government-wide reserves.

budget commitments will only make such forms of government support look inexpensive and politically attractive.

An adequate institutional framework requires that the government treat any noncash program involving a contingent fiscal risk as it does other budgetary or debt items from the viewpoint of aggregate fiscal stability and allocative and technical efficiency, control, public disclosure, and accountability. Rules for issuing, monitoring, and handling state guarantees and insurance programs and for monitoring and financial management of public, state-guaranteed, and subnational government institutions are also needed. As the role of the state transforms from direct provision of services to guarantees against residual risks, governments need to follow the example of the private sector in deepening their capacities for fiscal analysis and management beyond the state budget and debt.

Internalize and disclose the full fiscal picture. The rules and practices applied in the budget process, financial management, and public accountability framework determine how much flexibility the government has to assume immediate and future direct and contingent nonbudgeted obligations. Optimally, government choices will reflect qualitative and, where possible, quantitative evaluation of the future outlays and risks associated with alternative forms of government support, including programs outside the budget such as guarantees and activities of state-guaranteed agencies.

To address the problem of government accountability and fiscal discipline outside the budget, public disclosure is more important than full-fledged accrual-based accounting, budgeting, and risk measurement systems. Particularly for governments with lower institutional capacities, the system should require them to assess risk factors, make rough provision for contingent risks in the budget, and publish a statement of contingent liabilities and overall risk exposure. Such a system is more sensible than the optimal institutional framework, which involves accrual-based accounting and budgeting standards and sophisticated risk measurement methodologies.

Accrual-based budgeting and accounting standards make the potential fiscal cost and hidden subsidies of contingent liabilities more transparent ex ante. In this context, quantitative risk analysis reveals the difference between the full risk premium, topped up by the cost of evaluating, managing, and monitoring risks, and the fees the government charges for assuming a particular obligation (for instance, the pension liabilities of a privatized enterprise, a guarantee, or state insurance) at the time the coverage is extended. By bringing off-budget commitments into the budget and recognizing the hidden subsidies associated with contingent forms of government support, the government better reveals the long-term cost and benefits of its commitments and enhances public scrutiny of the potential use of public monies.

Public disclosure of fiscal information extending beyond the budget and direct debt enables the public and markets to monitor the government's full fiscal performance, including the fiscal risks accumulated outside the budget. Market agents such as investors and credit rating agencies are then able to take both direct and contingent fiscal risks into account in their analysis and investment decisions. Their ability to do so in turn indirectly encourages budgetary and overall fiscal discipline. In addition, greater fiscal transparency facilitates parliamentary scrutiny and monitoring by the market, particularly by investors and sovereign credit rating agencies, and by international institutions such as the IMF, World Bank, and European Commission.[12]

Domestically, the government can promote both fiscal transparency and prudent government decisions by empowering the ministry of finance and principal audit institutions to monitor, control, and

[12] The IMF has outlined the requirements and good practices for fiscal transparency in its *Manual on Fiscal Transparency* (1998). The manual briefly discusses the transparency requirements for contingent fiscal risks.

publish the size of contingent liabilities and other fiscal risks, the extent to which the government's risk exposures conforms to its proclaimed objectives, and the efficiency of both direct and contingent forms of government support.

Monitor, regulate, and disclose fiscal risks to the public and private sectors. Governments reduce the fiscal risks when they strive to prevent market failures and minimize the moral hazard associated with their programs, commitments, and residual responsibility for market failures. To reduce moral hazard and failures in the markets, the government maintains regulatory and law enforcement systems, monitors the systemic risks in both the private and public sectors, and enforces transparency about the risk exposure of both financial and nonfinancial institutions in the markets. Well-developed regulatory and public disclosure systems are particularly important when government embarks on privatization while assuming an explicit or implicit obligation to cover residual liabilities and ensure that private agents achieve particular outcomes.

Prevention of fiscal risks depends on a combination of analytical tools, incentives, and the capacities of parliamentarians, civil servants, regulators, supervisors, international institutions, and market agents. Research is being conducted to derive simple rules to indicate the dangers to fiscal stability, using indicators such as the total face value of all contingent liabilities, the overall risk assumed by a government, the size and allocation of foreign private capital, and the accrual-based budget deficit. Potentially the best place to develop risk monitoring capacities is in the central bank, given its role in collecting balance-of-payments data and, in many instances, supervising banks. Specific regulatory and supervisory agencies such as the securities and exchange commissions may best handle the monitoring of specific risks. Ultimately, the ministry of finance and the office responsible for public liability management would handle the monitoring and prevention of the government's overall risk exposure.

Undertake measures to reduce the fiscal risk of individual government programs and promises. Whether the government's programs, promises, and exposure to fiscal risks are appropriate depends on their consistency with government policies and actions. The following aspects of consistency in particular influence a government's fiscal performance:

- Consistency of government programs and promises with the stated role and strategic priorities of the state
- Consistency in the eligibility and management standards applied across government programs over time
- Consistency of the risks assumed and reserves provisioned under a program with the risk management capacities of the government
- Consistency between the authority of policymakers to assume contingent fiscal risks and their accountability.

Table 4 summarizes the steps a government needs to take to control its fiscal risks before, when, and after it announces a program or promise.

TABLE 4
STEPS TO CONTROL THE RISK OF INDIVIDUAL GOVERNMENT PROGRAMS AND PROMISES

Measures	*Fiscal Policy*	*Public Finance Institutions*
Before government admits an obligation (program, commitment, promise of support)	• Assess how the obligation fits the announced role and strategic priorities of the state • Consider the choices of policies and forms of support with respect to associated financial risks and government risk management capacity • Define and communicate the standards for and limits of government involvement to minimize moral hazard	• Evaluate the program risks individually and in a single portfolio along with existing risks, estimate the potential fiscal cost of the obligation, and set an additional reserve requirement • Design the program to protect the government against risks
When the obligation is held	• Stick to the pre-set limits of government responsibility	• Budget, account, and disclose the obligation • Monitor the program risk factors and reserve-fund adequacy
After the obligation falls due	• Execute the obligation within its pre-set limits and identify the lessons for future policy choices • If implicit, assess whether fulfilling the obligation coincides with the state's announced role and promotes desired behaviors in the markets	• Compare and report the actual fiscal costs versus the estimates, evaluate performance, and impose sanctions for failures

B. Before Government Admits an Obligation

1) *Fiscal Policy*

Assess how the obligation fits the pronounced role and strategic priorities of the state. What types of support the government decides to offer both outside or through the budget define the actual role of the state. Therefore, programs outside as well as inside the budget should, in principle, be subject to the same type of policy analysis and consideration. In the case of contingent support programs such as guarantees for state institutions and funds, the government must consider whether their objectives fit within its announced role and priorities and whether they justify the potential, risk-adjusted, long-term fiscal costs.

Consider the choices of policies and forms of support relative to the associated financial risks and government's risk preference and risk management capacity. The quality of fiscal performance benefits when the government acknowledges the cost of uncertainty about future public financing requirements in considering alternative programs and forms of support for particular policy objectives. As with corporations, an unexpected requirement for financing disrupts financial planning and increases the cost of borrowing or, in a worse case, runs the risk that no credit financing is available. Governments need to evaluate alternative ways to implement their policies not only on the basis of their potential cost and benefits but also on the extent of the uncertainty they involve for future public financing. In addition, the government would judge contingent forms of support in terms of the extent of the asymmetric information and transaction costs. These considerations would be made in the context of the government's own risk preferences and risk management capacities and the reliability of its access to ad hoc borrowing.

Define and communicate the standards for and limits of government involvement to minimize the moral hazard. It is not so much the budgeted expenditures but the contingent liabilities, particularly the implicit ones, as understood by the public and markets, that define the outer limits of state responsibilities and affect the behavior of the public and market agents. The more formally and precisely the government defines and signals its responsibilities (its area of commitment), the more distinct are the explicit liabilities and the smaller are the implicit liabilities. The more credibly the government defines its responsibilities and the pain market agents will bear in cases of their failure and reliance on government rescue, the less is the problem of moral hazard. Take the example of a society where the government has a strong tradition of extensive public services. In such a case the central government may be expected to take over any obligations of subnational governments in troubles. Such an expectations raises a scope for moral hazard on the side of subnational governments. The central government can reduce the moral hazard by signaling that it will only ensure the delivery of core services to citizens of insolvent subnational governments. At the same time, it can state that it will not bail municipalities out from their debts and non-core expenditure obligations.

The particular task of government is to signal credibly what actions the markets should *not* expect of it in the case of various market failures. If these failures occur, the government will gain needed credibility and reduce moral hazard in the markets, and so curtail its fiscal risks, if it follows through on its stated policies and refuses to submit to pressures for alternative actions.

2) Institutions

Evaluate the risks of programs individually and in a single portfolio that also contains existing risks, estimate the potential fiscal cost of each obligation, and set additional reserve requirements. Qualitative analysis of the risk factors in alternative government programs and estimates of their potential long-term fiscal costs and hidden government subsidies prior to any commitment helps optimize the choice and design of government programs. Rough quantification of the risk and potential fiscal cost of government contingent liabilities and commitments requires good qualitative analysis of the underlying risks. Specialized methodologies such as option pricing, actuarial analysis, rate-setting, value-at-loss, and loss-cost ratio are of great value in deriving a more precise estimate of the potential costs of a particular program.[13] According to government reserve policy, the risk exposure of a proposed program added to overall government exposure determines the amount of additional resources that should go into the government reserve fund.

Design the program well to protect the government against risks. Based on the qualitative risk analysis, the government needs to identify those risks it can control reasonably well, decide which risks to

[13] Various types of risk, such as sovereign (political, legal, and regulatory), financial credit (foreign exchange rate, interest rate, and refinancing), and program performance (development, completion, and operating) compound the fiscal risks of government programs and promises involving both direct and contingent liabilities. For a more detailed analysis of the types of risk see Chase Manhattan Bank (1996). For methodologies to estimate potential fiscal costs see Mody and Lewis (1997), Mody and Patro (1996), United States, General Accounting Office (1997), and Penacchi (1997).

cover under its proposed program of contingent support, and develop effective risk-sharing, regulatory, and control mechanisms to monitor the performance of the parties under the program. Apart from exogenous risks such as drought, the government faces endogenous risks that are mainly a function of program design. A poor design can create varying levels of market distortion and moral hazard, whereas a good design can reduce the potential fiscal cost of the program. An example is a guarantee contract that covers only political and not commercial risks, only 30–50 percent of the value of the potential loss, and the last rather than the first portion of the loss. Programs that involve implementation by an intermediary agency that itself must be established, such as a guarantee fund of any sort, are more difficult to design, particularly in terms of management incentives and performance monitoring by the government.

For some programs, the government may charge a risk-based premium, purchase reinsurance from private firms, or contract out particular risk management functions.[14] It may cancel other programs altogether when it corrects market functioning through its regulatory policies. For example, deregulation of the insurance markets will encourage foreign insurance firms to enter the domestic markets and greatly expand the pooling of some risks so that the private sector can cover them. Risks related to disasters that are uninsurable in a domestic market because the risk pool is too limited become insurable in the integrated international market. The government can in turn end such programs as crop and flood insurance. For the largest financial risks, such as major banking and currency crises, it can be argued that the IMF, World Bank, and other multilateral agencies will provide governments with some kind of reinsurance.

C. When the Government Accepts and Holds an Obligation

1) Policy

Stick to the pre-set limits of government responsibilities. After the government approves a program or commitment, the main challenge is to ensure that the markets and public do not expect any state support beyond the announced limits over the life of the obligation. Any indication that the government might provide financial support beyond the announced limits will raise the moral hazard for and distort the behaviors of the parties potentially benefiting from the program.

2) Institutions

Budget, account, and disclose the obligation. On the institutional side, the government faces the challenge of budgeting, accounting and provisioning for, and disclosing the obligation adequately. How does it ensure that no unknown contingent liability appears only after it is triggered? For instance, the public finance law can state that an obligation is valid only if it was assessed, budgeted, accounted, and, above all, disclosed at the time of its adoption by government.

Monitor the program risk factors and reserve-fund adequacy. Over the life of an obligation, the government needs actively to monitor the program's risk factors, the performance of the agents under the program and, in this context, also the adequacy of its reserve funds. Monitoring of intermediary agencies,

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14 The ultimate responsibility for project risk evaluation and program design is probably best placed with the ministry of finance, which approves and disapproves any potential financial commitments of the government. The office for public debt management is likely the best equipped to analyze contingent fiscal risks and integrate them into a single public liability portfolio. It is also best placed to decide on hedging and other risk-control instruments. For examples of policies to protect the government against excessive risk exposure see Schick (1998) and Irwin and others (1997).

such as banks and various credit and guarantee funds that the state uses to implement its policy objectives and guarantees, is particularly important. If the government lacks a good monitoring capacity, it can contract this task out for a performance-based fee. The cost of monitoring and administering programs of contingent support may be relatively high and should be reflected in the ex-ante calculations of the potential fiscal cost of a program.

D. After a Liability Falls Due

1) Policy

Execute the obligation within its pre-set limits and identify lessons for future policy choices. It is critical that the government meet an obligation when it falls due within the stated limits, particularly in terms of the credibility of future announcements and the scope for future moral hazard in the markets. For instance, paying depositors more than the specified deposit insurance levels tells the markets that the government will submit easily to political pressure, tells depositors that banks offering higher yields are "safe," and tells the banking sector that excessive risks are worth taking.

By applying the lessons from its involvement with direct and contingent liabilities, both explicit and implicit, the government is able to adjust its role incrementally, rather than abruptly, in a crisis. A timely and credible explanation of any adjustment in the state's role that will affect future policy choices will prompt the public and market agents to adjust their expectations and behavior. For example, by explaining that the public pension scheme is not fiscally sustainable and that future governments will have to reduce the pension benefit significantly, the government influences the saving behavior of people in the labor force.

If an obligation is implicit, assess whether it coincides with the state's announced role and promotes desired market behaviors. When public interest groups or market agents suddenly call on the government to extend more support than was originally specified, policymakers need to ask whether extending that support coincides with its announced role and how it affects future behavior in the markets. The long-term damage to the government of acting upon an ad hoc request may sharply exceed the potential short-term benefit. Acting upon ad hoc requests may, however, be politically attractive, and the government is often able to find ways to improperly use financial institutions and funds outside the public sector to implement and finance its actions. Thus the public, investors, and international authorities need to monitor the government's responses to ad hoc claims of an implicit government liability and apply sanctions for fiscally irresponsible choices.

2) Institutions

Compare and report the estimated and actual cost of government support, evaluate performance, and apply sanctions for failures. The requirement that the government report and compare the ex-ante risk evaluation and actual layouts for a program is critical to government accountability. Performance evaluation applies to government departments and officials as well as to the parties under a program. Sanctions may involve government officials (the case where particular interests distorted the ex-ante risk analysis), the managers of state-guaranteed and intermediary agencies implementing the government's programs (such as for exposing the government to unnecessary and excessive risks), and the parties under the program (where they breached an agreement).

V. Conclusions

Governments are exposed to increasing fiscal risks and uncertainties as a result of the increasing volumes and volatility of private capital flows, the changing role of the state, which is shifting from direct provision and financing of services to guarantees for certain outcomes, biases in policy decisionmaking under fiscal constraints, and the moral hazard in the markets associated with expected state interventions. The fiscal risks are particularly large for transition and emerging-market economies, where market opacity and the danger of market failures are greater.

Governments face four types of fiscal risk: direct and contingent, each of which may be either explicit or implicit. Most government and fiscal analysts concentrate on direct liabilities (direct explicit, such as the public debt and government budget, and direct implicit such as future pension and social security liabilities). Recent international experience, however, indicates that significant fiscal instability may result from contingent liabilities (contingent explicit such as the obligations of state-guaranteed institutions and deposit insurance, and contingent implicit such as local government obligations, foreign credit of the domestic corporate and financial sectors, and banking failures).

Therefore, a study of government fiscal position cannot be separated from obligations taken by the government outside the budgetary system. Fiscal analysis and medium-term fiscal framework for countries must factor in the cost of implicit subsidies provided by the government in the forms of contingent support programs. For international institutions, such as the World Bank and IMF, it is time to (a) extend the scope of their fiscal, policy, and institutional analysis beyond the budget and debt; (b) require countries to disclose information about their contingent government risks; and (c) assist countries to reform their analytical, policy, and institutional public finance frameworks to address all major fiscal risks.

Critically important to long-term fiscal stability and equity is public recognition of the limits of the state's role and the associated direct and contingent fiscal risks. Public accountability of politicians and civil servants in areas beyond the state budget must be defined to promote prudent and efficient fiscal policies and management. Governments need to address the sources of fiscal risks in three ways: (a) by understanding existing and future fiscal risks and pursuing policies that foster appropriate fiscal adjustment; (b) by developing an institutional framework that involves adequate public disclosure and incentives with respect to fiscal risks, and that promotes fiscal prudence and equity in all government programs, including those extending support outside the budget system; and (c) by building and employing institutional capacities to evaluate, regulate, control, and prevent financial risks in both the public and private sectors.

This paper offers an analytical framework to study contingent liabilities and other fiscal risks of governments so that analysts can better assess the quality of fiscal adjustment and the fiscal outlook of a country. A more detailed version is forthcoming that expands on both the policy and institutional aspects associated with fiscal risks and uses the analytical framework to assess fiscal risk in several countries.

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VII. Annex

Public Liabilities
how Big a Problem in a Country? A Set of Questions

The Whole Picture: Coverage

1. What are the major risks to future fiscal stability? Fill in the table below with specific items. *These include direct borrowing, guarantees, and institutions that are covered by some type of government guarantee, state insurance programs, and all government commitments to spend or intervene financially in the future. In classifying the items, think of direct liabilities (obligations of the government in any event) and contingent liabilities (obligations of the government if a particular event occurs), each of which can be either explicit (defined by a law or contract) or implicit (broadly predetermined by public expectations and pressures by interest groups).*

Liabilities[a]	*Direct (obligation in any event)*	*Contingent (obligation if a particular event occurs)*
Explicit Government liability as recognized by law or contract	• Foreign and domestic sovereign borrowing (loans contracted and securities issued by the central government) • Expenditures by budget law • Budget expenditures legally binding in the long term (civil service salaries, civil service pensions)	• State guarantees for nonsovereign borrowing and obligations issued to subnational governments and public and private sector entities (development banks) • Umbrella state guarantees for various types of loans (mortgage loans, student loans, agriculture loans, small business loans) • Trade and exchange rate guarantees issued by the state • Guarantees on borrowing by a foreign sovereign state • State guarantees on private investments • State insurance schemes (deposit insurance, minimum returns from private pension funds, crop insurance, flood insurance, war-risk insurance)
Implicit A "moral" obligation of the government that mainly reflects public expectations and pressures by interest groups	• Future recurrent cost of public investment projects • Future public pensions (as opposed to civil service pensions) if not required by law • Social security schemes if not required by law • Future health care financing if not specified by law	• Umbrella default of a subnational government and public or private entity on nonguaranteed debt and other liabilities • Liability cleanup in entities under privatization • Banking failure (support beyond state insurance) • Investment failure of a nonguaranteed pension, employment, or social security fund (social protection of small investors) • Default of central bank on its obligations (foreign exchange contracts, currency defense, balance-of-payments stability) • Bailouts following a reversal in private capital flows • Residual environmental damage, disaster relief, military financing

[a] Of the fiscal authorities, not the central bank.

2. Is there a precise legal delineation of the public sector (for example, in the form of a full list of public sector agencies) and of government responsibilities? *If yes, note the definition and reference appropriate legal documents.*

Selected Risks

1. State-guaranteed institutions and directed credit

   - List all institutions that fulfill orders of the government to extend financing to enterprises, banks, agencies of any kind, or households. Provide their balance sheets and statements of contingent liabilities.
   - What type of government support do these institutions receive (for example, privatization revenues, cheap financing via the central bank, state guarantee for borrowings)? *Try to draw a diagram showing the institutions involved in directed credit and the financial and cross-supporting flows.*

2. Guarantees

   - List all government guarantees, their issuer (the ministry of finance or other government agency), beneficiaries, creditors, face values, the type of risks and their shares covered, currency of denomination, and risk estimates if any.

3. State-owned enterprises and banks

   - List all large state-owned enterprises and provide their audited balance sheets and statements of contingent liabilities.
   - List all large state-owned banks and provide their audited balance sheets, statements of contingent liabilities, and risk assessment of assets.

Recording and Reporting: Transparency

1. For each type of direct and contingent liabilities you identified in the table above, list the institutions responsible for final approval, recording, monitoring, and data consolidation.

2. Which institutions can instantaneously retrieve from their databases up-to-date figures for the items listed below? Which documents report such figures? What is the time lag in reporting:

   - Sovereign debt portfolio (break down according to maturities, currencies, and interest rate types)
   - Debt service profile for the next months and years?
   - Guarantee portfolio (breakdown according to guaranteed institutions, sectors, currencies)?
   - Total face value of all state guarantees?
   - Total sizes of state insurance schemes?
   - Total sizes of reserve funds associated with guarantees and state insurance schemes?
   - Private foreign and domestic borrowing?
   - Sector allocation of foreign credit?

2. Which sources of fiscal risks are, in your view, *not* reported to the:

- Ministry of finance
- Cabinet
- Central bank
- Parliament
- Foreign investors
- Public.

Institutional Arrangements: Accountability

1. Are there any legal requirements that the government estimate, account, and report the *future* fiscal costs associated with its budgetary policies and off-budget promises (such as guarantees and other contingent liabilities)?
   No
   Yes— in the budget process
   when the government is called on to pay
   when cash is transferred
   other

2. Which of the liabilities that you identified in the table are *not* regulated by any law and depend fully on ad hoc government decisions?

3. Describe or provide references for:

   - State guarantees: the requirements for their design (the type of risks that can be covered, the extent of required risk-sharing), issuance (is only the ministry of finance authorized?), government control mechanism (required reports from the creditor and beneficiary, audit and valuation requirements), and realization mechanism if they fall due
   - Subnational governments, public sector agencies and enterprises, and state-guaranteed institutions: the financial management and reporting requirements and government control mechanism
   - Demands on the government to extend ad hoc, previously unforeseen financial support: the legal requirements and practice for deliberation in government decisionmaking.

4. Is the government legally required to explain the amounts of public liabilities?
   No
   Yes— to the Parliament
   to the public
   other

Policy: Practice

1. When considering alternative policy choices and forms of government support (such as direct provision and financing versus guarantees), do the ministry of finance, cabinet, central bank or parliament

   - Quantify the future fiscal cost of alternative options in a single medium-term fiscal framework?
   - Describe the risks of alternative options?

2. In which areas and under what circumstances do the public or interest groups expect the government to provide financial support beyond the budget?

3. List examples when the government withstood political pressure and did *not* provide financial support beyond the budgeted figures (for example, when the government refused to solicit financial support for a failed enterprise or bank).

4. Are public enterprises and banks, state-guaranteed institutions, and creditors and beneficiaries under state guarantees "rewarded" and "punished" for the quality of their management of risk? *Provide examples.*

Risk Management: Capacities

1. Describe the capacities of the ministry of finance, other government agencies, public sector institutions and enterprises, and state-guaranteed institutions to evaluate and control the risks of government programs and contingent liabilities.

2. Describe the process of designing a state guarantee or state insurance program.

3. How is the required size of the government reserve fund determined?

3. What steps do the ministry of finance and other agencies undertake to *prevent* fiscal risks arising from the public and private sectors (for example, are any actions taken if enterprise debt or central bank obligations appear too high)?

MANAGING FISCAL RISK IN BULGARIA

by

Hana Polackova, Sergei Shatalov and Leila Zlaoui

The World Bank

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1. Introduction

International evidence has confirmed again and again that fiscal analysis is incomplete if it skips over "hidden" fiscal risks, such as obligations made by the government outside the budget. First, as Kharas and Mishra (1999) explain, analyses of past increases in the stock of government debt have shown that governments often accumulate debt as a result of "hidden deficits" rather than reported budget deficits. Hidden deficits mainly arise from debt structure, as currency, maturity or interest rate risks materialize, and from off-budget government obligations, such as contingent liabilities that fall due. Most recently, some of the fiscal pressures that have emerged from the East Asian crisis can be attributed to the fiscal risks due to the governments' contingent liabilities (World Bank, 1999).

Second, any changes in the reported budget deficit are an illusion if they are accompanied by offsetting changes in the value of public assets and in the country's exposure to fiscal risks, such as government contingent liabilities (Easterly, 1998). Furthermore, as Selowsky (1998) emphasizes, reported deficit improvements do not necessarily imply "quality" of fiscal adjustment, which has the dimension of sustainability as well as efficiency. Narrow interests in reducing budget deficit may actually increase rather than reduce government exposure to fiscal risks, and deteriorate rather than improve the prospects of future fiscal performance.

Third, the conventional approach to the analysis of deficit sustainability is limited in two ways: it looks only at the liability side of the public sector balance sheet and it considers only direct liabilities, ignoring contingent liabilities, both explicit and implicit.[1] In this context, fiscal vulnerability is defined by Hemming (1999) as a situation where the government is exposed to the possibility of failure to achieve its broad fiscal policy objectives. It is concerned in particular with the emergence of unexpected fiscal risks and policy challenges and with the government's capacity to respond to them. Fiscal vulnerability takes into account: (a) the initial fiscal position (including the central government budget, other levels of government, extrabudgetary funds and quasi-fiscal activities, assets and liabilities, contingent liabilities, fiscal indicators), (b) sensitivity of the fiscal position to short-term risks, such as macroeconomic volatility, called contingent liabilities, and unclear expenditure commitments, (c) medium- and long-term fiscal sustainability (debt dynamics, baseline projection and stress testing, and long-term pressures from demographic trends, resource depletion, etc.), and (d) strucutural or institutional weaknesses (expenditure composition, revenue system, deficit financing, government access to debt markets, institutional capacity for fiscal management).

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1 Under the conventional approach, the actual deficit is compared with the estimated sustainable deficit level that will keep the debt to GDP ratio constant for feasible rates of growth, real interest, and inflation. This approach assumes that keeping a constant ratio of public debt to GDP will ensure public sector solvency and avoid debt crises in the future. Another, less stringent requirement is to test for the no–Ponzi scheme condition for public debt, followed up by the neoclassical solvency approach. This methodology checks for public solvency by comparing the ratio of public debt to GDP with the real interest rate. If the debt ratio systematically grows faster than the real interest rate, the public sector is considered insolvent. For background on fiscal sustainability analysis, see Anand (1988, 1989, and 1990).

Analysis of fiscal risks becomes increasingly important. Reasons include increasing volumes and volatility of private capital flows, transformation of the state from financing of services to guaranteeing particular outcomes, and related to both of these, moral hazards in the markets, and fiscal opportunism of policy makers. Fiscal risks become particularly threatening in countries with a limited scope for maneuver in government financing. Limited access to debt market and constraints on the use of monetary policy instruments reduce the amount of fiscal risks that governments "safely" take on.

Bulgaria's ability to absorb fiscal risks is limited. Currency board arrangement, limited access to debt markets, already high levels of tax revenues, and a large share of nondiscretionary expenditures severely constrain the scope for government maneuver in cases when fiscal risks materialize. The country is recovering from years of macroeconomic instability, high inflation and currency crisis. Its economy is still fragile and realization of fiscal risks thus may have very serious consequences for the country's economic and social development as well as fiscal performance. The objective of accession to the European Union also demands the government to maintain all fiscal risks under a very tight control while accommodating substantial infrastructure and environmental investment to achieve high growth and/or meet accession requirements. With already high level of indebtedness, Bulgaria faces a difficult trade-off. Should Bulgaria adopt a very conservative stance towards debt and fiscal risk at the expense of investment and growth or rather accept a slower pace of dis-indebtedness and guarantee the resources needed for economic restructuring and mitigation of the impact on the poor and vulnerable? So far, Bulgaria has been successful in reducing its debt burden while relying on high levels of fiscal reserves as a main contingency instrument. Its future investment and developmental agenda, however, call for a more optimal mix of fiscal reserve, debt management and risk mitigation strategies.

The objective of this paper is to present a systematic analysis of fiscal risks in Bulgaria and advise on risk monitoring, assessment, management and mitigation strategies. The paper is divided into four sections. After this introduction we present a simple framework, the Fiscal Risk Matrix, to identify and classify Bulgaria's fiscal risks. We set our analysis of fiscal risks in a broader macroeconomic and institutional background, leaning toward assessment of Bulgaria's overall risk exposure and fiscal vulnerability. Section II offers analysis of the individual sources of fiscal risk in Bulgaria. We analyze the size, probability and sensitivity of risks arising from direct and contingent, both explicit and implicit government liabilities. Section III outlines our recommendations for Bulgaria to strengthen its fiscal risk management framework and debt management policy. We offer a set of immediate and medium-term measures to contain some of the main sources of fiscal risk. Furthermore, building on country experience with medium-term expenditure framework (Campos and Pradhan, 1996), we develop a broader medium-term fiscal framework, as an institutional arrangement for country fiscal management. Finally, we summarize our findings in section IV.

I. Is Bulgaria Exposed to Fiscal Risks?

1. Bulgaria's Fiscal Risk Matrix

As in Polackova (1998) we focus on fiscal risks emerging from government obligations of four types: direct explicit, direct implicit, contingent explicit and contingent implicit (table 1). Government *direct explicit liabilities* are specific obligations that will fall due with certainty and are defined by law or contract. They are the subject of traditional fiscal analysis and, in Bulgaria, particularly include sovereign debt service and, in the long term, legally mandated pension and health expenditures. Government *direct implicit liabilities* represent a moral obligation or political, rather than legal, burden on the government that will occur with certainty. They often arise as a presumed consequence of public expenditure policies in the longer term. In Bulgaria, the largest are accumulated and expected public investment needs to deliver anticipated public services and meet key requirements for accession to the European Union. *Explicit contingent liabilities* represent government's legal obligations to make a payment only if a particular event occurs. In Bulgaria, state guarantees for nonsovereign borrowing and obligations for past environment damages are the main examples of this type of government obligation. *Implicit contingent liabilities* are those that are not officially recognized until a failure occurs. The triggering event, the value at risk, and the required size of the government outlay are uncertain.

Table 1 Bulgaria's Fiscal Risk Matrix

Sources of fiscal risk	*Direct* *(obligation in any event)*	*Contingent* *(obligation if a particular event occurs)*
Explicit Government obligation is recognized by law or contract	• Foreign and domestic sovereign debt (size and structure) • Future pension expenditures required by law • Health expenditures required by law	• Individual state guarantees for nonsovereign borrowing and obligations • Obligation to recover past environment damages assumed in enterprise privatization and other environment liabilities • Obligations of business promotion bank • Obligations of export insurance agency (insurance policies to cover political and medium-term commercial risks) • Obligations of state fund for agriculture
Implicit A "moral" obligation of the government that mainly reflects public expectations and pressures by interest groups	• Accumulated and expected public investment needs to sustain delivery of public services and meet key requirements for accession to the EU • Future recurrent costs of public investment projects	• Environment commitments for still unknown damages and nuclear and toxic waste • Clean up of enterprise arrears and liabilities • Default of municipalities on own non-guaranteed debt, own guarantees, and/or own obligations to provide critical public services • Support to the banking sector in case of crisis

Obligations listed above refer to the fiscal authorities, not the central bank.

Government exposure to risks is not negligible

Bulgaria's future fiscal position may suffer from short-term shocks arising from fiscal risks identified in the Fiscal Risk Matrix. *Structure and size of Bulgaria's sovereign debt* are somewhat worrisome. Even after the 1992-94 successful restructuring, Bulgaria remains one of the most heavily indebted countries of Central and Eastern Europe. High debt levels remain a significant source of fiscal vulnerability, threatening the country creditworthiness, and impeding Bulgaria's access to international financial markets.

Of the 83 percent of GDP of public debt, about 90 percent is foreign, nearly a half in Brady bonds and the rest mostly owed to international financial institutions. Most debt instruments are long-term, with a floating interest rate, and denominated in US dollars. The external debt service ratio is projected to remain within a manageable, but rather high range of 20-22 percent of exports of goods and services[2]. The debt structure is rigid and implies

2 Traditionally, a debt service ratio of 25 percent or higher is considered to be a fairly reliable predictor of debt crisis. Bulgaria's debt service ratio is below this crisis warning threshold, but is still rather high; further sections of this paper suggest that adverse developments could hike the debt service ratio above the 25 percent warning threshold.

significant refinancing risk. Bulgaria has not regained reliable capital market access and faces volatility of investors' preference. Integrated asset and liability framework indicates that currency risk is on average naturally hedged by dollar-denominated exports but is significant with regards to short-term exchange rate movements. Interest rate risk is also substantial. One percentage point rise in the international interest rates (Libor) would translate into an additional 70-80 million US dollars in annual debt service over 2000-2004. Stress-testing interest rate indicates that a 3 percentage points rise in Libor would bring Bulgaria's debt service ratio above 25 percent of exports – a level that often serves as a crisis warning indicator.

Other risks to fiscal stability in Bulgaria are mainly associated with the remaining transition process and with the cost of economic and social restructuring. Potential fiscal pressure may particularly arise from the financial and *environmental liabilities* of state-owned enterprises that the government may have to assume during restructuring, privatization or liquidation of enterprises. Part of these liabilities have already been made explicit, others are still unknown.

Environment, together with the country's infrastructure network and energy sector, also stands for a large amount of *investments required* in the context of Bulgaria's accession to the European Union. Overall environmental expenditures are expected to reach about US$8.5 billion, that is 69 percent of 1999 GDP, by 2015, implying an approximate US$0.5 billion per year in annual public investment expenditure. The Bulgarian government public investment program for 2000-2006 envisages an annual disbursement of US$ 400 (3 percent of GDP in 2000) million for environmental projects. With public investment projected at about 3.5 percent of GDP in 2000 and the years ahead, the need for investment in infrastructure, institutional capacity and social welfare is likely to result in significant fiscal pressures. Hence, Bulgaria's development and progress toward the EU accession will rely on the availability of concessional financing and on private sector participation. Private sector participation as well as loans from Internal Financial Institutions may demand government guarantees. Refraining from providing guarantees would entail developmental costs. On the other hand, generous and imprudent guarantee policy would generate moral hazard in the markets and fiscal threats to the government.

In the medium term, the government faces a trend of *increasing pension and health spending*, possibly averted by the proposed reforms. Both pension and health reforms, however, may generate significant transition cost. With reform, the government is likely to face around 2 percent of GDP of increased deficits on its pension account by 2001. Without reform, pension deficits are projected up to 2.7 percent of GDP. Total health expenditures are expected to increase from 4 to above 6 percent of GDP during 1999-2001. With reform, a newly established Health Insurance Fund is expected to mobilize about 1.5 percent of GDP directly from individuals and employers (offset by a reduction in funds collected by the National Social Security Institute). These reforms, however, will alleviate the state budget only after better institutional capacities to collect pension and health contributions are in place. Currently several institutions are involved in the collection of taxes and social contributions and the government wants to establish by mid-2000 a single revenue collection agency centralizing collection and control functions.

As for contingent liabilities, unlike in most other EU accession countries Bulgaria's risk exposure is relatively modest, though not unsubstantial. The government has applied prudent limits and regulations for *state guarantees.* Presently, the government reports the stock of guarantees of about 17 percent of GDP. Of these obligations, 9 percent of GDP is de facto direct debt owed to the IMF. Government obligation for almost 4 percent of GDP of domestic guaranteed debt expires in April 2000. Calls on the remaining guarantees, which currently amount to about 4 percent of GDP, however, could cause uncomfortable fiscal losses during 2000-2004. In addition, for private sector development purposes, the government guarantees *obligations of agencies,* like the State Fund for Agriculture, the Export Insurance Agency, and the Business Promotion Bank. These are small so far. As Bulgaria's creditworthiness remains weak, also the country's private non-guaranteed debt is very low.

Pressure on the government to provide guarantees and other forms of off-budget support, through the various existing and new state-guaranteed agencies, is likely to increase as the economy recovers, private investors substitute for public investment in agriculture, commercial banks continue to abstain from providing long-term credit, and foreign creditors fear of uncertainties.

In the *financial sector,* the 1996-97 hyperinflation, crisis, and subsequent policy actions by the Bulgarian National Bank have effectively cleaned up the banking sector. The ensuing reform has successfully capped both explicit and implicit government obligations for lost deposits and failed banks. Since then, an improved supervision has controlled exposure of banks to liquidity and interest rate risks. The quality of bank's loan portfolio and foreign exchange exposure cause concern but not a significant fiscal risk so far.

Government *institutional arrangements* for managing fiscal risks are strong in many aspects but not totally reassuring. Parliamentary scrutiny over contingent liabilities and public disclosure of their aggregate levels is good. Future fiscal pressures may, however, arise from legal loopholes or from the government practice to cover all risks under every guarantee, which insures both creditors and debtors against their possible failures. Finally, the government *capacity* to analyze, mitigate and manage risk needs to be enhanced. The government is presently not fully aware about the size and urgency of its risk exposure. And, without implementing new approaches, such as public-private risk sharing mechanisms, contingent liabilities may have negative consequences for the markets as well as for future government budgets.

2. Why Fiscal Vulnerability

What will be the government's capacity to respond to the realization of fiscal risks in the future? Building on Hemming (1999), in this section we briefly sketch Bulgaria's fiscal position, its sensitivity to risks, and sources of risks.

Current fiscal position appears good

Bulgaria's *current fiscal position* has been held in check following the introduction of a currency board arrangement in 1997[3]. General government budget deficit dropped from 12 percent of GDP in 1996 to 2.5 percent in 1997. In 1998, the budget registered a surplus of 0.9 percent of GDP and in 1999, despite the slow-down of growth due to the Kosovo crisis, deficit is expected to stay below 1.5 percent of GDP.

Recent revenue performance has been strong and resilient to the economic shocks that have marked the 1998-99 period (the Russian and Kosovo crises). General government revenues increased from 31.7 percent of GDP in 1997 to 36.8 percent of GDP in 1998 and an estimated 38 percent of GDP in 1999. General government expenditures, however, are also on the rise. For 1999, they are projected to reach 39.5 percent of GDP, up from 35.8 percent in 1998, recovering from their collapse during the 1996-97 crisis. Leading this trend, social expenditures have increased by 1.8 percentage point, while wages and contingency to pay for the cost of structural reforms by 0.8 and 0.7 percentage points, respectively.

Beyond general government budgets, Bulgaria's fiscal position does not suffer from any imminent major pressures either. The Currency Board Arrangement (CBA)[4] precludes the National Bank from engaging in quasi-fiscal activities. The number of extrabudgetary funds declined from over 1000 in 1998 to 28 in 1999. We limit our analysis here to the largest ones, the Pension Fund, Health Fund and Agricultural Fund. Though these funds are rife with fiscal risks, which we will discuss in the following section, their positions appear balanced so far.

Medium-term and long-term sustainability is at moderate risk. Bulgaria's fiscal framework presented in Annex 1 as well as debt dynamics, which we will illustrate later, suggests relatively stable baseline. Main fiscal pressures come from debt service payments and transitional costs associated with the implementation of the health and pension reforms. In the baseline, debt service payments will remain substantial at about 20-220 percent of exports of goods and services, growing to about US$1.4 billion per annum by 2004. The pension deficit

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3 Annex 1 presents Bulgaria's fiscal framework for 1997-2002, including the main revenue and expenditure items as well as the projected deficit and its financing.

4 Introduced after a spell of large deficits and hyperinflation in July 1997, the currency board arrangement came as a response to several unsuccessful money-based stabilization attempts and to widespread lack of financial discipline of large state-owned enterprises and financial institutions as well as budgetary agencies. CBA was meant to stop a vicious circle of government subsidies and soft commercial bank financing, that have kept loss-making enterprises afloat. The arrangement has fixed the domestic currency, lev (BGL), to the German mark, and prescribed full coverage of the monetary base with foreign reserves. Furthermore, it cut off central bank credit to both the government and the banking sector. Since January 1, 1999, the lev is fixed to the Euro at the same rate as the DM peg to the Euro. In addition, the original rate BGL1000/DM was changed on July 5, 1999 when three zeros were removed, the denomination became BGN, and the peg 1BGN per 1DM. Under the June 1997 law, the Bulgarian National Bank is not allowed to extend credit to the State or any state agency except against purchase of special drawing rights from the IMF. Similarly, the Bulgarian National Bank (BNB) is forbidden to extend credit to banks, except under very strict conditions in its narrowly defined role of lender of last resort.

and health expenditures increase by 2 and 1 percent of GDP, respectively, between 1999 and 2001.

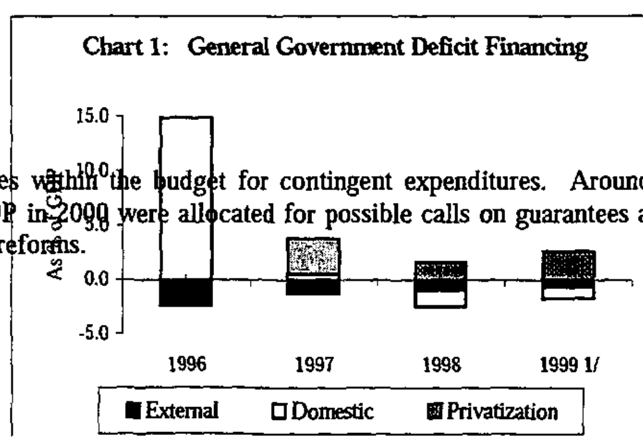
The government has committed to a fiscally responsible behavior. Under its IMF supported program and with EU accession objective, the government intends not to run deficits in excess of 3 percent of GDP and in the medium term reduce its debt to GDP ratio below 60 percent (thus comply with the Maastricht deficit and debt criteria). Furthermore, the government aims at keeping the debt service below 25 percent of exports and 30 percent of fiscal revenues, at pursuing market risk benchmarks in its debt portfolio, and at cushioning possible future shocks with large reserves.

In line with the requirements of a currency board arrangement, Bulgaria has maintained comfortable levels of both external (central bank) and fiscal reserves. External reserves have exceeded the equivalent of six months of imports of goods and non-factor services. On its Fiscal Reserves Account (FRA), which consists of the balances of all government budgetary and extra-budgetary accounts in the banking sector, the government maintains certain floor throughout the fiscal year. This floor which exceeded 8 percent of GDP at the end of 1998 is the main contingency instrument to address selected fiscal risks. The floor on the FRA can be adjusted to accommodate larger than expected structural reform-related contingent expenditures, higher than projected interest payments or shortfall of official financing relative to program projections[5]. Large reserves impose, however, opportunity cost of investment and growth. As we will discuss further, only major improvements in risk mitigation and risk management capacity would reduce the reserve requirement, opening a way toward a more optimal mix of reserve and hedging strategy and releasing resources for investment.

Room to accommodate fiscal risk is, however, limited

A combination of factors explains why Bulgaria's fiscal position is less resilient to fiscal risks than it appears from the analysis of the current fiscal position. First, while the CBA is very effective in achieving fiscal stability, it does by definition reduce the range of options otherwise available for deficit financing, and therefore the scope for fiscal expansion or for accommodating sudden expenditure hikes due to the materialization of unaccounted for fiscal risks. Out of the four possibilities that are available to most countries in financing their public sector deficit (printing money, running down foreign reserves, and foreign and domestic government borrowing), the CBA rules out the former two. Foreign and domestic borrowing, along with exceptional proceeds such as privatization revenues, thus remain the only means of deficit financing and of raising money to face sudden shocks.

Following the CBA adoption, the main source of deficit financing shifted from the domestic banking system (on a net basis) to privatization revenues (chart 1). High negative net domestic financing in 1998-99



5 In addition, the government allocates resources within the budget for contingent expenditures. Around 1 percent of GDP in 1999 and 1.2 percent of GDP in 2000 were allocated for possible calls on guarantees and implementation problems of pension and health reforms.

reflects the amortization of past bonds. Net external financing also shows a negative transfer of 1.3 percent of GDP in 1997 declining to 0.7 percent in 1999. In 1998, the overall balance registered a surplus equivalent to 0.9 percent of GDP. Privatization receipts contributed to 68 percent of the overall financing while net domestic and external financing were negative. A deficit of 1.5 percent of GDP is projected for 1999 while privatization receipts are expected to approximate 2.6 percent of GDP, comfortably covering the financing needs. Privatization receipts cannot be used for current budgetary expenditures. They enter the fiscal reserve account and can be used for debt repayments and investment financing. The privatization receipts of the municipalities can be used for ecological projects, investment debt repayments or writing off non-performing loans of municipality-owned enterprises.

As the privatization process comes close to an end, revenues from the sale of state-owned enterprises will fall down. The largest and most profitable state-owned enterprises have already been or are now being privatized. Further sizeable revenues could be expected from the privatization of BTC (Bulgaria telecommunications company), Bulgartabac (tobacco company), Bulbank (the largest state-owned bank) and several power distribution companies in 2000-01, after which the scope for raising substantial revenues from privatization shrinks. This may raise questions about the availability of resources for debt payment and investment financing.

Second, in responding to shocks, the government faces a constraint on both the revenue and expenditure side. With revenues at about 38 percent of GDP in 1999 and a bias toward payroll tax, further increase in tax rates would damage investment and growth. Actually, the main fiscal policy objective is to broaden the tax base and strengthen collection in order to lower tax rates on labor and income.

Social security contributions rates have remained high at (depending on workers categories), 49.7, 44.7 and 34.7 percent of gross wages, paid by the employers, with additional 1 percent (deductible from the personal income tax) paid by employees. The combined corporate tax rate arising from profit tax and municipal tax is 34.5 percent (a reduced 26-percent rate applies to small enterprises). The value added tax rate is 20 percent. Social insurance contributions generate about 8.5 percent of GDP, similarly as the value-added tax. Non-tax revenues, such as municipal fees, various levies, and income from rented properties generate additional 6 percent of GDP. Reflecting trade liberalization, excise and custom duties account for less than 5 percent of GDP. Positive institutional developments, such as improvement in tax administration have contributed to stronger revenue performance in most areas.

The structure of government expenditure is rigid. At around 39 percent of GDP in 1999, government expenditures are dominated by social protection programs, debt service, and wages. Pensions and other social outlays account for 13 percent of GDP and wages for over 5 percent of GDP. Interest payments now exceed 5 percent of GDP. Necessary maintenance and operating expenditure are projected at around 5 percent of GDP. This comes up to about 30 percent of GDP, leaving about 7 percent of GDP in total for defense and capital expenditure in 1999.

Experience of the last years has shown that in case of emergency the government avails of instruments for a temporary reduction of spending. The annual budget law provisions impose consistency between spending and revenue flows-- in the course of the year only 90 percent disbursement on expenses is allowed, only if revenues perform as expected, is spending allowed to increase up to 100 percent of the Budget Law. The law also explicitly states the priorities in case of lower than expected revenue flows. While these provisions appear effective to reach deficit targets, expenditure cuts, as a possible response to shocks, or to accommodate higher investment levels will be difficult to make without a thorough and detailed analysis to prioritize expenditure and identify efficiency gains.

II. Analysis of Individual Sources of Risk

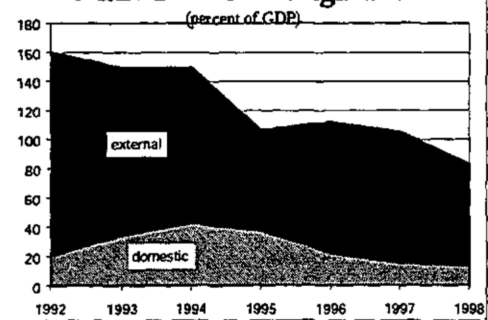
This section evaluates fiscal risks that emerge in the form of direct and contingent, both explicit and implicit liabilities of the central government. In this context, we define risk broadly, as elements involving uncertain fiscal cost (hence contingent liabilities for instance) and as variability in the effective cost of government obligations and in the associated financial flows.

1. Direct explicit Risk

Sovereign debt poses medium-term fiscal risk

Trends in government debt appear reassuring. Until recently, Bulgaria's government debt was a major obstacle to growth and investment. External debt exceeded US$10 billion, or 57 percent of GDP, in 1990. As the cost of debt service had risen above Bulgaria's perceived capacity to pay, the government announced a unilateral moratorium on debt service payments. In the following years, output collapsed, and sovereign debt to GDP skyrocketed to 150 percent of GDP. Restructuring of debt to the Paris Club in 1992 and London Club in 1994 eased the external debt burden by 33 percent of GDP. Domestic debt, however, had been rising swiftly, as the government borrowed to prepare state-owned enterprises for privatization, and to bail out failing banks. Bulgaria was unable to access international capital markets, and its official lending has been limited ever since. Striving to return its debt below the Maastricht threshold of 60 percent of GDP, the government generated sizeable primary surpluses of 6.4 percent of GDP annually over 1994-1999, reducing its debt to 82 percent of GDP in 1998 (chart 2). This level on gross basis, as well as 59 percent of GDP on net basis is still among the highest of the EU accession countries.

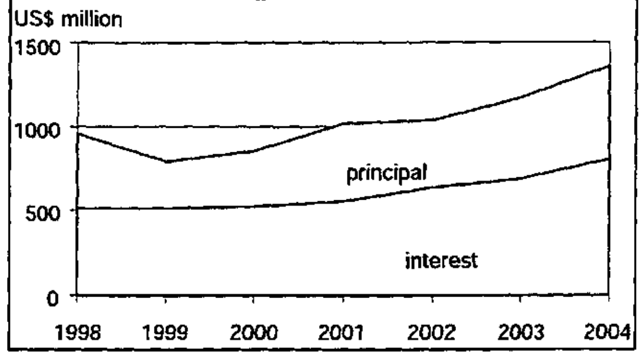
Chart 2 Sovereign debt



As Bulgaria had to regularize its relations with its external creditors, it had to cope with a negative transfer of resources, that averaged 5 percent of GDP during 1994-1998. Meanwhile, the budget deficit was financed from domestic sources. Domestic deficit financing averaged 6.7 percent of GDP annually during 1994-1995, peaking at 14.9 percent of GDP in 1996. Investors' confidence eroded quickly, and average maturity of the of Treasury bills collapsed from ten months to mere two weeks at the peak of the crisis.

Introduction of the CBA brought confidence back. The burden of interest payments eased to around 5 percent of GDP, but foreign debt service is projected to remain substantial[6]. In absolute terms it is expected to exceed US$1 billion in 2001 and stabilize at about 21-22% of exports of goods and services (Chart 3). This level is uncomfortably close to the empirical crisis threshold of 25 percent and will continue to constrain Bulgaria's flexibility in the use of debt financing to dampen fiscal shocks.

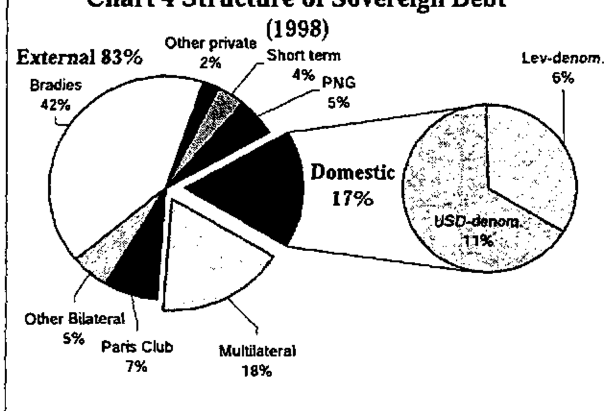
Chart 3. Projected external debt service



Since the introduction of the CBA, the government has been cautious in its borrowing policies. It prudently refused repeated offers from the commercial creditors in the Eurobond market in 1998. Aftershocks of the Russian and Kosovo crises that have shifted the yield curve substantially upwards in 1999 prove that this prudent stance was well grounded. Net financing from the domestic market has been negative since mid-1998, while the external debt has been reduced by two successful debt buyback operations in 1998-99 at deep discounts. The total face value of debt eliminated via buybacks is estimated at well over US$1 billion. Bulgaria was rewarded for its responsible borrowing strategy by a 1999 rating upgrade (to B+) and by a steady increase in the average maturity of the Treasury bills from 13 to 21 months as of end-1999.

Debt structure has stabilized but remains rigid. The share of foreign debt dropped briefly after the Paris and London Club restructuring deals. Rapid erosion of the value of domestic currency during 1995-1997, however, wiped out the lev-denominated debt and brought the external debt burden back to unsustainable level of 90 percent of GDP. The 1998 share of domestic debt was 17 percent of the total public debt, with about two thirds (mainly associated with the realization of past contingent government liabilities) denominated in the US dollar. The remaining one third of the domestic debt is in Treasury bills (Chart 4). The share of foreign and domestic debt denominated in US dollar is about two thirds of the total debt in 1999. Brady bonds dominate the foreign debt portfolio followed by debt owed to international financial institutions. Most debt instruments have long maturity. Current financing constraint makes it difficult to change the debt structure and improve the risk structure of the debt portfolio.

Chart 4 Structure of Sovereign Debt (1998)



6 Projections include new identified borrowing and gapfill financing. Source: IMF staff estimates.

Integrated asset and liability framework reveals substantial exposure to several risks. Integrated asset and liability management seeks to handle in a comprehensive fashion all three main forms of market risk facing government: (a) refinancing risk, (b) interest rate risk, and (c) foreign exchange risk. In a financial portfolio approach we compare the risk structures of financial flows and the stocks of financial assets and liabilities on the two sides of the government balance sheet. [7] We define our approach rather narrowly, focusing on government direct debt portfolio and central bank reserves. We do so because the direct debt portfolio is very large compared to contingent liabilities, and central bank and fiscal reserves are large compared to other financial, existing and potential, assets. In addition, we take into account the lev's peg and the country's trade flows since these drive Bulgaria's capital account developments.

We consider *refinancing risk* first. Refinancing risk can be defined as the volatility of a sovereign's access to liquidity and to sources of debt financing over a longer-term period. As the 1997-98 emerging-market crisis illustrated, Bulgaria again may face prohibitively expensive market access in the future. Moreover, Bulgaria's ability to refinance domestic debt is also very limited, since the domestic capital market remains rather shallow.

In this context, we evaluate refinancing risk by the overall maturity of sovereign debt portfolio and by the volatility of its repayment profile. Maturity structure seems reassuring. Brady bonds and debt to international financial institutions mature in 16.5 and 10 years, respectively, bringing thus average foreign debt maturity to above 13 years. The dollar denominated domestic debt is also long-term. Maturity of the outstanding Treasury bills has reached 21 months by end-1999. However, this maturity structure is rigid. Neither restructured London Club debt nor the debt to international financial institutions can be rolled over. Net Treasury bill financing has been negative since mid-1998, issuance small, and auction placements consistently below offer volumes. In addition, as we will discuss further, a significant amount of Bulgaria's government debt has a floating interest rate and thus makes the repayment profile volatile. Refinancing risks will increase as debt service rises in the medium term.

Evaluation of the *currency risk* is simplified under the CBA. The CBA credibility appears strong. Thus we treat the Euro-denominated debt not much different from domestic debt. Bulgaria's cross-currency risk boils down to the US dollar/Euro risk, as the share of other foreign currencies is modest, both for the assets and liabilities. Bulgaria's natural hedges to currency risk in its government debt portfolio include foreign exchange reserves, mainly denominated in the Euro, and current account cash flows, essentially net exports of goods and services, mainly denominated in US dollars, with a deficit emerging in the Euro-denominated trade.

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[7] This approach skips over possible valuation changes driven by the exchange rate movements in the government's real assets and liabilities. A *full balance sheet approach*, incorporating real assets and liabilities, is methodologically more attractive, but more difficult to implement. First, there usually exists a large maturity mismatch between the asset and the liability sides, since government's real assets are normally longer-term than its financial liabilities. Second, the usefulness of financial instruments to hedge currency risk in the government's real assets and liabilities is limited since markets to hedge long-term risks are not well developed. (Hansen, 1998)

With respect to foreign exchange reserves, we observe a large mismatch between the bias toward the Euro in their structure and the bias toward the US dollar in the structure of Bulgaria's sovereign debt. In stylized terms, we present a simple combined balance sheet of the government and the central bank in table 2.

Table 2 Simplified balance sheet as of 12/31/98

(bill BGL)	BNB (issue dep)			MOF			Net exposure		
	BGL	USD	EUR	BGL	USD	EUR	BGL	USD	EUR
Currency reserves		258	4162				0	258	4162
Gov. Account	-651	-258	-103	651	258	103	0	0	0
Gov debt					-10709	-1761	0	-10709	-1761
	-651	0	4059	651	-10451	-1658	0	-10451	2400.6

Central bank's exposure: euro

Sovereign debt: US$

Source: World Bank staff estimates

With respect to the current account flows, Bulgaria's large share of foreign and domestic debt denominated in US dollar broadly satisfies general hedging objectives. This holds, even though, the lev is pegged to the Euro, making Bulgaria's exposure to currency risk determined primarily by the US dollar/Euro exchange rate. Indeed, strengthening of the dollar since October 1998 (Chart 5) had so far cost Bulgaria's budget an extra $80-100 million in debt service cost. In the current account, however, this loss was mirrored by increases in the dollar-denominated export revenues. Chart 6 compares currency composition of net merchandise exports and debt service payments in 1998 and shows that the US dollar exposure on the sovereign debt was broadly matched by the dollar inflows on net exports. The peg to the Euro serves as a natural hedge to Bulgaria's large deficit in Euro-denominated trade.

Chart 5. Daily exchange rate, Lev/$1

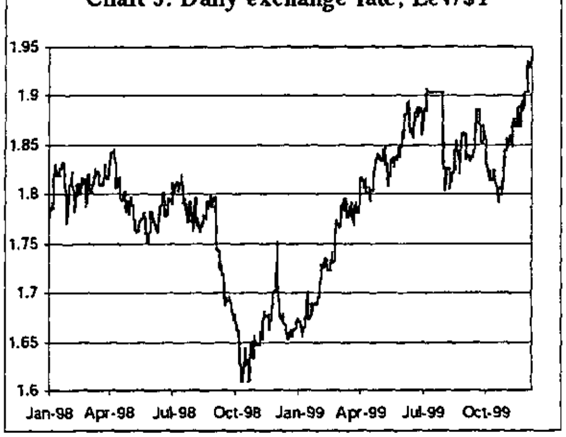
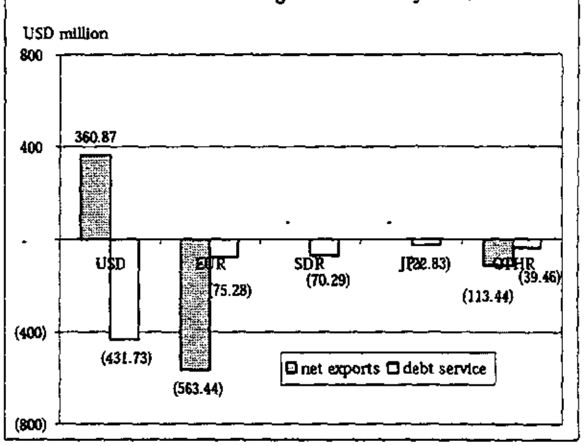


Chart 6. Natural hedge for currency risk, 1998



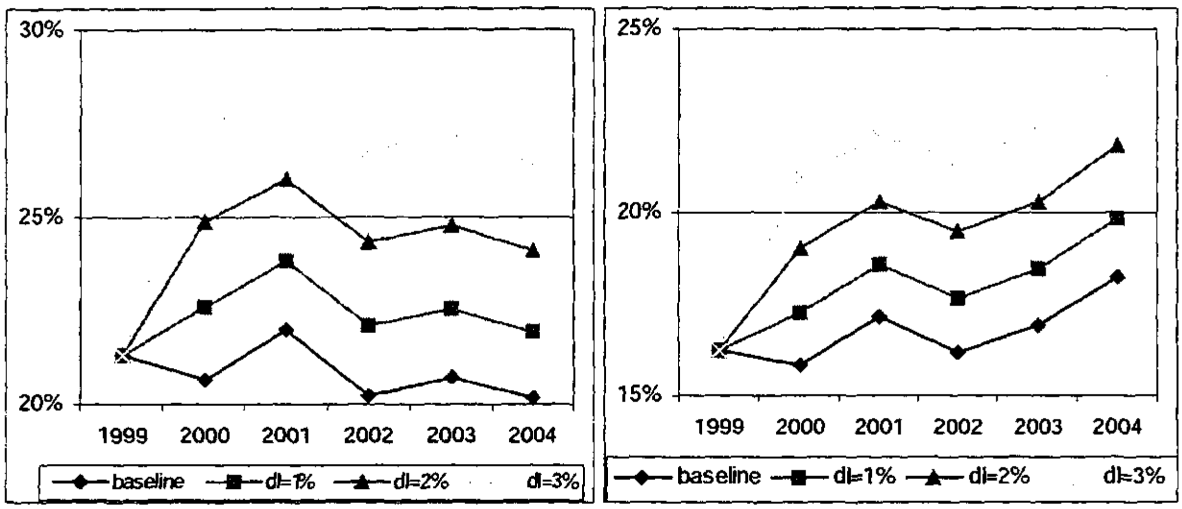
Source: World Bank staff estimates.

The natural hedge on the dollar, however, is not complete and is on the wane. In 1998, the mismatch was some 20 percent of the dollar-denominated exports of US$70 million; in 1999 it is estimated to over 1/3. Chart 6 excludes dollar exposure on the dollar-denominated domestic debt, which constitutes another 10 percent. And there is a large quarter-on-quarter variance in the currency structure of debt service against foreign trade, exposing the country to short-term currency risk.

Interest rate risk in public debt portfolio is a more serious reason for concern. The share of floating rate debt in both external and domestic debt portfolio was over three quarters at end-1998. The drop in LIBOR over 1997-1998 made this to government's advantage, lowering its debt service costs. Possible increases in LIBOR in the future, however, will reverse this trend.

Chart 7. Stress testing: the impact of higher interest rates on the ratios of...

debt service-to-exports... *...and debt service-to-budget revenues*



Source: World Bank staff estimates.

For external debt, the risk of losses on higher interest rates is significant. The relationship between higher interest rates and debt service is exponential, as the interest costs will open wider the financing gap in the future years. Stress testing the debt service profile with an interest rates increase of 1%, 2% and 3% (see chart 7), we find that higher interest rates would result in the debt service to exports ratio to be on average higher than the baseline scenario by 1.5-5.2 percent in 2000-2004[8]. Any increase of international interest rates in excess of 3% over the current levels may lead to unsustainable levels of debt service. The fiscal impact of additional interest payments over 2000-2004 provides more comfort under the baseline scenario which assumes continued strong fiscal performance. Nevertheless, higher international interest rates would add from US$ 95 million (for a 1 percent increase in interest rates) to US$ 340 million (for a 3 percent increase) to the annual budget expenditures, or 1.5-6.5 percent increase in a debt service to revenue ratio in 2000-2004.

Domestic interest payments represent the equivalent of a mere quarter of the external debt interest payments, but they are more volatile than the latter. As the domestic fixed income

[8] The baseline scenario is based on the Ministry of Finance assumptions about the future track of international interest rates.

market is shallow, it is extremely sensitive to shocks. In 1999, a combination of factors caused a rise of yields on domestic debt by 4-5 percentage points, while the effective cost of Bulgaria's external debt had risen by less than 1 percent. In a not unlikely scenario, an increase in domestic interest rates in parallel with international rates may raise government debt service costs by 1-2 percent of GDP or 2-6 percent of the 1999 budget revenues. For Bulgaria, the current predominance of instruments with floating rates is thus quite risky. In the short run not much can be done about it, as the government continues with its prudent borrowing policy. Once this policy bears its fruits in terms of improvement in sovereign risk rating and decline in borrowing costs, new borrowing decisions should aim to contain the interest risk in the debt portfolio by contracting debt with fixed interest rates. At that time, a sensible interest-rate benchmark for both external and domestic components of the debt portfolio should be constructed.

Risk of derivatives, as volatility in the cost of derivative instruments, is negligible. Similarly to other sovereign borrowers with sub-investment grade ratings, Bulgaria faces difficulties in accessing derivative markets and finding the needed counterparties. Bulgaria would benefit particularly from interest rate swaps and currency swaps to smooth the fiscal impact of exchange and interest rates volatility. But possible availability of derivatives also makes the development and application of asset and liability management framework for risk management more urgent.

Institutional and transaction risk refers to possible failures in the debt management processes. Since 1998, Bulgaria has been systematically strengthening its debt management capacities. As one of the steps, the Ministry of Finance has consolidated debt management into a single Department for Government Debt. The department includes specialized units that manage and track debt, guarantees, and on-lending. Bulgarian National Bank (BNB), as the Government's fiscal agent, conducts primary auctions of government securities and aims at deepening the secondary market. Both the BNB and the Ministry of Finance have been enhancing their debt tracking systems. The BNB debt monitoring system tracks both external and domestic debt, but generates only external debt service projections. Debt database of the Ministry of Finance covers state guarantees as well as the entire government debt, but its projection and reporting engines are under development.

Both institutions lack tools to analyze debt sustainability and to assess risks of their asset and liability portfolios. There exists no structured procedure to assess and compare the risk exposures, and decisions are thus made with little reference to any risk management objectives. For example, servicing the dollar-denominated debt from the Euro or lev accounts alters the net combined exposure of the fiscal authorities and the Bulgarian National Bank, thereby adding to Bulgaria's fiscal vulnerability. As a hurdle in the development of further institutional capacities, both the Ministry of Finance and Bulgarian National Bank suffer from high staff turnover.

The system for transaction processing remains complex, with several overlapping procedures in the Ministry of Finance and the BNB. It has been successful in preventing any payment slippage since 1994, but in some instances, erroneous decisions with regards to accounts and source of funds used for debt servicing have increased debt servicing costs.

Streamlining the transaction processing within the overall Treasury management framework is therefore strongly warranted.

The proposed reform would bring social security under control

Bulgaria's government legally guarantees an old-age pension and other social security programs. Social security guarantees are becoming fiscally expensive. Bulgaria has 2.4 million pensioners and 3.2 million insured in the mandatory social security system. The old dependency ratio, as the share of population aged 60 plus to those between 15-59, has surpassed 0.43. The system dependency ratio, as the share of pensioners to the working population, has exceeded 0.75. Social security programs are exerting increasing pressures on the budget, rising from 9 percent of GDP in 1997 to 13 percent in 1999. Social security programs include: (a) retirement and various social pensions, (b) unemployment and one-off retraining benefits, (c) various social assistance programs for specific groups (students, families with numerous children, and others), and (d) social benefits paid through the municipal budgets, but subsidized from the central budget, for the uninsured and poor.

The government spends 9 percent of GDP on old-age and social pensions. The pension system suffers from arrears in contributions (200 million BGN, which is about 1 percent of GDP, as we will discuss in the enterprise section of this paper) but not from any arrears in benefits payment. With no reform, expected demographic trends threaten to generate cash deficits in the pension system of nearly 2.7 percent of GDP by 2002 (table 3). To contain these expected increases, the government proposes to downsize the existing pay-as-you-go, improve options for voluntary private pension saving, and introduce mandatory defined contribution professional and employer saving plans. Proposed changes into the present pay-as-you-go system include a gradual increase in the retirement age and its convergence for men and women[9], transfer of the responsibility for early retirement to professional pension funds, and adoption of universal mandatory pension contributions based on salary levels. On the front of other social security programs, government particularly aims at restricting access to short-term social security payments.

Table 3 Projected Social Security Expenditures

	Projected pension deficits: w/o reform		Projected pension deficits: w/reform		Total social security spending w/o reform		Total social security Spending w/reform	
	BGN, *mil*	% of GDP	BGN, *mil*	% of GDP	BGN, *mil*	% of GDP	BGN, *mil*	% of GDP
2000	489	2.1	492.9	2.1	2081	8.9	2041	8.7
2001	648	2.6	476.2	1.9	2405	9.5	2176	8.6
2002	744	2.7	524.8	1.9	2700	9.9	2408	8.8

Source: NSSI

Under the reform scenario, projections of government pension expenditures look more reassuring, with incurred cash deficits around 2 percent of GDP. Projections shown in table 4

9 The present retirement age (55 for women and 60 for men) will be preserved until 2003. After the year 2003, the retirement age for men will grow by 4 months each year until it reaches the age of 65. The retirement age for women will grow by 6 months each year until it reaches the age of 63.

assume the envisaged increases in the retirement age, reductions in pay-as-you-go pension benefits, but also higher compliance, resulting in a cash deficit of around 1 percent of GDP annually, for the next five years.

Table 4. Projected Public Pension Expenditures After Reform

	Total Outlays		Annual Cash Deficit/Surplus	
Years	BGN, *mil*	% of GDP	BGN, *mil*	% of GDP
1999	2173	9.5	-114	0.5
2000	2315	10.1	-296	1.3
2001	2432	10.0	-262	1.1
2002	2550	9.8	-240	0.9
2003	2667	9.7	-238	0.9
2004	2743	9.4	-341	1.2
2005	2780	9.0	-261	0.9
2006	2802	8.6	-130	0.4
2007	2798	8.2	45	0.1
2008	2798	7.9	169	0.5
2009	2802	7.5	309	0.8
2010	2848	7.4	420	1.1
2011	2877	7.1	796	2.0

Source: Agency for Economic Analysis and Forecasting

Hence, according to the above calculations provided by two different sources in Bulgaria, deficit from pension and other social security benefits could range between 1 and 2 percent of GDP per year in the next 12 years. The state has provided no guarantee or commitment under the planned pillar 2 and 3. Therefore, no explicit fiscal liabilities are expected from these programs in future.[10]

Health financing is likely to grow, either directly or through contingencies

Similarly to social security, Bulgaria's government also legally guarantees its citizens' access to healthcare. Health care has been available free of charge to the population, costing the government budget around 4 percent of GDP. Since population aging often has a stronger impact on the cost of health care than pensions, the budget may expect increasing pressures. In this respect, health-financing obligation of the state is of direct nature. The government, however, has been considering a reform that would reduce direct budgetary health outlays, but introduce another, contingent portion of public financing in the new health system. Law on Health Insurance, which has established a National Health Insurance Fund to partly cover health care cost, formulates an obligation for the state to cover the Fund's possible future deficits as well as to pay contributions of all of the state employees as their employer. Table 6 shows expected sources of health financing in the reformed system.

[10] In the early stages of the new program design, we found it impossible to estimate any possible implicit liabilities that might arise from pillars 2 and 3.

Table 6 Health Fund: Expected Revenues

	1999		2000		2001	
	BGN mil	*% of GDP*	*BGN mil*	*% of GDP*	*BGN mil*	*% of GDP*
Health insurance contributions	257	1.2	577	2.4	650	2.5
o/w from government	97	0.5	213	0.9	231	0.5
State budget	806	3.6	840	4.0	1,035	4.1
Total	1063	4.8	1417	6.4	1,685	6.6

Source: Ministry of Finance.

Contingent government liability arising from the new arrangement will realize, should the NHIF face difficulties in collecting health contributions. Collection difficulties may arise from the complexity of the Fund's contribution structure. Contributions will be levied on the higher income family member, with additional amounts imposed for dependents and other non-wage earners. The system would require detailed monitoring of family relationships and incomes. Collection and enforcement problems are particularly expected vis-a-vis non-cash compensations and self employed. Furthermore, the Fund is designed to contract health services with health providers. Thus, government's obligation to cover the Fund's deficits is likely to erode incentives in the entire health system and to become costly, also for the state budget. Initially envisaged for mid-1999, actual payments under the new system have been postponed to mid-2000 in view of the above-mentioned implementation problems.

2. Direct implicit Risks

Public Investment Program may generate significant fiscal pressures

Bulgaria's Public Investment Program, first developed in 1998 for years 1998-2001, offers many positive features but also suffer from weaknesses experienced earlier by other countries. Particularly, Public Investment Program does not include estimates of recurrent and maintenance cost implications of proposed investment programs. This shortcoming may lead to unexpected pressures on the budget in the future and, consequently, to disruptions in further investment programs as well as in the provision of expected services. In addition, risks associated with Bulgaria's investment program are three-fold: (a) project and program quality, (b) availability of expected financing schemes, and (c) counterpart requirements.

Public Investment Program covers planned capital expenditure by the state budget, budgetary spending agencies, large state-owned enterprises, and funds, such as National Environmental Protection Fund, Republican Road Network Fund, National Telecom System, and Air Traffic Management. The PIP is an integral part of the organic budget law of the current year and indicative for the following years. Over the last three years public investment expenditure increased from 1 percent of GDP in 1997 to 3.5 percent in 1999. The Government program for 2000-2006 fixes public investment at 3.5 percent of GDP per year. This limit may come under significant pressures from competing requirements of infrastructure rehabilitation, environmental clean-up, institutional capacity building, restructuring of social services, and poverty alleviation programs, all key to the country's development and growth and/or EU accession.

Project quality risk mainly emerges from capacities of the sectoral agencies, which are responsible for economic and financial analysis and for the overall soundness of their proposals. The agencies' capacities, however, vary greatly and most agencies suffer from tight human resource limitations. Similar problems are facing the Ministry of Finance, which is responsible for review and prioritization of proposals prior to submitting them to the Council of Ministers.[11] Thus, project proposals are not necessarily well designed and well assessed. Coupled with the fact that PIP does not include recurrent and maintenance cost implications of investment programs, this may cause that future pressures on the budget exceed expectations.

Financing risk, risk that pre-identified sources of financing fall short, is also real. The 1998-2001 PIP envisages a US$3.9 billion investment program for the public sector. Out of this, US$2.6 billion belongs to state-owned enterprises. The state is expected to guarantee credits to finance over half of the investments. As we will discuss further, many large state-owned enterprises are incurring losses and accumulating arrears. Unless these enterprises are restructured to become commercially and financially viable entities, state guarantees on their credits may produce significant contingent fiscal risk for future state budgets.

Counterpart requirements mainly relate to Bulgaria's investment-related borrowing from International Financial Institutions and EU accession funds. EU programs, such as SAPARD (Special Accession Program for Agriculture and Rural Development), require government to co-finance between 25 and 50 percent of investment cost. These requirements do not produce fiscal risk by themselves but require attention in order to have the needed room in future budgets.

3. Contingent explicit risks

State guarantees are not large but should be treated with caution

In 1999, Bulgaria has reported about 17 percent of GDP of outstanding state guarantees (table 7). This amount includes 9 percent of GDP of IMF debt that is intermediated by the Bulgarian National Bank. There is no doubt that state budget will cover IMF debt repayment. Thus, in our framework we consider IMF debt as a direct rather than contingent liability of the fiscal authorities, and thus analyzed it as a part of sovereign debt above.

Table 7 Bulgaria : Publicly Guaranteed Debt Outstanding (end of 1998)

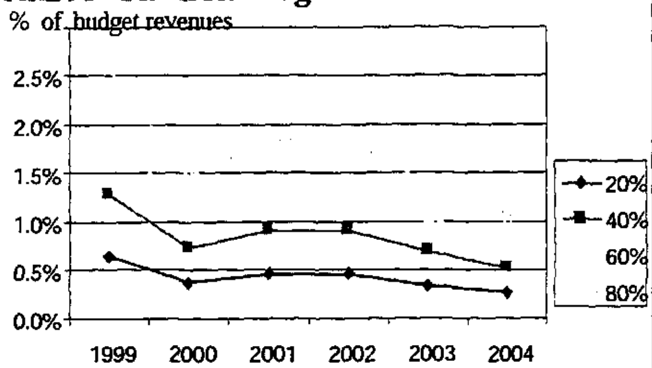
	Amount	As % of GDP
External (US$ million)	1596	13.0
IMF	1114	9.1
Others	482	3.9
Domestic (BGN million)	840	3.9

Source: Ministry of Finance and Bulgarian National Bank (Monthly Bulletin, December 1998)

11 Selection criteria are established by the Council of Ministers to emphasize: (a) compliance with the governmental development strategy, (b) contribution to economic growth and employment creation, (c) regional, social and ecological priorities, (d) reduction in the amounts of incomplete construction, (e) mobilization of external funds, (f) project readiness, and (g) administrative readiness and implementation capacity. The PIP is now expected to be closely linked with the new, seven-year national strategy.

Non-IMF state-guaranteed foreign debt, reaching almost 4 percent of GDP, is dominated by official creditors on the financing side (99 percent) and infrastructure state-owned enterprises (92 percent) as the debtors (see Annex 2). The main source (95 percent) of domestic guarantees are obligations of (that is deposits in) the State Savings Bank. For this Bank, the guarantee fully covers deposits denominated in domestic currency until April 2000. After this date, these deposits become subject to the Deposit Insurance Law, which provides for limited coverage under the Deposit Insurance Fund.

Chart 8 Fiscal risk of guaranteed debt



Source: World Bank staff estimates

Excluding the IMF debt and assuming a run on State Savings Bank's deposits before April 2000 unlikely, the amount of outstanding guarantees comes to some 4 percent of GDP. Compared to some other EU accession countries, such as the Czech Republic (Brixi and Ghanem, 1999), this amount is not excessive. But most of these guarantees are risky. Most of the state-owned enterprises, which are their main beneficiaries (covered debtors), have been incurring losses and accumulating arrears in taxes, social security contributions, and/or wages, and/or to their suppliers.[12] Prior to the end of 1998, 13 domestic and two external guarantees have been called. Expanding our ALM approach to cover contingent liabilities, we mainly observe that enterprise debt covered by state guarantees largely has floating interest rate and is denominated in foreign currency. An increase in interest rates and appreciation of the dollar vis-à-vis the Euro will make the guarantees more likely to be called as well as will raise the budgetary cost of each guarantee called. Chart 8 shows future possible budgetary cost of the outstanding external guarantees (excluding the IMF guaranteed debt) according to different default risk levels. The maturity of enterprise debt is relatively short, thus front-loading the fiscal risk of the existing guarantees. Under a 60-percent default scenario, the fiscal loss would range between 1.2 and 1.4 percent of budget revenues in 2000-2004.[13]

12 Beneficiaries of state guarantees include such continued loss-makers as the Bulgarian Railways, Bourgas Port, and Maritza Iztok mines. Other large loss-makers with obligations covered by the state, such as Zarneni Hrani, are in the process of shutting down.

13 In Hungary and the Czech Republic, state guarantees covering all risks under the contract have been called with roughly 20 and 40 percent probability.

The demand for new guarantees is high emanating both from official donors and the private sector. Box 1, below illustrates the case of the energy sector.

Box 1 Bulgaria: Fiscal risks associated with the energy sector

Fiscal risks arise on account of state ownership of energy enterprises and the responsibility of the Government to guarantee, either directly or indirectly, the obligations of state-owned enterprises (SOEs). The main sources of existing and expected fiscal risk associated with Bulgaria's energy sector include: (a) non-payment/non-collection for energy services, resulting in accounts payable; (b) inadequate tariffs to cover reasonable supply costs, resulting in the need for direct budget support or a cross-subsidy between consumer groups; (c) non-competitiveness of coal and briquette enterprises, resulting in either direct budget subsidies to mitigate the social impact of mine closures or cross-subsidization by power companies; (d) implicit state guarantees for loans to energy SOEs (owing to state ownership or control of enterprises); (e) explicit state guarantees for loans to energy SOEs; (f) explicit or implicit state guarantees of long-term take-or-pay contracts and other obligations. Fiscal risks associated with (a)-(d) are relatively well understood and addressed. Fiscal risks associated with guarantees to SOEs loans and take or pay contracts are growing rapidly and will be the most challenging to manage and to mitigate. Investment requirements are being driven by EU Accession requirements (nuclear safety, environmental performance, and technical compatibility), external and domestic demand considerations, and reliability and efficiency improvements in existing electricity and heat services to underpin economic growth and social protection.

Fiscal risks associated with (e) and (f) are likely to increase rapidly if investments to modernize energy infrastructure and meet EU Accession requirements are not carefully selected or properly structured. While the Government rightly intends to maximize the use of private capital to minimize fiscal risks, on-going sector restructuring and privatization should ensure that private investors and operators increasingly assume all commercial risks. State guarantees should only be considered for sound projects and where they are needed to secure private financing for projects without which the country's economic growth or social condition would be jeopardized.

With regard to (e), in 1999-2000 state guarantees have been provided or are being considered for investment loans of about $850 million to be implemented in the 2000-[2004] period. These include investments in nuclear plant safety, waste disposal, and plant upgrade ($380 million), electricity transmission and dispatch($150 million), district heating ($120 million), and expansion of gas transit capacity to Turkey ($47 million). The implied level of energy-related guarantees approximates the amount of overall investment guarantees at end 1998.

With regard to (f), an explicit state guarantee has been provided for the gas supply contract between Bulgargaz and Gazprom, signed in May 1998, which requires Bulgaria to take or pay for pre-determined annual volumes of gas until [2010]. The contracted volume for 1999 (4.0 billion cubic meters) is valued at $320 million. A slightly higher volume is contracted for 2000. The continued decline in demand is likely to result in an obligation to pay against the part of the contracted volume that is not taken.

Implicit or explicit state guarantees are also being considered for long-term take-or-pay power purchase agreements (PPA) between the state-owned National Electricity Company (NEK) and privatized power producers. The first PPA, to support a $400 million rehabilitation project (840 MW), would impose an obligation on NEK of about $180 million/year for 15 years in electricity off-take and fuel supply upon completion of the project. Similarly, the second PPA, to support a $1.0 billion new plant (600 MW) would impose an obligation on NEK of about $175 million/year for 10-15 years. To the extent possible, these deals should be structured after reforms are more advanced and the investors, not NEK, can take more of the market risk.

The government has established a simple framework for dealing with guarantees. Particularly the government has developed a comprehensive register of guarantees (placed in the State Audit Office as well as both the Ministry of Finance and Bulgarian National Bank) and introduced regular publishing of the aggregate amounts of guarantees outstanding along with government debt figures. The register covers all external and domestic guarantees, indicating the beneficiary, creditor, project title, amount, currency, and debt repayment schedule. The government also centralized the issuance of new guarantees and subjected each new guarantee to executive and legislative scrutiny associated with regular budget process. Each guarantee request, accompanied by opinion of appropriate line ministries, has to be reviewed by the Ministry of Finance. With opinion of the Ministry of Finance and possible input of the State Audit Office, each guarantee needs an approval by Council of Ministers and Parliament's ratification.

In terms of nominal limits, Decree 482 of 1997 set the annual limit on guarantees (face value) issued at 20 percent of expected budget revenues. A recent amendment to this Decree, however, dropped the complementary ceiling of 20 percent of GDP on the total amount of guaranteed debt outstanding (replacing it with a flexible ceiling to be set in the budget process each year). This change significantly expands the legal room for the government to issue new guarantees. Moreover, relatively lax limits on guarantee amounts are accompanied by flexible reserve requirements. So far, the government has followed prudent reserve policy, though not underpinned by any rules or clear risk assessment practices. The state budget included reserves in the amount of 50 and 20 percent of the total scheduled guaranteed debt repayment (normally to be paid directly by the debtors) in 1998 and 1999, respectively. Furthermore, under guarantee contracts the government always covers all risks, without analyzing their determinants, and the full amount of debtor's obligation. Official creditors, providing concessional resources for development projects and balance of payment support, dominate the list of creditors and require full risk coverage by the government. If extended to commercial creditors, this practice has, negative implications for market behavior, creating moral hazard on the side of debtors and creditors. Finally, for guarantees as for debt management, government lacks capacities to analyze and control risk. The capacities to design private-public risk sharing mechanisms are also to be developed at the MOF. Compared with other advanced EU accession countries (see box 2), Bulgaria's problems in managing guarantees appear smaller. As we have noted, however, its need for caution is much greater.

Box 2 Managing contingent liabilities in the Czech Republic

The management of contingent liabilities in the Czech Republic suffers from two major weaknesses. First, the institutional framework does not encourage adequate prioritization in the use of guarantees. Second, the framework neither encourages pricing of guarantees nor sets sensible nominal limits on their amounts.

First, the law authorizing guarantees contains no guidance on when guarantees are the appropriate public policy instrument or how they should be compared to other forms of state assistance. "This shortcoming has created an incentive for entities and spending ministries unable to secure the desired level of state assistance through the budgetary process to seek state assistance outside of the budget process through loan guarantees. The additional state assistance provided via guarantees is perceived as cost free and is not included in the overall financial support provided to a given sector. ...guarantees are often extended as a result of emergency and political pressure rather than as a result of a strategic decision to support outcomes..."

Second, in the absence of systematic budgeting, one way to contain contingent liabilities is to place limits on their issuance. In the Czech Republic, the sum of expected payments on guaranteed loans in a calendar year is required to be lower than 8 percent of the expected state budget revenues. This limit is too high. In Hungary, the limit is set at 1 percent of the face value of the guaranteed amount.

The Czech system is ahead of systems in other countries in as much as procedures are in place to document the contingent liabilities, to categorize them according to risk categories, and to analyze the government exposure. The payments made under guarantees called are also recorded.

Source: Brixi and Ghanem, 1999, and Brixi, Papp and Schick, 1999.

Large environment damages need to be financed

Bulgaria's Environment Protection Law states that the state will not be liable for past environmental damages of enterprises privatized before February 1999. In addition, to comply with EU environment regulations, by 2015 Bulgaria will need to finance large environmental improvements as well as adopt new legislation and institutional arrangements. The Ministry of Environment and Water estimates the 1999-2015 cost of containing past environmental damage and financing the required treatment of water supplies, management and disposal of solid and hazardous wastes, and air clean up to come up to US$8.5 billion[14]. Assuming equal annual amounts, the government will need nearly US$570 million (about BGN1 billion) annually. The 2000-2006 PIP envisages annual amounts of US$400 million.

Based on the above overall estimate, the Ministry of Environment and Water and Ministry of Finance have developed a forecast investment program for ecological improvements for 2000-2006[15]. The government estimates the total minimum required expenditures in 2000-06 around USD2.8 billion.

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14 Assessment for general costs to be incurred in order to reach EU standards in treatment of water supply, management and disposal of solid and hazardous wastes and air pollution clean-up during 1999-2015 prepared by Halgrove Associates funded by EU PHARE. This estimate is the most comprehensive one currently available and covers the overall costs of containment of past environmental damage and implementing programs to attain EU standards for pollution and emission control, including the possibility of closing the old nuclear plants.

15 This investment expenditure program covers: (a) support to the municipal water treatment/sewage systems programs; (b) past environmental damage containment expenses for 'large polluters' in mining and metallurgy, chemicals and petrochemicals, oil refining and petroleum distribution that will be privatized; (c) support for the disposal of solid waste programs for the municipalities; (d) disposal of hazardous waste programs for closed mines; (e) rectifying the hazardous sulfur emission from thermal power plants; (f) past environmental damage

How large obligations will guaranteed agencies be permitted to accumulate?

Business Promotion Bank, recently established with 95 percent government ownership, is based on a German model and a recipient of a credit line on concessional terms from Germany. Its main objective is to channel long term credit to small and medium size enterprises. The government guarantees repayment of the German credit line as well as other foreign borrowing by the Bank. The government does not guarantee its deposits. The Bank is not operating yet, leaving, for the time being, the risk-exposure of the state near zero.

Bulgarian Export Insurance Agency was established in 1998 as a joint stock company, with the Minister of Trade and Tourism representing the Republic of Bulgaria as the major shareholder, to provide exporters with insurance policies to cover political and medium-term commercial risks. The Agency's capital is about DM 10 million. On its own account, the agency will ensure export credits, guarantees and financial losses against short term credit risks. On the government account and with full government guarantee, the agency insures against non-commercial and medium and long-term commercial risk. According to the Export Insurance Law, a limit for the export credit insurance benefiting from Government support should be imposed in the State budget annually. For 1999, the Parliament approved a DM30 million limit. The coverage against short-term commercial risk protects Bulgarian exporters against permanent insolvency and protracted default of the foreign buyer for up to 85 percent of the incurred loss. The coverage against non-commercial risk protects the Bulgarian exporter against default payment by the foreign buyer as a result of war, revolution, host government's moratorium on debt, expropriation, nationalization and similar. The insurance covers no more than 90 percent of the insured loss. The coverage against medium and long term commercial risk protects the Bulgarian exporter against permanent insolvency and protracted default of the foreign buyer, up to 85 percent of the incurred loss. On the government account, the Agency has also started an export credit insurance against short-term non-commercial risk from private and public foreign buyer. Demand for this as well as other policies is, however, still very limited, keeping the state's risk exposure very low.

State Fund for Agriculture, under the Ministry of Agriculture and with its obligations explicitly guaranteed by the state, provides financial support to the agricultural sector through short and long term loans, credit lines, interest subsidies and guarantees. Credit lines channeled through commercial banks support long-term agricultural investment. The number of commercial banks participating in this program has increased from 2 in 1998 to 11 in 1999. Through an irrevocable order of payments issued by the commercial banks in favor of the Fund, credit risk appears fully assumed by the banks. The State Fund for Agriculture charges the commercial bank a 2 percent interest rate, the banks charge the producers 6 percent, and the remaining 4 percent cover the bank's margin. In the context of market interest rates, the implicit subsidy to the producer is about 10 percent of the credit amount outstanding annually. This program is growing rapidly from 150 projects approved for BGN 11 million in 1998, to 350

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containment investments for the non-privatized ore mines(coal) and liquidated/closed entities; and, (g) some estimates for compensating the land-owners for recultivation of the contaminated land around the industrial sites. It does not cover the disposal of solid waste from closed uranium mines, phasing out the old nuclear plant, and conversion of thermal power plant inputs from lignite to better quality coal.

projects and BGN 24 million credit in mid 1999. In addition to yearly allocation from the state budget, this program is supported by a revolving fund financed from repayments by the commercial banks. Direct support to agriculture producers is also provided through interest subsidy and short-term credit. Support under these programs amounted to BGN 46 million in 1998 and was scaled down to BGN 35 million in 1999. These programs are being phased out and expected to disappear by 2001.[16]

While the short term support programs are subject to a yearly limit in the budget law, no ceiling is imposed on the volume of long-term investment credit. In addition, a new instrument is being introduced whereby commercial banks would extend long-term credit from their own resources with a full guarantee of the State Agricultural Fund. It is unclear whether the Fund's guarantees are subject to any specific limit. Finally, under the Grain Law, public warehouses will be established and warehouse receipts could be pledged as collateral for commercial bank credit. The State Fund for Agriculture is expected to participate to this scheme through provision of guarantee or participation in an indemnity fund.

4. Contingent implicit risks

Enterprise obligations may turn out expensive

Enterprise restructuring has been slow in Bulgaria, and state-owned enterprises have been accumulating losses and arrears. In 1999, arrears reached nearly 2 billion lev (around 8.5 percent of GDP), concentrated primarily in about 90 largest enterprises. These include the Bulgarian Railways, Bulgargaz (energy) and Neftochim (chemicals). Out of the total amount, about one half are due in taxes and social security contributions and have led in the past to shortfalls in tax and social security revenues. The other half is largely due to suppliers (mainly energy state-owned enterprises), leaving around 2.3 percent in wages due to employees.

Future possible clean up of these obligations may negatively affect the budget as far as the arrears to suppliers and enterprise employees go. Should the government be liable for tax and social security contribution arrears, their payment from the budget would be an accounting procedure of no consequence for the fiscal balance. In order to break the inter-enterprise chain of arrears leading to accumulation of tax arrears, the government is implementing a strategy to recapitalize enterprises and thus enable them to pay suppliers (typically the gas and energy public monopolies), who would in turn pay tax and social contributions arrears to the budget. In order to limit moral hazard, this operation is available as a once-off option at the time of privatization. Without hard budget constraint, however, future problems in collecting taxes and social contributions from enterprises would translate in revenue shortfalls and affect government's fiscal position

16 The Fund's revenue base consists of allocations from state budget and of fees from leased state properties. A 2-percent levy recently introduced on the turnover of agro-processing companies is subject to cancellation in December 1999 under the government program supported by the IMF-EFF.

An implicit fiscal pressure from municipalities?

Municipal borrowing is subject to a legal limit of 10 percent of their annual revenues. Out of this amount, as much as 10 percent of the preceding month's revenues can be in the form of a short-term interest-rate free credit from the central budget. Municipalities are allowed to seek the remaining credit from commercial banks and from other municipalities. For this credit, municipalities can request state guarantee. Furthermore, subject to further market development and to the approval by the Securities and Exchange Commission, municipalities will be able to issue bonds. Sofia already successfully issued bonds in Luxembourg for 50 million Euro. The existing law is not clear whether bond debt is subject to the overall indebtedness rules. As experience in many south American countries, including Argentina, Brazil, and Mexico has illustrated, markets often perceive municipal bonds as implicitly (even when clearly not explicitly) guaranteed by the state[17]. Possible increases in municipal credit in any form may thus bring about strong pressure on the fiscal authorities in case of default. The government is closing some of these loopholes in the draft 2000 budget law submitted to Parliament.

Fiscal risk for the central government may also emerge from municipal guarantees and other contingent municipal obligations. These are not currently regulated under any existing law. Thus, municipalities face no ceiling on the number and overall value of guarantees they can issue. Further risk of a financial pressure to spill over from municipalities to the central government relate to the municipal ownership of loss-making and indebted enterprises and financial institutions. The spill-over mechanism is likely to be the stronger, the more municipalities become responsible for the provision of core public services. Central government may find it plausible to let a municipality default on its debt to commercial banks. Possible subsequent failure of the municipality to deliver such core services as running water and schooling may be, however, politically too sensitive to let the central government abstain from "emergency" financial support. On the positive side, the State Audit Office is authorized and active in screening municipal performance and financial management. The cost of nuclear safety is not yet fully known.

Major government financing may be required by Bulgaria's nuclear power program. The Kozloduy nuclear power plant site has 2 units of 1000 MW each and 4 units of 440 MW each. International observers have declared the 2 large units in compliance with environmental damage containment measures. The other 4, older, units are determined by the European Commission for an early closure, on the basis of a Nuclear Safety Account Agreement. The cost of decommissioning of the power plant has not been taken into account in the past (for example, depreciation costs have not been integrated into the energy prices). Bulgaria's government, while implementing short-term safety program, indicated in the context of EU accession discussions, its preparedness to implement the decommissioning in two steps, closing down 2 units by 2003 and the other 2 before 2008, possibly by 2006.[18]

17 Dillinger and Webb, 1998.

18 Discussions on the timetable are still underway and exact costs of decommissioning , future demand and capacities remaining after the closing of the old nuclear units not yet fully worked out. Similarly, subsequent price, income and substitution effects on the household and enterprise sectors have not been analyzed. Therefore, no firm estimates of new investment, if needed, to meet electricity demand are available.

Fiscal risk from the financial sector is currently low

Bulgarian bankers, regulators and depositors were badly burnt by the experience of 1996-97. Their response has been one of caution. This limits the fiscal risk that needs to be accounted for. *Risks from the past* mainly relate to possible ongoing fiscal risk of past bank failures. In practice, high inflation has eroded much of the continuing claims on banks in liquidation. Recoveries from these liquidations are expected low but still uncertain. Bulgarian National Bank indicates that government claims on past failed banks amount to 400 million lev.[19] Remaining non-government deposit claims total about BGN 160 million. The government rules out any further compensation of non-government claims (of which 50 percent were compensated). Unrecoverable claims by state-owned banks, including State Savings Bank, on the liquidated banks have already been fully provisioned. The privatization of the remaining four banks might realize less funds than had been originally hoped. But further government injections needed are unlikely to exceed BGN 100 million.

Risks from the current situation reflect several factors. One very short-term potential risk is liquidity risk that lies in the decision to transfer accounts of the central budgetary and extra-budgetary funds, which are currently held by banks, to the government single treasury account held by the central bank. This transfer will not change the overall liquidity of the total banking system. However, transferring the accounts with all their deposits, estimated at 400 million lev, will require individual banks to liquidate some of their asset portfolios (that is their holdings of T-Bills, foreign exchange placements with overseas banks, and similar). The selection of assets to liquidate and conversion of remaining assets by banks may, however, cause temporary lack of liquidity in the money markets. This problem appeared in the early 1999 when around BGN 80 million of funds collected from the proceeds of asset sales of banks under liquidation was transferred to the account of the Ministry of Finance.

More generally, the major banking system risks are typically to be found in loan portfolio weakness, interest rate or exchange rate risk, liquidity risk, or in self-dealing or fraud. Past loan-portfolio weaknesses have been flushed out by the crisis of 1996-97, and indeed the real value of any non-performing loans at that time has been substantially eroded. The major state-owned banks have since been under a privatization scrutiny, which has limited their appetite for any risky lending, and this process also gives some increased confidence in the reliability of the accounts and the classification of loans for most of these banks. Many of the second tier of banks have received foreign capital accompanied by a degree of diligence. Therefore, the true aggregate capital position of the banks is likely to be fairly close to what they report. That means that aggregate compliance with capital standards is good, and that no immediate threat to the limited resources of the deposit insurance fund exists, unless external conditions change.

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19 Government expects several payments from the liquidations. If transferred to the Government's account at the BNB and sterilized in the normal way, as provided for in the currency board arrangements, this could have the unintended effect of tightening liquidity. While this is a monetary policy issue, and as such outside the scope of our paper, any special arrangements adopted to deal with it, such as special deposits retained by Government in commercial banks, could conceivably present a longer-term fiscal risk.

Concerning the obligations of Deposit Insurance Fund, from January 1999, the blanket deposit insurance, introduced during the crisis, was replaced by a new Deposit Insurance Fund. The fund collects, relatively high by international standards, a levy of 0.5 percent on end-year deposits of the banking system, and covers 95% of the first BGN 2,000 of any deposit, and 80% of the remainder up to a maximum payoff of BGN 6,900.[20] No estimate is currently available of what the average percentage payoff from the actual distribution of deposits would be. The figure is likely to be as low as 40 percent or even less.[21]

Despite a payoff of about BGN 10 million in January 1999 (see below) the Deposit Insurance Fund still has assets of about BGN 30 million (inclusive of an endowment of BGN 17 million). Failing other calls on its resources, it will accumulate funds at a rate approaching new BGN 25 million per annum at the current insurance levy rate. The Banking Department deposits at the Issue Department [22] are explicitly defined as the resources available for the lender of last resort facility in case of a systemic crisis in the banking sector. In 1999, these funds have covered nearly 20 percent of total deposits net of settlement accounts and thus have provided additional cushion to the Deposit Insurance Fund. The Fund also has the authority to increase this rate up to 1.5 percent of end-of-year deposits. If still inadequate, subject to parliamentary approval, the Fund can obtain credit from the government. In the context of a wider possible "too big to fail" policy, this recourse to the government allows bank failure to present a fiscal risk.

Because of the relatively intense scrutiny of the larger banks, the likelihood of significant self-dealing or fraud is limited. There is no reported evidence of malpractice in the smaller banks either, and these are supervised by the central bank. The re-licensing process for insurance has sharply reduced the potential for abuse in that sector.

Less is known about the business of finance houses, which enjoy very light prudential regulation and supervision. By far the largest of these has a balance sheet of the order of BGN 100 million and a very small capital base. Whatever the risks being faced by the investors (whoever they may be) in such companies, it is unlikely that the fiscal authorities would meet any deficiency here, so the fiscal risk remains small.

Banks' exposure to external risks entails three standard risks: (a) economic downturn, (b) sharp and sustained interest rate movement, and (c) exchange rate change. Ideally, a systematic

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20 Interestingly, this insurance cover differs from a common-sense reading of the relevant legislation, which would have limited the payout to BGN 4300. However, the drafting contained an ambiguity, and the higher amount was paid in the case of the Credit Bank which had to be dealt with only days after the new scheme came into effect (see below).

21 On the other hand, if closure was preceded by a lengthy period of suspicion, experience elsewhere shows that uninsured depositors would likely withdraw their deposits before failure, leaving the bank with a higher share of insured deposits.

22 The Issue Department and the Banking Department are the two principal financial departments within the Bulgaria National Bank, following the model of the Bank of England. The Issue Department holds all of the BNB's monetary liabilities and invests the BNB's foreign assests subject to restrictions in terms of quality and liquidity explicitly stated in the law on the BNB. The Banking Department is responsible for enforcing reserve requirements, monitoring financial markets and the payment system.

stress test would be carried out on each bank's portfolio to assess the impact of substantial adverse developments on all of these fronts. Even without the data to conduct such an analysis, preliminary broad estimates can give an indication of the broad magnitude of risks here. Deriving these estimates, we treat the risks one-by-one, thought they could be correlated.

The risk of a sharp economic downturn that would affect loan recovery mainly correlates with such events as Kosovo crisis or as deterioration of competitiveness of Bulgaria's enterprises. Most of the Bulgarian banks have sufficient capital to absorb even a substantial increase in loan-losses. The aggregate of capital and reserves in the banking system comes to almost 60 percent of the net loan portfolio, and (with the exception of the SSB), each of the large banks has sufficient capital to absorb the total loss of as much as one-third of its portfolio without insolvency. Further calculations will refine the picture, but it appears that, despite the limited resources of the Deposit Insurance Fund, the banking system might not impose severe direct fiscal costs arising from a major economic downturn.

Interest rate risk is negligible for most domestic banks because nearly all loans and deposits are subject to repricing on a monthly basis. To the extent that banks are trying to profit from the upward-sloping yield curve in foreign investments (as some are allegedly doing) there could be a risk. However, these positions are typically in major currencies such as dollar or euro, where interest rate volatility is not very great. Such positions would therefore present a risk to bank profitability, but are most unlikely to be large enough to knock-on to the state budget.

Foreign exchange exposure may be a more significant issue. There are three aspects to this. First the exposure of dollar against euro. This is strictly limited by regulation for banks. But it could be a problem for Bulgarian borrowers, whose receivables are in euro, but whose loans are denominated in US dollars. The existence of such cross-currency risk is generally acknowledged, and banks find themselves in need for greater hedging. The second foreign exchange risk relates to open positions in lev against euro. Overall, the banks are considered long in Euro but a precise quantification is not available. Such positions are not restricted by regulation, the argument being that the currency board eliminates all such risk. Of course, a stress-test needs to take account of even highly unlikely events. Experience from other countries shows it is exactly when a fixed peg comes under extreme pressure that large open positions emerge. Should lev interest rates rise as a result of pressure on the currency board, local banks (following the example of Mexico, among other countries) might use their freedom to take a large long positions in lev to profit from the high local interest rates. Were the currency board subsequently to fail, this could result in widespread bank insolvency and a major fiscal risk.

Risks from the future are limited if government continues in tightening prudential regulations, supervision and supervisory practice for banks and non-banking financial institutions, streamlining the institutional structure for regulation of pension funds, finance houses and mutual funds and improving effective implementation of bankruptcy procedures. Without continuous regulatory vigilance, a risk may arise from the excessive bank capacity relatively to the current and prospective market opportunities in Bulgaria. As present behavior would suggest, environment of low profitability may result in orderly exit of the least viable. But international experience shows that it can also encourage reckless behavior as bank owners or bank management "go for broke" when failure or exit is otherwise inevitable. Finally, the currency board arrangement may generate a risk in the long term if it is not supported by adequate fiscal, income and structural policies.

III. Developing Fiscal Risk Management Framework

1. Individual measures to address selected fiscal risks

In this section, we develop an action plan with measures to reduce the government's exposure to fiscal risks. We place emphasis on public finance institutional arrangements and capacities rather than on structural policies.

Priorities for the short term

Continue cautious borrowing strategy, adjusting it to risk management objectives. Given Bulgaria's vulnerability to shocks, policy makers need to acknowledge the need to minimize volatility in government financing and in debt service cost. By definition, a low- risk borrowing strategy may be costlier than an adventurous one. As the country rebuilds its creditworthiness, it will become increasingly able to manage short-term external shocks and to reduce the effective cost of its debt portfolio.

A strategy of low risk would imply the need to adjust the government debt structure as well as to strictly limit contingent liabilities (see below). The government will need to conduct a detailed analysis of the structure of both relevant assets and liabilities and construct a benchmark to outline an optimal debt portfolio. Through possible buy-backs and through new borrowing on as needed basis the debt management office then can gradually adjust the sovereign debt structure in the appropriate direction. Our brief analysis suggests that this direction is likely to point toward the lev- and Euro-denominated, long-term, fixed-interest rate debt instruments. This approach would result in a costlier, but low-volatility portfolio.

While considering any new borrowing operation, Bulgaria will need to take into account the risk structure of its outstanding debt portfolio. This approach is particularly valuable for heavily indebted borrowers, since its access to market-based tools is limited, principally because of its credit rating. For example, of particular relevance for Bulgaria is the World Bank's new loan product -- a fixed-spread loan, that has an interest rate based on LIBOR, plus a spread that can be fixed for the life of the loan. The product allows the borrowers to flexibly fix the interest rate on disbursed amounts at any time during the life of the loan; to cap or collar it; to unfix or refix the rate on disbursed amounts; and to change the currency and loan repayment terms, within financial policy limits. This new product offers Bulgaria an attractive opportunity to increase the flexibility of the government borrowing policy while keeping its low-risk profile. For example, it may consider fixing the maturity of a new loan from the World Bank in such a way that it would smooth the uneven debt servicing profile in the years ahead; or, balance the currency structure of its outstanding obligations with the currency structure of its exports.

Additional opportunities to mitigate risks in the government asset/liability portfolio are provided by the World Bank hedging products such as interest rate swaps, caps and collars;

currency swaps; and commodity swaps. Again, tapping international derivatives' markets may be prohibitively costly for Bulgaria at its level of creditworthiness. The Bank's hedging products will only be available to transform the risk structure of Bulgaria's debts to the World Bank. This innovation is significant both because the bank's share of Bulgaria's overall portfolio is substantial (and reducing the risk exposure on it would contribute to the broader risk containment strategy of the government); and because the sovereign borrower would thus gain experience that may later be applied in the international derivatives' markets.

On the other side, Bulgaria's return to the international capital markets may still be premature. An early debut in the capital markets is unlikely to contribute to the reduction of the effective cost of external debt and may (due to Bulgaria's low rating) even exacerbate the refinancing risk. On the contrary, another two years of strong fiscal performance and rigorous debt servicing are bound to further improve the country's sovereign rating and to reduce the cost of new financing. Meanwhile, further debt buyback operations, similar to the buybacks executed in 1999, may shave some percentage points off Bulgaria's public debt burden. This will give it larger windows of opportunity for more proactive debt management and borrowing policies years ahead.

Define strict limits for and build reserves to cover obligations guaranteed by the government. Vulnerability to fiscal risks and of the EU accession objective require Bulgaria to implement a tight limit on the amounts of newly issued and outstanding obligations under state guarantees. Ideally, this limit would fully reflect government budgetary constraints. For example, assuming a 30-percent default risk, the government would immediately set aside 30 percent of face value of new guaranteed obligations to build its contingency reserve fund possibly within he Fiscal Reserve Account. This fund would maintain reserves across fiscal years (rather than being a simple budget allocation that disappears unless utilized in a given fiscal year). Ceilings, reserve requirements, and an imperative to prioritize should apply to all sources of explicitly guaranteed debt, encompassing obligations of all agencies, including Export Insurance Agency, Business Promotion Bank and State Fund for Agriculture, that are backed by the government.

Analyze and regularly report fiscal risks. Require that analysis of fiscal risks be added to government fiscal reports. Regular reports should show debt scenarios (ideally in net present, mark-to-market value as well as on annual, cash basis), discuss the potential future fiscal impact of contingent liabilities and tax exemptions. These reports would form a basis for reassessing government borrowing and risk management strategies.

Priorities for the medium term

Close loopholes, require due diligence, monitor all sources of fiscal risk, and prepare contingency plans. Legal status and regulatory framework applying to public sector institutions, municipalities, and agencies, backed by the state, need to cover all possible sources of their financial risk to be effective in preventing possible spill-over on the central government. For example, the budget law should close any remaining loophole allowing the municipalities to issue guarantees and take on other contingent obligations, such as municipal insurance programs or issuing municipal bonds outside the overall limits on indebtedness and guarantees. Furthermore, all programs and agencies explicitly or implicitly associated with the state, should be subjected to tight reporting requirements and supervision. Supervision as well as their design and legal status need to ensure that their performance (including maintenance and investment) and financial management will not create fiscal pressure on the government in the future. To enhance its monitoring, the government should include all sources of possible obligations in its registers of contingent liabilities. While implicit contingent obligations may remain confidential, the government needs to understand their size and determinants and prepare adequate contingency plans for how to face possible pressures in advance.[23]

In the Public Investment Program, incorporate investments associated with EU accession and reflect on the recurrent cost of all proposed investments. Bringing all investments into the Investment Program and incorporating recurrent cost into investment decisions is crucial to a good fiscal performance in the future. Eventually, a medium-term fiscal framework should replace the Public Investment Program and ensure that future investment and recurrent costs correctly show in the medium-term fiscal planning.

Designate risk management responsibilities and build risk management capacities. To optimize government liability portfolio so that it is consistent with government risk management objectives, to design programs of contingent support (such as guarantee contracts) in a way to minimize moral hazard in the markets and future fiscal cost, to assess adequate reserve requirements so that they provide the needed cushion but without entailing unnecessary opportunity cost, and to benefit from sophisticated hedging instruments and derivative markets, the government needs to clearly outline risk management responsibilities of its agencies and support their capacity building. This is not an easy task but experience of countries like Ireland, the Netherlands and Sweden offers useful lessons. Meanwhile, new risk-hedging products of the World Bank allow Bulgaria to reduce risk exposure, particularly the government's significant exposure to interest rate risk, with minimal counterpart risk, and to gain needed experience in using more complex derivative instruments.

2. A better framework for fiscal management

In this section, we outline a possible development of the overall public finance institutional framework in Bulgaria to better capture fiscal risks. This framework aims at promoting government fiscal performance across all types of government fiscal activities and with respect to all sources of fiscal risks as well as to the budget. One of the specific goals for the new framework is to promote risk-awareness culture in government. Below, we summarize the key features of the new institutional framework.[24]

Monitor and report. Statements of contingent liabilities, tax expenditures and other fiscal risks should list the various sources of fiscal risk, discuss their nature and sensitivities, implications on future fiscal position and equity, and where applicable provide their face and/or

23 For background on how to deal with implicit contingent liabilities see Schick, 1999, Polackova, 1998, and, with respect to the financial sector, Honohan, 1999.

24 For a more comprehensive list of measures and questions associated with the management of fiscal risks, see Annex 3.

estimated value.[25] Good practice is offered by Australia, Canada, Colombia, Netherlands, New Zealand, and the United States. Budget documents of these countries stress-test the fiscal baseline with respect to major macroeconomic, policy and demographic risks. Since risk exposures change with time, as underlying conditions evolve, government should reassess assumptions that underlie its risk analysis several times a year and adjust its reserves.

To prevent spill-over of risks held by various agencies, such as subnational governments and other public entities, state-guaranteed funds, state-owned enterprises, and large financial institutions and banks, it is critical for the government to enforce transparency in the markets. In addition, government needs capacity to monitor and analyze its risk exposure vis-à-vis these implicit sources of fiscal risk. As a part of monitoring its risk exposures, government more than risk managers in the private sector needs to monitor behavioral determinants of fiscal risks. These include performance (moral hazard) under its guarantee contracts, legality of claims against tax duties, and performance of subnational governments or other entities that may affect future government fiscal position.

Adjust medium-term fiscal strategy to risks. Government medium-term fiscal strategy is hardly viable if it does not reflect implications of fiscal risks. The best way to show medium-term implications of fiscal risks for the overall fiscal position, is to develop baseline medium-term cash projections and stress-test these projections with respect to specific determinants risks (ideally, taking into account any existing correlations). Results of stress-testing will be critical for government to re-estimate periodically the sensitivities of its risk exposure with respect to changes in the underlying assumptions and to decide on reserve and hedging strategies accordingly. For implicit risks, medium-term fiscal strategy should be accompanied by confidential contingency plans on how to proceed when implicit and indirect risks materialize.

Similarly, equity and efficiency considerations are relevant only if they address the whole range of fiscal activities and their future likely costs. The budget law should require that guarantees and other promises of contingent government support be subject to the same scrutiny as budgetary programs.

Create accountability for risk analysis and management. To ensure that policy makers adequately reflect fiscal risks in their fiscal plans, they must become accountable for their analysis and assumptions. Therefore, supreme audit institutions and budget reports should comment on, and evaluate ex post, government risk analysis and risk management.

Share risk. To create proper incentives for the borrower, lender, and program manager under programs of government contingent support, the budget law should demand a significant amount of risk to be shared by these parties. The budget law may advise that state guarantees

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[25] Since no cash is spent from the budget when governments assumes a contingent obligation or provides a tax exemption, cash-based accounting systems fail to detect such fiscal risks. But a full accrual-based accounting system is neither necessary nor sufficient as a remedy. International accounting standards, for instance, require only *probable* contingent liabilities (contingencies with relatively high probability of realization) to be included in the balance sheet, leaving the others in a separate statement of contingent liabilities.

will not cover either the full credit/obligations or risks that are under control of the borrower and lender, such as specific commercial risks.

Make provisions and account for fiscal risk Budgeting and provisioning for fiscal risk has three main objectives: First, draw more attention to risk analysis, and thus build risk awareness of policy makers and the public. In this context, the process of risk analysis is often more important than the actual end estimate of government risk exposure. Second, make policy-makers cash neutral, that is neutral between alternative forms of providing government support from the viewpoint of deficit measurement and sectoral budgetary envelopes. Third, particularly important for governments with a limited access to debt markets, create a buffer for the event that risks materialize.

Box 3 Private Sector Logic on Provisioning

The private sector offer examples, why to provision fully for the expected cost of contingent support immediately in the year the program is issued. Programs of contingent support can be often shown as a put option written (given) by the government. In the private sector, financial institution charges full option price when writing (selling) an option. Price of an option reflects the present value of the future possible loss, which may be incurred by the underwriting institution. As illustrated by the Black-Scholes formula, the price increases with the time to expiry (e.g., maturity of the guaranteed loan) and with the volatility of the underlying asset (e.g., share price of the enterprise the debt of which is under the guarantee). Financial institutions charge the full option price immediately at time of selling the option. The amount is then used either to build reserves or to buy a hedge. See Hull, 1997.

Allen Schick, 1999 has summarized the contemporary approaches to meet the above objectives in the following principles[26]:

- Apply joint ceiling for the cost of budgetary and off-budget support for each sector in a fiscal year. Off-budget support is a form of subsidy, which should be considered along other forms of government support for each sector.
- Calculate the cost of off-budget support as the present value of the future expected fiscal cost.[27]
- Reflect the cost of off-budget support in full in the year when it is issued (see box 3).
- Transfer an amount equal to the cost of off-budget support from the budgetary envelope of the related sector to a central contingency reserve fund.

These principles pull the expected fiscal cost of off-budget support into deficit accounting in the year when the programs are launched. The amount transferred to the reserve fund is accounted for like an expense. On the other hand, when contingent claims are paid out from the reserve fund, fiscal deficit remains unaffected. Implementation of the Federal Credit Reform Act in the US has confirmed that this approach is plausible even when accounting and budgeting systems are not fully on an accrual basis.

26 For suggestions in a country-context see Brixi, Ghanem and Islam, 1999, Mody 1999, and Brixi, Papp and Schick, 1999.

27 There may be a discount applied on a newly proposed policy (say drought insurance) if its risks are negatively correlated with the risks of other policies (say, minimum agricultural price guarantee and flood insurance). This is because in such a case the newly proposed policy would increase government overall risk exposure by less than its full expected cost.

Utilize asset liability management strategy to neuter fiscal risks. An integrated approach government assets and liabilities (particularly to borrowing, debt management and to the management of reserves) allows to find natural hedges to fiscal risks and thus reduces the contingency reserve requirement and the need of derivative instruments. Particularly if facing constraints in the choice of available risk management tools, the government needs to decide on its new borrowing and on rebalancing the portfolio of outstanding liabilities in the context broader challenges posed by the structure of its assets, future revenue streams, and contingent and implicit liabilities.

Assign risk management functions and build capacities. For risk management as well as for conventional budget management, control structures and accountability are crucial. Important features to improve control and reduce scope for fraud and corruption include centralization of risk-taking authority and division of risk management responsibilities (see box 4). For government risk management, crucial authority and responsibilities are likely to be best placed at the Ministry of Finance, particularly in its departments managing debt and budget. Their functions, as well as government risk management strategy should, however, reflect the level of their financial and risk management capacities. And country experience has indicated that a lot of attention (including, for instance, aggressive hiring approaches and independent, market-based salary scales) is needed to develop and retain such capacities in the public sector.

Box 4 Division of Responsibilities

Large banks, including JP Morgan and Deutsche Bank, have divided the functions of designing and authorizing new transactions, analysis, and record keeping among three different offices. The front office centralizes designing of financial instruments and has the exclusive authority to enter into new derivative and debt transactions. Its objective is to ensure required levels of available cash and optimize overall return-risk ratio. Middle-office provides analysis of future obligations and payoffs, and their sensitivities for the entire portfolio. Finally, back-office is responsible for record keeping and maintaining comprehensive databases.

Maintaining these functions independent of each other improves transparency and control of portfolio risks, and it prevents the front office from exceeding their predetermined risk exposure limits.

Governments of Ireland and Sweden, among others, have successfully applied such division of responsibilities in their debt management. Many governments have successfully centralized the authority to issue debt, guarantees, tax exemptions, and other off-budget programs. Further, they should now expand the scope of risk management and adjust organizational structures and responsibilities accordingly. See Nars, 1997.

IV. Conclusions

Bulgaria's current fiscal position is strong. The CBA has been effective in imposing fiscal discipline, but it leaves limited room for accommodating potential risks. Significant pressures could arise from increases in international interest rates, from environmental liabilities and investment requirements, and from failure to strengthen the collection capacities of the social protection institutions and to establish adequate fiscal risk monitoring. Our analysis demonstrates the importance of limiting future exposure of the government of Bulgaria to risks while accommodating investment needs, crucial to growth and development. For this, Bulgaria needs to find an optimal mix of debt management, fiscal reserves and risk mitigation strategies.

Specifically, there are several steps for the government to follow in dealing with the *existing risks and to constrain the scope for further* accumulation of risks. In this context, priorities include mitigating currency and interest-rate risks in the government liability structure, implementing of the envisaged institutional and financing reforms of the pension and health systems, building adequate contingency reserves, introducing risk-sharing arrangements, prioritizing and placing strict limits on the amounts of new guaranteed obligations, and developing government capacities to analyze and manage risk. Fiscal risks should become fully integrated with government policy considerations, in the process of fiscal management, and in an integrated asset and liability management strategy.

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Table on Bulgaria General Government, 1994-2002

	1995	1996	1997	1998	1999 Proj1/	2000 Proj1/	2001 Proj1/	2002 Proj1/
	(In percent of GDP)							
Revenues	36.1	32.6	31.7	36.8	38.0	38.0	38.1	38.3
O/w Tax revenues	29.3	26.5	26.7	31.4	31.5	31.7	31.9	32.0
O/w VAT taxes	6.7	6.7	8.5	8.5	8.6	8.6	8.8	
Social insurance contributions	7.9	6.9	6.9	7.7	8.7	8.7	8.7	8.7
Nontax revenues	5.7	4.9	4.4	5.3	6.4	6.3	6.3	6.3
Expenditures	42.4	45.2	34.2	35.8	39.5	39.4	38.4	38.9
Non-interest expenditures	27.8	24.9	25.8	31.4	34.6	34.7	34.5	34.4
O/w Compensation	4.6	3.5	3.7	4.7	5.5	5.5	5.6	5.6
Subsidies	1.1	0.8	0.7	2.0	1.2	0.8	0.5	0.4
Maintenance/operating	5.5	4.9	6.3	5.7	5.4	5.4	5.3	5.2
Social expenditures	10.8	9.1	8.5	10.9	12.7	13.5	13.5	13.4
O/w Pension	8.0	7.0	6.3	8.3	8.1	7.9	7.6	7.3
Capital expenditures	1.1	0.7	1.0	2.8	3.4	3.5	3.6	3.6
Primary balance	8.3	7.7	5.9	5.4	3.4	3.2	3.6	3.8
(Excluding costs of structural reform)	8.3	7.7	6.2	5.2	4.3	4.4	4.4	4.4
Interest	14.6	20.3	8.4	4.4	4.9	4.7	4.4	4.4
External	3.3	3.4	3.0	3.2	3.6	3.4	3.1	3.1
Domestic	11.3	17.0	5.5	1.2	1.3	1.3	1.4	1.3
Overall balance	-6.3	-12.7	-2.5	0.9	-1.5	-1.5	-0.8	-0.6
(Excluding costs of structural reform)2/	-6.3	-12.7	-2.2	0.8	-0.5	-0.3	-0.1	0.0
Financing	6.3	12.7	2.5	-0.9	0.9	1.5	0.8	0.6
External(net)	-0.9	-2.4	-1.3	-1.0	-0.7	0.4	-0.4	-1.2
Domestic(net, include IMF)	7.0	14.9	0.5	-1.5	-1.0	0.0	0.0	0.9
Privatization	0.0	0.0	3.3	1.6	2.6	1.3	1.2	1.0
Memorandum item:								
Nominal GDP (in old lev bn)	880.3	1748.7	17055	21577	22010	23472	25216	27271
Fiscal Reserve Account (% of GDP)	0.0	0.0	7.8	9.2	11.1	11.8	10.1	7.0

Sources: Ministry of Finance, and IMF staff projection

Notes: 1/ Including the activities of the State fund for Reconstruction and Development (SFRD) and the Energy Resource Fund (ERF) which were closed with the approval of the 1999 budget.

2/ From 2000, costs of structural reform include projected additional costs of social security reforms.

Table 1: State Guaranteed Credits, By Creditor, December 31, 1998

million USD	Negotiated amount	Disbursed amount	Amount Outstanding
Official creditors			
European Investment Bank	386.7	202.6	192.6
World Bank	304.5	154.0	144.8
The Overseas Economic Cooperation Fund	182.7	2.7	2.7
EBRD	172.0	127.3	103.4
K F Arab Economic Development	40.1	0.0	0.0
USA government	15.0	14.9	14.9
Total official creditors	1,100.9	501.4	458.4
Private creditors			
Siemens	52.3	0.0	0.0
Nichimen Co	6.4	6.4	4.8
Total private creditors	58.7	6.4	4.8
Total	1,159.6	507.7	463.2

Table 2: State Guaranteed Credits by Borrower, December 31, 1998

Million USD	Negotiated amount	Disbursed amount	Amount Outstanding
Public borrowers			
MRDPW-Transit roads	161.5	59.2	57.1
Bulgarian Telecommunication Co	133.2	130.1	114.8
Port-Bourgas	117.0	0.0	0.0
Sofia Airport	101.5	0.0	0.0
Bulgaria - energy	93.0	43.0	36.9
Railway rehabilitation	91.7	57.3	57.3
Air traffic control	67.4	46.9	46.9
NEC	63.8	42.4	33.9
Water companies restructuring	53.6	11.6	11.6
Ministry of Health	52.3	0.0	0.0
Bulgarian State Railways	45.0	26.6	26.6
NRA - project transit roads	43.0	43.0	33.6
Social insurance administration	22.5	1.4	1.4
Ministry of Agriculture	15.0	14.9	14.9
MA (project wholesales markets)	6.7	1.9	1.9
Bulgarian National Television	1.0	1.0	0.3
Total public borrowers	1,068.2	479.4	437.3

Table 3: State Guaranteed Credits, by Borrower, as of December 31, 1998 (continued)

million USD	Negotiated amount	Disbursed amount	Amount Outstanding
Private borrowers			
KCM, S.A.	48.7	1.8	1.8
Eliseina, LTD	17.0	0.8	0.8
Private investment and Export	14.1	14.1	13.2
VMZ-SOPOT	6.4	6.4	4.8
Banks - Mediators APEX	5.2	5.2	5.2
Total private borrowers	91.4	28.3	25.9
Total (public & Private)	**1,159.6**	**507.7**	**463.2**

Notes to Tables 2 and 3:

1/ Data is in accordance with the Bulgarian National Bank (BNB) register of government and publicly guaranteed debts based on official MoF information on ratification of NA credit agreements and on official MoF information on credit servicing.

2/ USD equivalent is based on central exchange rates of the relevant currencies against BGN quoted by the BNB on 5 July 1999

3/ 16,370.64 activated state guarantee on APEX loan. Interest is paid by sources of MoF. Data is submitted by BNB International Relations Directorate.

How to Build Risk Management System for a Government?

What are the key principles for government to manage its fiscal risks? Experience in both the public and private sector suggests that following two tasks are critical for governments to ensure future fiscal stability and allocative efficiency in the use of future as well as present public finances. First, understand the government risk exposure and build risk awareness. Second, enforce accountability for dealing with risks. Below we summarize the specific questions that policy makers will need to ask to bring government fiscal performance fully under their control. Further research is needed to elaborate on some of the recommendations below.

Questions to ask with respect to the already existing fiscal risks:

- What are all sources of fiscal risks?
- What are the sources of future possible increases in government obligations (direct and contingent, explicit and implicit liabilities)?
- What are the sources of future possible reductions in the value of government assets and revenues (explicit and implicit risks to assets and revenues)?
- What are the types of these risks (applying the Fiscal Risk Matrixes)?
- What are the limits of government responsibilities for implicit liabilities and for conditions of sudden revenue and asset shortfalls?
- How sensitive are the risks to their underlying variables?
- What is their expected fiscal cost and value at risk (e.g., applying stress-testing)?
- To which risks is the government over-exposed?
- To reduce over-exposure, is it possible to redesign government obligations, and asset and revenue policies, and to reorient its role?
- How to make the Fiscal Risk Matrixes public and benefit from transparency? Which implicit liabilities, if any, should remain undisclosed and why?
- Should the government build reserve funds or use hedging instruments to deal with possible future obligation increases and revenue and asset shortfalls?
- How to hedge the government's overall risk exposure that is emerging from its entire portfolio of fiscal risks? Less optimally, how to hedge specific risks?
- If hedging is not an option or not sufficient to offset government risk exposure, how large reserves should be with respect to future possible? Should the government purchase insurance or re-insurance instead?

Steps to build a new risk management system:

- Seek to ensure that government has the cash available to meet its obligations and deliver.
- Establish analytical framework for government to regularly analyze its fiscal risks, including the future possible increases of government obligations and shortfalls in government revenues and assets. Regularly update the Fiscal Risk Matrixes in the budget process.

- Seek private sector solution to any request for government support to avoid risk exposure.
- Analyze expected and maximum likely fiscal cost of obligations and expected reductions in future revenue and asset values prior to making any policy decision.
- Design government support, revenue and asset policies so to achieve the policy objectives with minimum government risk exposure and without inducing moral hazard in the markets.
- Outline a strict policy for hedging government fiscal risks (future obligation increases and asset-revenue shortfalls) according to the government risk management capacities. Require hedging decisions done in the context of the entire portfolio of all fiscal risks. Regulate the possible use of risk-offsetting bonds and financial derivatives. Discourage dynamic hedging strategies.
- Outline reserve policy with respect to fiscal risks on both liability and asset-revenue fronts according to the government ability to absorb shocks. Determine government ability to absorb realization of fiscal risks according to its market access to borrowing (the depth of government securities market). In reserve policy, specify requirements on the reserve amounts (proportionately to government risk exposure), management (investment of reserves), and on the use of reserves (only to cover the realization of risks that have been identified ex ante). Consider new possible institutional approaches of contract-based or market-value based reserve management.
- Outline principles for government to purchase possible insurance and re-insurance under competitive terms.
- Establish a medium-term fiscal framework to optimize government management of expenditures, obligations, revenues and assets.
- In fiscal reports, require a statement of contingent liabilities, tax expenditures and other fiscal risks.
- Reflect on future possible realization of existing fiscal risks in the medium-term fiscal cash projection scenarios and medium-term fiscal strategy.
- Before designing new government support, revenue or asset policy, consider what is and how to limit government risk exposure. For support (budget, contingent liabilities, and tax expenditures), evaluate the fit with government priorities. Minimize and announce clearly the limits of government responsibilities to reduce moral hazard. Require public-private risk sharing.
- Make provisions for fiscal risks already in the year when the government takes on the risk by transferring the expected fiscal cost from the budget allocation of the related sector to a reserve fund (or to cover the cost of hedging and/or re-insurance).
- In execution, stick to the present limits of government support. Before fulfilling an implicit obligation, assess the impact on moral hazard in the markets.
- Monitor fiscal risks, their sensitivities, and expected and maximum likely fiscal costs.
- Monitor reserve adequacy.
- Monitor hedging strategies.
- Ensure sufficient transparency and controls in government risk management.
- Involve the state audit in assessing the quality of government risk analysis, reserve adequacy, risk management, and execution of risks that have realized.
- Explain publicly any departures from originally envisaged realization of fiscal risks as well as from the originally envisaged budget.

- Ensure adequate monitoring of fiscal risks that may arise from both the public and private sectors.

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RISK MANAGEMENT OF CONTINGENT LIABILITIES WITHIN A SOVEREIGN ASSET-LIABILITY FRAMEWORK

by

Elizabeth Currie

Antonio Velandia

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Abstract

Important research has already been made on the potentially destabilizing fiscal impact of contingent liabilities. Additional insights can be gained by working within a broader conceptual framework based on the government's balance sheet. This approach would place contingent liabilities alongside other sovereign exposures arising from both assets and liabilities. A number of sovereigns using asset-liability frameworks have assigned risk monitoring and policy formulation functions for managing risk originating from CL to debt offices. It seems to be a logical step extending the infrastructure available for risk management of sovereign debt to CL, since techniques and skills required are in both cases the same. Given the risks involved for most emerging economies from recent crises, it is expected that this pattern will be followed by more countries in the future.

I. Introduction

The focus of this paper is the insight gained into managing sovereign contingent liabilities (CL) by considering their risks together with those of other government assets and liabilities. Important research has already been made on the potentially destabilizing fiscal impact of CL, which can mask the true fiscal situation of a sovereign[1]. Additional insights can be gained by working within a broader conceptual framework based on the government's balance sheet. This approach would place contingent liabilities alongside other sovereign exposures arising from both assets and liabilities, in order to systematically identify and then quantify both the interaction between the various risk types and total sovereign risk. Although CL have characteristics which imply a specific approach to their valuation, there are more similarities than differences with other balance sheet items when it comes to identifying and quantifying sovereign risk.

The balance-sheet approach also has implications for risk management of CL. In general, risk can be managed at a decentralized level, as for example, by sub-national entities and SOE. However, for many developing countries it may be convenient to have central government monitoring of significant balance-sheet risks, including those originating in CL, so as to ensure that actions of third parties do not increase its exposure as guarantor of last resort. In some cases, the central government may wish to go beyond this and to manage residual public-sector risk, risk that remains unhedged at a sub-national or SOE level. This allows the central government to address risk from a portfolio perspective, taking into account correlations between different types of risks.

Also, the central government may deem it convenient to establish policy guidelines for decentralized CL risk-management that promote good governance and reflect the sovereign's risk tolerance. Such guidelines may include principles such as establishing caps on CL risk, risk-sharing, neutralizing budgetary incentives in favor of CL compared to direct loans or subsidies, as well as disclosure and accountability. These principles may be applied even more strictly in countries where particular economic and financial vulnerabilities and/or a weak risk-management capacity produce a low risk tolerance.

[1] See Polackova, Hana (1998), Shick, Allen(1999), and Kharas, Homi (1999)

The central government may take on private-sector risk if it implies systemic risk, such as in the case of a financial sector crisis. In this case, risk can be partly controlled *a priori* with effective regulatory structure and tight supervision. Additional risk coverage by the central government, beyond systemic risk, is a matter of political economy policy. In any case, those policies should take into account their complete fiscal implications and be expressed in a set of clear rules that govern the sovereign's commitments.

A sovereign asset and liability management (ALM) framework also has organizational implications for the government. Depending on the country's context, economic vulnerability and risk-tolerance, some kind of centralized arrangement that systematically addresses risk-issues in a transparent and explicit manner may be advisable. This could imply assigning, either to a formal asset-liability management unit or to the government's debt office, the responsibility for reviewing the risk of the entire balance sheet, establishing policies for sub-national government units, and monitoring of risk at various levels of the balance sheet. In some countries, the debt management office has a significant role to play in monitoring and managing an important part of sovereign risk, because of the fact that it directly manages part of the liabilities and is frequently involved in granting guarantees to other state entities. Whether or not the debt office ends up performing this function, the ALM approach strongly suggest the need for strengthening the typical middle-office function of risk analysis at different levels of the public sector.

The degree of risk-management centralization, both in policy and organizational terms, may depend on the macroeconomic context, on risk tolerance and risk management capacity, and on the type of institutional and political arrangements, such as the degree of political decentralization, etc. The more vulnerable the sovereign is to shocks and the weaker its risk-management capacity, as well as that of the rest of the public sector and indeed the private sector, the more stringent central government guidelines and monitoring should be. This is particularly important with regards to CL, which are often hidden and unaccounted for. The central government may end up not only monitoring and managing balance-sheet risks, but also promoting a risk-management culture in the rest of the public sector.

The paper is divided into eight sections including this introduction. Section 2 describes the ALM practice used in the private sector as an appropriate framework for the analysis and management of sovereign risk. Although governments have different objectives than those of corporates, and therefore a different conceptualization of risk, the same portfolio management principles can be applied to sovereign risk identification and strategies for controlling risk. Section 3 discusses the government balance sheet as the conceptual framework for applying ALM. It differs from the traditional accounting balance sheet in that it includes only those items affecting sovereign risk, as defined in the previous section. Contingent liabilities are treated as on-balance sheet items, as they are major contributors to sovereign risk. Section 4 discusses risk identification in an ALM context, with particular focus on its application to CL. In this framework it can be seen that risks affecting CL are no different from those affecting assets and direct liabilities, and that the techniques used to quantify CL risk are similar to the ones used for estimating risk of other balance sheet items. The analysis of risk in the government balance sheet also helps to better understand the typical vulnerabilities of emerging economies, particularly those relating to CL. Section 5 focuses on CL risk quantification by first giving a description of different valuation techniques and then emphasizing on simulation analysis, which is the same type of technique used for risk analysis in a sovereign ALM context. Section 6 covers risk management of CL, suggesting some general principles as an introduction to best practice. Section 7 deals with organizational issues that stem from the risk management discussion. Finally, section 8 documents some practical applications of the two former sections with country examples.

II. The ALM framework

A. ALM approach for a private firm

The asset liability management (ALM) framework for risk management has been in use for a few decades by banks and other financial institutions[2], and has subsequently been adopted by other private sector agents. Traditionally, it starts with the characterization of a firm as a profit or net worth maximizer under conditions of uncertainty. Faced with budgetary restrictions, the firm seeks to reduce risk stemming from the unpredictability of business conditions until that point when the corresponding cost becomes higher than the risk reduction benefit. Risk within this context can thus be measured as the volatility of net worth or profits; more precisely, risk is perceived as potentially diminishing profits, or worse still, zero or negative net worth i.e. bankruptcy.

The ALM approach gives insights on the way a firm can manage both assets and liabilities in order to reduce the volatility of net worth by applying some basic principles of portfolio management, like diversification and hedging. Indeed, a central argument of the ALM framework is to contain risk by matching the financial features (e.g. interest rate characteristics) of the assets and liabilities, as then one side of the balance sheet will be hedged –or immunized- by the other side.

Matching, however, does not need to be complete. In fact, normally banks borrow from the public at short maturities and lend at longer maturities and their return is partly a function of managing the risk embedded in the maturity transformation. This draws attention to liquidity risk as one of the critical exposures faced by these firms: when liabilities cannot be rolled over or assets cannot be liquidated, a bank may face liquidity difficulties, which, if prolonged, may lead to insolvency.

For risk management purposes, the ALM framework suggests that risks that cannot be hedged can nevertheless be controlled through diversification. Banks apply this principle spreading their loan portfolios by industry or geographically. Also, in the case of assets that run the risk of not being recovered, the ALM approach would propose the creation of provisions equivalent to the expected loss, and the maintenance of reserve capital in an amount equivalent to the unexpected loss.

In sum, the ALM framework helps firms analyze situations that can threaten their main objective of profit maximization, by processing the information contained in the balance sheet, deriving from there the potential risks, quantifying them, suggesting ways to reduce risk and providing guidelines to manage residual risk.

B. An ALM approach for sovereigns

Governments are expected to deliver certain services to society, for which society pays taxes. Like corporates, sovereigns´ future net worth is subject to uncertainty, depending on a number of unpredictable factors; e.g. business cycles, political events, developments in foreign markets, etc. Unlike corporates, however, governments are not profit or net worth maximizers, and have the capacity to raise taxes, if necessary. These two distinctive features have important implications for sovereign risk definition and for the application of the ALM framework.

For a sovereign, therefore, risk could loosely be defined as the possibility that services delivered have to be severely curtailed for a given level of taxes, or that taxes will have to be increased to maintain a given level of government services, both of which could result from different situations, including

[2] See Bitner, John (1992) and Fabozzi, Frank (1990)

sovereign illiquidity and insolvency. More formally, the government's objective, and by association, its risk definition, could be derived from the two streams of economic literature that deal with the optimal combination of taxes and debt[3]. As will be shown, the tax-smoothing and the default risk literature provide a well defined objective for the government: to manage assets and liabilities in such a way as to minimize the need to raise taxes or the need to curtail services when faced with unexpected shocks causing a permanent fall in fiscal revenues or a rise in the value of liabilities.

In the first place, the tax-smoothing literature proposes that higher long-term growth is more likely to be achieved if tax variability is minimal, since it reduces uncertainty. Taxes, other than lump sum, create inefficiencies as they distort economic decision- making and volatile tax rates create significant losses inasmuch as they complicate long-term investment decisions, depress consumption and possibly channel excess savings into short-term financial instruments. However, sufficiently volatile debt service, or liquidity risk, may oblige the government to raise taxes and can actually threaten default as there is a limit to the government's ability to raise taxes.

In the second place, the default risk literature emphasizes the costs of default in debt-servicing, including: i) output losses from economic recession ii) financial institutions' bankruptcies, possibly leading to systemic risk, either directly because the entities hold government debt in their portfolios, or indirectly, as a consequence of the economic recession iii) income redistribution from debt-holders to non debt-holders iv) loss of reputation and higher costs of future borrowing, and v) higher funding costs for private sector borrowing as a result of the government's reputational loss.

The two streams of literature therefore suggest that the government should avoid raising taxes, not only because this decreases welfare, but specially because this erodes the cushion that protects it from incurring significant default costs.. That cushion -namely, their ability to raise taxes- is the very especial asset of governments, and at the same time it constitutes governments' net worth. Consequently, balance sheet and off-balance sheet items, including CL, should be managed in a manner consistent with the objective of maintaining the level of services the government is expected to deliver without raising more taxes.

By avoiding situations in which shocks cause liabilities to permanently exceed assets, the government avoids the need to raise taxes, protects its net worth and keeps it for emergency circumstances for which there is no possible hedge. For the sovereign's balance sheet management, this entails that asset and liabilities should fall or rise together when responding to movements in interest rates or exchanges rates, or, in other words, that liabilities should be immunized with assets, at least against shocks on the financial variables.

Thus, the same ALM framework used by private firms could be applied to a sovereign balance sheet. Mismatches between the financial characteristics of assets and liabilities risk having to raise taxes and erode government's net worth. A mismatch of currency of denomination, tenor, interest-rate refixing period and liquidity of the instruments, could result in a gap between the value of the assets and that of liabilities, as a response to market movements or due to an illiquid market context which makes liability refinancing more difficult. The ALM framework would thus require a thorough analysis of the sensitivity of both sovereign assets and liabilities, including CL, to the financial variables that determine their performance over time.

Nonetheless, it should be noted that both assets and liabilities are also sensitive to macro-economic variables and that immunization in this case can be far more complex. Useful insights can be gained from

[3] For analysis on government objectives from the tax smoothing perspective see Missale, Alessandro (1997) and Barro (1995). For the default risk perspective see Alesina (1992)

analyzing the assets' sensitivities to these variables, and whether they add to the sovereign's risk, for instance, in terms of excessive dependence on a narrow economic base. In a sense, sovereigns could take the assets as a given, as fiscal flows may be dependent on structural macroeconomic variables of the economy, and may be less flexible to changes than a financial entity's asset flows. The ALM framework would then suggest that risk-management focus on the liabilities, as will be discussed in section 6.

In theory, this risk identification should analyze asset and liability *portfolios*, in order to evaluate the interrelation among the different types of exposures, so as to take advantage of diversification benefits, and to manage aggregate risk dimensions. A more systematic and holistic approach to risk management can thus be implemented, as opposed to dealing with individual balance-sheet items. Another advantage of the all-inclusive, portfolio approach is that it implies a higher likelihood of identifying and perhaps better managing, systemic risk scenarios, when the various sovereign exposures of both asset and liabilities are triggered at the same time. This is the worst-case event that is rarely modeled, but that has the most important implications for macro-economic stability and growth.

Risk, or the mismatch between assets and liabilities, can be measured either in present value or in cash flow terms, whichever is more convenient or useful. However, the complexity of the government cash flows and the importance of analyzing liquidity risk through time make cash flows a preferred vehicle for analyzing sovereign risk.

Finally, the same principles of diversification and provisioning used by the private sector in risk management also hold for sovereigns. Nonetheless, governments may have less flexibility in diversifying their portfolios, and a limited ability to build reserves against unexpected losses. Section 6 discusses in detail a number of tools available to governments for risk-management.

III. The conceptual government balance sheet

Governments, unlike corporates, do not normally draw up balance sheets. Instead, their main financial reports are the budget and the estimate of public sector borrowing required to finance it. The budget typically consists of a report of expected cash inflows and outflows for the year, and as such, is not intended to reflect the fundamental, long-term financial condition of the sovereign.

Budgets regularly use cash accounting, which is one of the causes of the substantial growth of contingent liabilities in some countries inasmuch as they appear to be a cheaper source of financing when compared with subsidies or direct loans, as the latter do register an immediate expense using up the government's spending capacity[4]. Accrual accounting, as will be discussed later, is more neutral when the government decides on the vehicle for resource allocation and it is more effective for controlling spending.

Nevertheless, for the evaluation of the sovereign's risk exposures, the budget is not enough; instead, a more adequate framework for the analysis of the government financial condition is provided by the sovereign balance sheet[5]. Since this departs from the traditional type of budgetary analysis, two points merit further comment.

[4] The contingent liability will only be accounted for as an expense until default or underperformance occurs. See Shick (1999) pg. 11

[5] Traditional measures of fiscal deficit and adjustment programs judged on those traditional measures also lack the more complete picture given by the entire balance sheet. See Easterly (1998)

First, although balance sheet items are normally treated as stocks, both assets and liabilities can be measured and expressed as present values or as cash flows. In fact, information for some items like tax revenues is primarily available as a flow, and the stock is computed by discounting the cash flow. For other items, like foreign reserves, the stock is known and some assumptions on interest rates are necessary to convert them into flows. As will be shown in section 4, for complex risk analysis it is more convenient to work with cash flows, even though fundamentally they are merely expressing the value of assets and liabilities in another form.

A second and more important consideration relates to the items to be included for running a solvency test. The criteria for inclusion has to do with the focus of the analysis, namely, sovereign risk. This risk has been defined as a situation in which external shocks force a sovereign to raise taxes in order to maintain the expected level of services, or worse, when the capacity to raise taxes has been exhausted, its inability to service its financial liabilities in general. Consequently, items that may cause greater indebtedness, or that may help the sovereign fulfill its financial commitments, should be included. This leads to the exclusion of assets that do not generate financial flows and the inclusion of contingent liabilities.

Indeed, some items that would normally be part of the accounting balance sheet can be irrelevant for this analysis, namely, illiquid assets such as national parks, military equipment, official buildings, etc. Some SOE may also fall into this category, although a strong case can be made for including them in balance sheet if they are part of a privatization program.

On the liability side a critical role is played by CL, that according to the traditional accounting principles, are off balance sheet items[6]. In some cases CL pose such an enormous threat to tax stability, that they represent the major source of sovereign risk, and as such should be included in the balance sheet.

In sum, the conceptual balance sheet referred to in this paper is an economic one[7]. It can be seen as the accounting balance sheet modified to include only those items representing potential financial obligations, or that can effectively be used to meet those obligations. The difference is economic net worth, and as explained, the government's objective is to avoid eroding net worth by raising taxes.

Based on this conceptual balance sheet, the ALM approach provides useful insights on the sovereign's exposure, as the following examples illustrate. If, for instance, assets tend to be denominated in local currency, then liabilities should also be denominated in local currency; issuing debt or contingent liabilities in foreign currency exposes the sovereign to the risk of a local currency devaluation. Similarly, if the sovereign has few real assets that generate financial flows, holding commitments indexed to inflation exposes the sovereign to the risk of an increase in inflation.

This type of assessment can be done without actually computing the so-called economic balance sheet[8], allowing sovereigns to identify major exposures and adopt strategies that greatly reduce its vulnerability. In fact, a number of OECD countries, most notably Belgium and Denmark, built their debt management strategies based on an ALM approach without actually computing the current balance sheet. It should therefore be emphasized that the conceptual balance sheet is more an organizing framework that helps to identify the main sources of risks and the potential strategies that can help reduce it, rather than a set of numbers from which actual risk can be directly quantified.

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[6] According to the Accounting Standards, a liability can only be recognized in the balance sheet when it is likely to generate an outflow of resources that can be reliably measured. See Shick (1999), pgs 3-4.

[7] It is worth noting that modern accounting theory is also moving in the same direction.

[8] Few countries publish even an accounting sovereign balance sheet. One such country is New Zealand, whose balance sheet can be consulted at the web page of the Treasury www.treasury.govt.nz , and another more recent example is Colombia, see Echeverry (1999).

In practice, the main government assets are future fiscal surpluses. These are usually denominated in local currency, and tend to be largely insensitive to the movement of short-term interest rates and to inflation. Hence, when liabilities are denominated in local currency, have long duration and are not indexed to inflation indices, it is unlikely that the government will be forced to raise taxes to respond to a shock in these financial variables. Risk therefore can be minimized based on the previous analysis, without actually computing the balance sheet.

Nonetheless, quantification of the economic balance sheet plays a critical role in the consolidation of the government's fiscal position. As a number of analysts have pointed out, the international experience shows that significant fiscal risk arises from CL that sovereigns keep hidden from the budgetary system. In this sense, transparency and disclosure of CL is the first step towards proper risk management. Quantification of the conceptual balance sheet may also be required for a more rigorous analysis that attempts to determine the asset and liability portfolios the sovereign may wish to hold as a function of the cost/risk trade-off and the sovereign's risk tolerance.

The following is a summarized illustration of a government's conceptual balance sheet.

Table 1
Conceptual Government Balance Sheet

Assets	Liabilities
	Direct Liabilities
PV of fiscal revenues	PV of fiscal expenditures
Foreign exchange reserves	Net market value of sovereign debt[9]
Marketable securities	
Onlending (e.g., IBRD loans)	**Contingent Liabilities**
Investments in SOEs	Explicit contingent liabilities
Investment in infrastructure (e.g. roads)	Implicit contingent liabilities
	Equity
	Net worth of government estate

Following the above rationale, the assets included are mostly financial. The difference with the traditional accounting balance sheet lies in the inclusion of CL in the liabilities, and the exclusion from the assets of government investments in national parks, military equipment, and the property portfolio.. However, there might be cases when even some of these assets should be included, as in the case of sovereigns that include their property portfolio in their privatization programs. As mentioned, the particular content of the so-called conceptual balance sheet depends on the particular country being analyzed.

The following items are the CL that may play a role in a sovereign economic balance sheet.

Contingent Liabilities are obligations that materialize if a particular event occurs. They can be explicit, if the sovereign contractually acknowledges its responsibility to cover the beneficiary under specific circumstances, or implicit, when the government is expected to do so because it has a "moral" obligation, in most cases related to a high opportunity cost of not intervening. In

[9] Includes the monetary base and is net of Central Bank holdings of government debt.

the conceptual balance sheet, CL are recorded as the present value of expected costs for the government, and not as the face value of those liabilities[10].

Explicit contingent liabilities

i). Credit guarantees: the government accepts to fulfill the obligations of the guaranteed entity if it fails to repay a loan. This mechanism is frequently used with subnationals, SOE's and private firms participating in a privatization process. Insurance against losses on bank deposits are also a type of credit guarantee.

ii). State insurance schemes: this is a mechanism by which governments insure against losses on crop failures, natural disasters or guarantees a minimum return on private pension funds.

iii). Legal proceedings and disputes: legal claims against the state may arise from property damage by public projects, malpractice in public hospitals, claims against army or police forces, tax in dispute, claims against sub-nationals and SOE's, and others. Once the court settles against the government, it becomes a direct liability.

Implicit contingent liabilities

i). Financial system bail-out: the financial sector may generate a huge economic cost if lack of government intervention allows a systemic crisis to develop. As illustrated by the East Asian experience, this item could be the most important CL on a sovereign's balance sheet. Even governments of industrialized countries such as Sweden and the USA have in the past intervened beyond their contractual obligation. Standard & Poor's has developed a methodology to measure the size of this CL and its estimates are readily available.

ii). Fixed exchange-rate regime: the adoption of a currency peg as a foreign exchange policy implies that the central bank stands ready to defend it by buying or selling foreign reserves until excess supply or demand are cleared. Thus the regime entails a contingent liability for excess demand for foreign exchange that could deplete the country's international reserves. This contingency might be triggered either as a consequence of poor macro policies, or as a result of exogenous capital flows over which the government has less control.

iii). Corporate sector bail-out: the government may bail out corporate entities, because of externalities. In Korea, banks' dependency on chaebols implied that not helping the latter would have resulted in the bankruptcy of the financial system. Although difficult to estimate, this item can be calculated from information of previous government interventions, ownership concentration in the corporate sector and linkages between government banks and corporates.

iv). Uncovered losses or default on non-guaranteed debt issued by subnationals, SOE's or central bank: because of reputation and potential credit risk reappraisal from rating agencies, governments may choose to honor those obligations, even when they have not backed them explicitly. The less explicit the commitment, the harder it is to quantify this CL. Complexity increases with the number of variables that should be estimated, such as entities that might be bailed out, size of the potential default and timing. Past experience can be an indicator 11

[10] In some cases however a sovereign may decide to record the face value of the CL as an expenditure to discourage its use as did The Netherlands when guarantees were first incorporated into the budget, see Shick (1999) pg. 29-30.

v). Cleanup of liabilities of privatized entities: governments may have to take over obligations of entities to be privatized, in order to attract investors[12]

vi). Disaster relief: natural disasters, the dismantling of nuclear plants and environmental recovery are force majeure events that compel the government to assume the costs involved and which are difficult to predict[13].

vii). Critical social and welfare functions: failure of private pension or social security funds could become government obligations in some countries because it is believed that social services ultimately are an obligation of the government[14].

IV. Contingent Liabilities and Sovereign Balance Sheet Risks

The risk of a potential shock forcing the government to raise taxes can be analyzed in terms of a potential fall in assets, an increase in liabilities or a combination of the two. However, for the purposes of the present analysis four different sources are identified: i) decreased net fiscal flows ii) reduced asset values iii) increased direct liabilities and iv) increased CL.

i) A severe contraction in tax revenues or a significant expansion of government expenditures caused by external shocks may cause a fiscal shortfall, that in turn may induce a tax hike and increase the likelihood of sovereign default. As is later argued, non-G7 countries are more exposed in this sense because of specific features of their economies.

ii) A second source of risk is decreased asset value, such as a fall in international reserves, or financial losses registered by SOE's and by sub-national entities. Underlying factors such as the defense of a fixed exchange rate, the collapse of the price of main commodity exports, and credit or liquidity problems of public entities could cause the fall in asset value, with significant risk to the government.

iii) A third source of risk to the government is an increase in the value of direct liabilities relative to asset value. As government expenditures have already been mentioned, this alternative refers mainly to debt and tends to reflect debt-servicing volatility caused by fluctuations of exchange and interest rates.

iv) Last but not least, if significant CL unexpectedly materialize, there is the risk that taxes may have to be raised. Various explicit and implicit CL could trigger this situation, including credit guarantees, bailouts of financial and/or public enterprises, insurance for major natural disasters, etc.

A brief mention has already been made of different events that could negatively impact the stability of taxes. This leads to the question of whether the underlying factors threatening tax stability are different for traditional balance-sheet items, and for CL. It will be argued that potential tax volatility may result from either risks in the macroeconomic fundamentals or from risks in financial variables, and that these

[12] For an illustration see the case of Hungary in Polackova (1999a) pg. 20-24

[13] In the case of Colombia, Echeverry finds out that during the last decades, the country has experienced a severe earthquake once every four years and a flood of major consequences every two years. He estimates a corresponding contingent liability of about 1.1% of 1997 GDP. See Echeverry (1999)

[14] For an illustration see the case of the pension reform in Hungary in Polackova (1999a)

two generic underlying factors affect CL, as well as regular assets and liabilities. Although macroeconomic and financial risks are interrelated and can be modeled together, they are separated for the purpose of the following analysis.

i) Macroeconomic risk: demand or supply shocks, such as a deterioration in terms of trade, may trigger an economic contraction and lead to increased government expenditures, reduced tax reserves and possibly inflation.

ii) Financial risk: a second type of risk inherent to financial variables. Financial risk includes: a) market, b) liquidity, and c) credit risk.

a) Market risk is understood as the uncertainty in the value of sovereign balance sheet items, due to movements in financial variables such as exchange, interest rates and commodity prices.

Exchange rate risk tends to be significant. As evidence shows, local currencies in emerging economies display a pattern of infrequent and unusually large jumps. A number of these currencies have from time to time shown fundamental overvaluation, providing an opportunity for speculative attacks and massive devaluations. Since assets are largely denominated in local currency, whereas a substantial part of the liabilities is denominated in foreign currencies, devaluations have depleted sovereign assets, and made direct and contingent liabilities more expensive, thereby forcing the government to increase taxes and in some cases threatening to provoke a default since the capacity to raise taxes has been taken to the limit.

Similarly, SOE and sub-nationals with foreign currency debt can face serious difficulties in the timely servicing of foreign debt, for their revenues are largely in domestic currency. Liquidity problems may trigger explicit and implicit CL, particularly when reputational risk has significant externalities. A massive devaluation could also trigger exchange-rate guarantees issued to infrastructure projects. It could also cause a liquidity crisis in a banking system having a significant short-term foreign currency debt, (which in turn may require a government bailout in order to avoid systemic crisis), or bring about the insolvency of public sector enterprises with foreign currency debt.

Domestic and foreign interest rate shocks may have similar effects as those described above for exchange-rate shocks. If liabilities have a duration significantly shorter than that of assets, the cost of servicing domestic debt may greatly increase when there is a significant and prolonged tightening in monetary policy, thus endangering the tax stability objective. This can also be the case of a prolonged defense of a fixed exchange rate. However, if interest rates display a mean-reverting pattern, the negative impact on the sovereign's net worth may be inferior to that of an exchange rate shock. In any case, a marked increase in interest rates can make debt servicing more expensive, erode the financial situation of SOE and sub-nationals, induce a contraction of aggregate demand and affect the health of the financial system, all of which tend to induce an increase of taxes and subsequently increase the risk of default.

b) The second financial risk is liquidity risk. Assets and liabilities may register mismatches in maturities and liquidity, with assets having longer maturities, or less liquidity, than liabilities. Most commonly, this situation arises as a result of an accumulation of short-term obligations that cannot be rolled over and where governments lack the funds to service the obligations. CL can also generate liquidity risk insofar as they behave like American options, which can be called at any time; they can thus trigger a liquidity crisis, especially with implicit CL that tend to be large by nature, the most striking example being a financial sector bailout. Another special feature of CL is that normally there are no assets readily available to match those liabilities, given the lack of budgetary procedures that account for the expected cost and the deficiency of reserves against unexpected costs.

c) Credit risk refers to a debtor's inability to fulfill its financial obligations. Credit risk for the central government can originate from both sides of its balance sheet, namely, from its assets and from its CL. In particular instances the two may be connected, such as when SOE or sub-nationals have central government equity and at the same time expect the government to intervene in case of financial difficulties caused by excessive leverage, for example.

Different aspects of credit risk affect the government cash flow in varying degrees. On the asset side, a deterioration in the financial situation of SOE, sub-nationals and even the Central Bank, may reduce the cash flows the government expects to receive from those assets. If financial difficulties increase, explicit guarantees given by the central government may be called, and if they deteriorate further, these entities could face a liquidity crunch or a solvency problem that could trigger a more significant cash outflow from the government, in terms of a bail-out.

The degree of credit risk to the government originating in CL depends largely on the degree of central government intervention in the rest of the public sector and the economy. At one extreme there is small sized government with limited assets in vital sectors and enterprises, which promotes a strong autonomy of public entities, very restricted explicit CL and virtually non-existent implicit CL. Moral hazard is not an issue. At the other extreme, there is ample intervention of the government in the economy reflected in a wide variety of investments in the real sector, management intervention by the central government in entities it invests in, widespread issuance of explicit CL and the de facto acceptance of implicit CL. The two typologies result in different CL credit risk implications for the central government's cash flows.

From the previous analysis it can be concluded that CL are exposed to the same types of risks, both macroeconomic and financial, that affect assets and other liabilities. The ALM framework shows that situations that may force the government to induce tax instability can arise from different sources; hence the importance of looking at the entire balance sheet.

This kind of analysis is particularly important for non-G7 economies, for the above-mentioned risks are more significant than in their G7 counterparts, and therefore require better monitoring and management. Emerging economies tend to be more prone to financial and economic instability than their counterparts in industrialized countries, as the following examples show:

i) They have more volatile business cycles since their economies tend to be less diversified: GDP and government revenues sometimes depend excessively on one or two economic sectors or commodities. Price swings and negative terms of trade can have excessive effects on these economies' asset flows, without offsetting flows on the liability side.

ii) In some countries, there is an inherent trend for pro-cyclical fiscal policies that mismatch fiscal revenues and expenditures in the downturn of the economic cycle. In effect, because of pent up demand that builds up during recession, governments can not run a restrictive fiscal policy in periods of economic expansion, whereas in recessions, government expenditures are highly inertial and difficult to cut.

iii) Emerging market countries generally lack developed deep and liquid capital markets, which forces them to have short term domestic currency debt with increasing refinancing risk and/or incur foreign currency debt with consequent currency risk. Since assets are mainly long term and denominated in local currency, this represents a major cause of vulnerability.

This vulnerability seems to be aggravated by the role played by CL. The following examples highlight only a few important CL: guarantee issuance, the implicit backing of the financial system, a fixed exchange-rate regime and the potential bail-out of SOE and sub-nationals.

i) Many non-industrialized countries are in the process of privatizing their infrastructure, searching for benefits including new infrastructure development, reduction of budgetary subsidies and improvements in operation of existing infrastructure[15]. Sovereigns may extend guarantees in order to implement this process, and thus promote private sector participation in desirable economic areas, or obtain funding for socially desirable projects. These are important CL that may eventually bring problems to the sovereign´s ALM.

ii) Financial sectors of emerging market countries often lack adequate regulation and supervision which makes it easier for the banks to exploit the implicit backing of the government by adopting riskier positions. This situation is aggravated when the country opens its capital account, for banks already in a vulnerable position are exposed to more risk, especially to the volatility of capital flows.

iii) Some emerging economies have used a fixed exchange-rate regime as an anchor to help reduce inflation. This may sometimes lead to maintaining an overvalued exchange rate, that is an invitation for speculators to make profits when the central bank starts losing significant reserves.

iv) If the public sector is relatively large within the economy, sovereign balance sheet statistics will result in a complex layering of explicit risks. If there is an additional dimension of moral hazard arising from implicit CL, more privatized economies do not necessarily imply less risk for the central government, as was learned from the East Asian crisis. CL in particular are generally not clearly identified and documented.

V. Risk Measurement-Valuing Contingent Liabilities

The first step in quantifying risk is to value CL, in terms of the present value of future net costs that the government expects to incur by accepting such liabilities. The CL value can be estimated in various ways, including actuarial techniques, econometric and financial models, and contingent claim analysis.

Actuarial techniques are widely used in the insurance industry. They estimate the future pattern of losses based on historical tendencies. For results to be statistically significant, both a large database and a highly stable distribution of losses to be insured are required. This method can be explained with an example of an explicit guarantee extended by the central government to cover a portion of social security or health benefits. The actuarial method computes the CL's expected cost as the nominal or face value of the guarantee, times the probability of the guarantee being used, where the probability is based on the historical frequency of such guarantees being called. If a large part of the population receives social security or health benefits guarantees for a sufficiently long period and maintains the same pattern of using them, on average the estimation will be right. However, this technique has some limitations that make it difficult to extend its application beyond these cases. Firstly, there is insufficient data on specific events that triggered the use of CL in the past. Secondly, even when such data is available, the micro and macro economic context may have changed in such a way that the assumption of a stable distribution of

[15] This is the case of transitional countries that are shifting the role of the government from directly financing and providing services, to guaranteeing that the private sector will accomplish particular outcomes

expected costs does not hold. Thirdly, the CL must involve large samples, so that diversification can substantially reduce the variance on the aggregate.

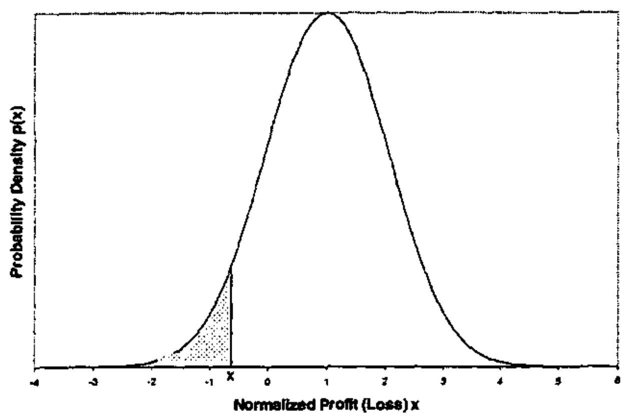
Econometric and financial models recognize the potential instability of the expected cost of CL, since those costs are triggered by economic and financial variables whose behavior can change over time. Instead, the government's expected CL cost -or the mean of the distribution- is calculated with models that forecast the underlying economic and financial variables that cause the CL to be called, but no attempt is made to measure the variance. These models are also used to assess the impact of different assumptions regarding the economic variables on the government's expected cost, in order to obtain a sense of the individual risk profile of a particular CL. This technique is frequently applied to CL incorporating credit risk, whose behavior is a function of the general state of the economy. However, econometric and financial models also require substantial data inputs, do not provide an estimation of the variance of CL costs, and do not offer the minimum variance resulting from large samples used in the actuarial technique.

Since both actuarial and econometric models focus on the mean of the CL costs, these techniques offer limited information to compute risk. An alternative approach based on option valuation techniques presents a richer description of the behavior of CL and provides an estimate of the variance of the distribution, which is the key component to value risk. Two of the techniques used to value options that have been applied to CL are contingent claim analysis and simulation analysis.

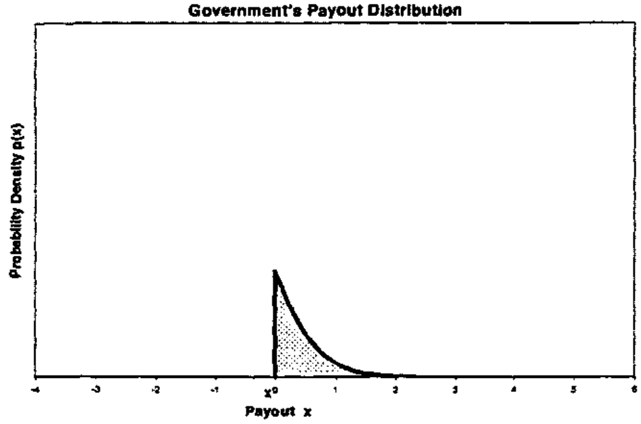
Contingent claim analysis is based on the concept that a CL is an option, in the sense that it can be exercised if a certain event occurs. The distribution of the pay-out for the government issuing a CL therefore looks like the truncated distribution of an option pay-out. Consider, for instance, a credit guarantee granted by the government on a loan to a SOE. The risk to the government is that the SOE may experience financial difficulties to the point where it is forced to discontinue its debt servicing, thus forcing the lender to call the guarantee and transfer the loan obligation to the government.

This example can be illustrated in the following graphs. In graph 1, the profits of the SOE are depicted as the risk factor that may trigger the guarantee. It is assumed that profits are normally distributed about a mean, assumed to be 1 in this case. At a point X, the losses experienced by the SOE will absorb the firm's equity, forcing the SOE to default on its debt and causing the lender to exercise the option. Graph 2 displays the distribution of the government cash flow. If the option is not exercised, the cash outflow will be zero; if it is exercised, the cash outflow is equal to the value of the guaranteed loan, less any recovery from the SOE. For simplicity's sake, it is assumed that the government's net exposure under the guarantee is equal to any losses realized by the SOE in excess of the equity. The distribution of the government's potential exposure is therefore the same as the distribution of the SOE's income truncated at point X.

GRAPH 1
SOE Profit (Loss) Distribution



GRAPH 2
Government's Payout Distribution



Thus, as graph 2 illustrates, contingent claim analysis not only gives the expected value of the government losses as the area under the curve, but also the dispersion i.e. the risk of facing unexpected losses. Before referring to the decomposition of a CL value into the expected value and a risk premium, it is important to understand how a CL can be valued.

A useful perspective for this purpose is that of the lender. From his point of view, if the SOE does not pay, the government does –guarantees are options that protect lenders against default. Thus, a loan to the SOE backed by a guarantee is like having a risk free loan. In this sense, the government guarantee can be valued as the difference between the price of a risky and the price of a risk free loan. Alternatively, if those loans are traded in the market, the put option can be valued based on the value of the loan, its price variance, the term of the option and the risk free interest rate This is how contingent claim analysis can be used to value a credit guarantee or in general any CL.

The advantage of this type of model is that the value of the option can be calculated directly from the value and the variance of an underlying asset, in this case the loan being guaranteed, the term of the option and the risk-free interest rate. This has enabled the application of the technique to value a variety of CL, such as loan guarantees, guarantees supporting corporate failure, mortgage guarantees and insurance products. In the USA for instance, the Office of Management and Budget applies option technology to estimate future expenses derived from such CL as deposit insurance, pension insurance and mortgage guarantees.

A more important advantage of these models is that they allow to decompose the value of the CL into the expected value and a risk premium. The difference between the pricing that results from the option model and the expected cost is precisely the market value of risk. In a simulation model this can be thought of as the market value of the capital allocated for risk, while the expected cost is similar to provisioning expenses.

To better illustrate the application of estimating both the expected value and the variance of the cost of the CL, the same example of a credit guarantee given to a lender in favor of an SOE might be considered. In effect, the above-mentioned credit guarantee can be treated as if the government was borrowing the funds and on-lending them to a SOE. This unbundling highlights the role of the government as a financial intermediary. According to the ALM framework, a bank in a similar situation should deal with credit risk in order to price the loan to the SOE: moreover, it should first provision against expected losses, then allocate capital against unexpected losses and, with that information, compute the risk premium on the operation. Replicating the same principle, the government could build budget provisions, set aside reserves and finally calculate the true cost of the CL[16]

Options therefore can be seen as simulation models that allow a richer description of the behavior of CL. Actuarial techniques, as well as econometric and financial models, value CL on the basis of the expected value of the losses that the implicit or explicit commitment entails for the government. Options not only provide the expected value of losses, but also the variance of the distribution of government losses, which is a more appropriate measure of risk. Hence, actuarial techniques as well as econometric and financial models can be seen as special cases of option simulation.

Nonetheless, it should be recognized that data may not be available for most CL. In fact, if there were a market for the majority of the underlying assets in which the CL could be unbundled, there would probably be little need for the government to accept those CL and the corresponding risk would be handled by the private sector from the start. Data availability therefore is the main limitation to derive the price of CL directly from option pricing models.

Still, if options cannot be applied directly, they can be recreated from a simulation of the risk factors that trigger CL. In the illustration given above, this is like simulating the distribution of the SOE's profits depicted in graph 1, and from there deriving the CL pay-out shown in graph 2, rather than assuming that the market will provide it.

This simulation technique could then be used for a number of CL, replicating the distribution of crop results, financial system performance, occurrence of natural disasters, and so on. Nonetheless, in order to simulate them, information on the parameters of such distributions is required. It can be found in historical statistics collected by the government, or from evidence of other countries that have dealt with those CL for longer periods. In the absence of statistics from which the mean and the variance can be derived, it will still be possible to recur to a Bayesian type of simulation in which the distribution of a occurrence of a natural disaster, for instance, collapses into the probabilities of binary events: either the disaster happens, or it does not.

[16] Section 6 addresses the implications that contingent claim analysis has for risk management purposes, namely: (i) if the government should charge the beneficiaries the "fair value" of the CL, (ii) if the government should provision expenses in the budget for an amount equal to the expected cost of the CL, and (iii) if the government should set aside reserves against risk, or if there an alternative and less expensive way to deal with this issue.

One important aspect is that the simulation techniques described here are inherently part of the same type of techniques used to measure risk in the broader balance sheet context. When modeling risk for debt service relative to the government budget, for instance, it is often difficult to have a direct estimation of the debt service volatility vis-a-vis government revenues. Instead, debt service has to be simulated from a given distribution of exchange rates and interest rates, for which a common approach is to derive the distribution parameters as a combination of historical information and judgmental input.

On the other hand, the simulation of any CL, like SOE profits in the above mentioned example, is a function of economic and financial variables that are the same ones that generate risk for other balance sheet items i.e. interest and exchange rates and macro-economic shocks. In theory, it would therefore be possible to find the elasticity of the value of a CL to changes in the independent variables and therefore quantify the portfolio effects of CL. With this information, it would be feasible to design a portfolio composition that uses diversification to minimize overall risk.

These considerations also have organizational implications as the teams in charge of risk measurement for debt are already familiar with simulation techniques and with the factors that generate risk. In this sense, and as will be suggested in section 7, there might be some advantages in having a centralized ALM team expanding the use of risk analysis techniques to the entire government's balance sheet and eventually to advice on macro hedging for the residual risk that results from the interaction of the different balance sheet items.

To summarize, contingent claim analysis is a technique that values CL either directly, or by simulating the spectrum of developments that may cause the CL to be triggered. It allows to estimate not only the mean, but also the variance of the potential CL costs. On the one hand, this feature explains why contingent claim analysis tends to produce higher estimates for the CL value compared to the more traditional techniques whose valuation is centered exclusively on the mean. On the other hand, the analysis provides an estimate of risk as the variance of the distribution of the government expenditure, which corresponds to the difference between the CL value minus the expected cost of the CL. Since very few of those CL have underlying assets that actually trade in the market, direct computation of the CL price and its risk from option modeling might be the exception. More generally, techniques that allow to simulate the risk factors that trigger CL are required. Not only are these simulation techniques part of the same technology used to quantify risk for regular assets and liabilities, but also the risk factors - macroeconomic shocks and financial variables- are the same ones that endanger the government objective of tax stability and can ultimately produce a default on the government's financial obligations. This commonality suggests the possibility of finding the elasticity of CL to those risk factors, in order to better understand their portfolio effects and to allow the construction of a portfolio that minimizes the risk of asset and liability mismatches.

VI. Risk Management

The first step in defining a CL risk-management policy is to determine the risk exposure that the government is willing to take. It is a political economy decision on the part of the central government as to whether it will manage only its own narrow balance-sheet risk, or whether it will also cover some of the risks generated in other parts of the public sector, and indeed in the private sector. Systemic risk originating outside of the central government balance sheet will most likely be covered, even if it originates in the private sector. However, there is an ongoing discussion with regards to the appropriate limits of the central government's granting further risk insurance and guarantees, e.g. in order to promote growth and development. This topic goes beyond this paper, which limits itself to underlining that there should be a strategy for dealing with CL risk, and that risks taken on by the central and sub-national government should be addressed explicitly and systematically and be incorporated into a broader balance sheet management of sovereign risk.

These strategies are precisely what most governments of non-industrialized economies lack. In a sense, CL in emerging economies have not been the result of deliberate political economy decisions, but rather have been accumulated "passively" as a result of the lack of explicit policies addressing sovereign risk management, combined with budgetary systems that favor CL over other forms of government financial support. In these cases, governments need to measure the CL risk inherited in that manner, evaluate their own risk-management capacity, and decide to what extent they will continue using CL in the future. If the analysis shows that CL are inefficient vehicles of public finance vis a vis other instruments and excessively risky for the government, it may be highly convenient for the government to implement an explicit policy which severely restricts the issuance and acceptance of CL. Countries like New Zealand and Argentina claim that not even financial system problems represent a CL for the government. These are examples of explicit political economy decisions to limit moral hazard by not accepting certain CL, as are the cases of debt defaults by the City of New York in the 70's and, more recently, by Gitic in China, where the governments did not intervene in order to avoid default.

For those governments that either accept to cover some of the risks generated in other parts of the public sector, and in the private sector, or that inherit a stock of CL from previous administrations, there are two broad approaches to risk management: decentralized or centralized. The difference between the two refers to the existence of a body in the central government that oversees risk for the entire balance sheet, and helps design risk-management policies both for the central government and for other entities whose risk is being covered. As will be shown in section 8, the United States is an example of decentralized management with a number of regulatory bodies that control risk for different CL without a central coordinating entity.

Centralization, however, seems to be the path followed by countries that did experience severe difficulties associated with debt management. Countries like New Zealand, Belgium, and Ireland, that experienced severe fiscal crises and high indebtedness which put macro stability at risk in the 70's and 80's, decided to create a debt office that was assigned the responsibility of managing what was then considered to be the biggest risk for the government: sovereign debt. Partly as a result of their success, and partly because of economies of scale, some of these same offices subsequently expanded their scope of influence, in order to deal with the risk of the entire government balance sheet, including CL. This trend, and the advantages in terms of positive externalities, have encouraged other countries to adopt a similar centralized strategy, most notably Colombia and South Africa.

It is worth noting that economies of scale may be significant. In effect, and as discussed in section 5, the simulation techniques used for valuing and quantifying CL risk are the same type of techniques used to measure risk in a broader balance sheet context and in particular for sovereign debt. Therefore, the same skills and technology are required in both cases. Investment in human capital and systems for an adequate functioning of a debt office may take various years, and once it is available it makes sense to extend it into an ALM office.

Thus, the trend for centralized risk management can be related to the size of the risks being managed and probably to the economies of scale that result from extending to CL the infrastructure available for risk management of sovereign debt. Both conditions seem to take place in most emerging economies. The more vulnerable the sovereign is to shocks and the weaker its risk-management capacity, as well as that of the rest of the public sector and indeed the private sector, the more stringent central government CL guidelines and monitoring may have to be. The central government may end up not only monitoring, and even managing residual balance-sheet risks, but also promoting a risk-management culture in the rest of the public sector. In this sense, it may want to bring out guidelines for CL risk identification, quantification and management. This may be especially applicable in the case of developing countries. In some cases, the central government may wish to go beyond this and to manage residual public-sector risk, risk that remains unhedged at the sub-national or SOE level. This allows the central government to address risk from a portfolio perspective, taking into account correlations between the different types of risks.

No matter whether risk management is centralized or decentralized, moral hazard must be contained. The policies in place should therefore ensure that beneficiaries of government backing will behave as if the support had not existed, and that they will not undertake excessive risk increasing the exposure of the guarantor of last resort. Two types of policies could be considered depending upon the degree of influence the central government has on CL beneficiaries: policies designed for the public sector, and policies directed to the financial system.

The following principles could be useful for containing risk of CL granted to the public sector:

i). Promote disclosure and accountability with regards to all CL
ii). Contemplate risk-sharing mechanisms and, whenever possible, refrain from covering risks that are under the control of the beneficiary, for this creates moral hazard. One way of risk sharing is pricing the CL and charging the corresponding value to the beneficiaries. Another way is to establish collateral requirements from the beneficiaries. In general, blanket risk guarantees should be unbundled into their different dimensions, in order to determine the best way to implement risk sharing among the different parties. It is convenient to determine what party can best manage specific types of risk. Important progress in this area has been made in the domain of project finance, and valuable insights can be incorporated into public sector risk management.
iii). Promote good governance of sub-national entities and SOE's, by delegating risk and promoting the ALM balance sheet approach described above at a sub-portfolio level, making sub-national entities accountable for managing their own risk and CL guidelines for state and municipal governments, whereby their financial autonomy is lost once a pre-established and quantifiable level of CL risk is reached.
iv). Ensure that CL compete on equal footing (e.g. in budgetary terms) with other forms of financial support, such as direct subsidies, tax exemptions, loans, etc, so that CL choices does not lessen public finance efficiency
v). Provision expected costs in the budget to make CL costs visible and in some cases build reserves against unexpected losses, possibly using the risk quantification methodologies mentioned above. Provisioning of expected losses should always be made, but the level of reserves will depend on the sovereign's risk aversion and its ability to withstand unexpected losses.

For the decentralized government sector, the experience of industrialized countries shows that proper accounting, using a medium-term horizon, with controls on direct and contingent indebtedness, disclosure of the financial information, performance measurement and accountability, have significantly reduced if not eliminated the risk of these CL.

In those cases where the government cannot promote the former principles because the CL is implicit and there is limited control, as is the case of the financial sector, the central government should encourage good governance and risk management with an effective regulatory structure and tight supervision. This includes specific limits on risk taking, minimum capital requirements, and periodic reports to an oversight institution for monitoring purposes. A sound financial system reduces the credit risk of the sector, diminishes the likelihood of a government intervention and the size of the CL. In turn, however, the good health of the financial sector depends on prevailing macro-economic policies and on risk management practices in the private sector.

The central government should also take the necessary actions to avoid the extension of systemic risk beyond the financial sector; again in this case, risk can be partly controlled *a priori* with effective regulatory structure and supervision on the involvement of the financial system with the corporate sector. The Glass Steagal act in the United States can be understood as an example of restriction of implicit CL to the banking system, whereas the involvement of the Korean government in the rescue of the Chaebols offers an illustration of a systemic risk originated in the private sector that surpasses the limits of the financial system. As mentioned, additional risk coverage by the central government, beyond systemic risk, is a matter of political economy policy. In any case, those policies should take into account their complete fiscal implications and be expressed in a set of clear rules that govern the sovereign's commitments.

VII. Organizational implications

A comprehensive sovereign ALM framework has important organizational implications for the government. For some countries, it shows the convenience of having some kind of centralized arrangement that systematically addresses CL risk-issues in a transparent and explicit manner, such as:

i) a formal asset-liability management unit (e.g. as in New Zealand or South Africa) that analyses the sovereign´s balance sheet risk, and

ii) independent centralized operational units, that nonetheless feed information into a centralized sovereign risk evaluation, possibly implemented by the debt management office, where the skills and techniques are the same for debt management and for sovereign risk management

A centralized organizational scheme of this sort may be particularly helpful for developing countries, with the particular kind of vulnerabilities mentioned above, and with low tolerance for risk. However, other frameworks can be equally useful in countries with other characteristics. For example, the USA does not have a centralized ALM monitoring of CL arising from the financial sector, but rather a decentralized scheme monitored and supervised by different agencies. However, even the USA tries to centralize an evaluation of guarantees and risk-covering instruments in the Department of Treasury, in order to standardize budgeting procedures and better control their budgetary impact. Although the best organizational arrangement for any given country may depend on the macroeconomic context, on risk definition, on technical capacity for risk-management, and on the type of institutional and political arrangements, such as the degree of political decentralization, recent country experiences show a trend towards centralized arrangements. As explained, this trend is related to the size of the risks been managed and economies of scale present in the process.

Whatever the organizational arrangement decided on, the most important element is that it should contribute to the institutional exercise of ALM and include CL within the risk-management exercise (e.g. promote clear objectives, such as avoiding budgetary shocks and protecting net worth; establishment of clear guidelines for managing CL risk,
assure mechanisms for quantifying risk-return trade-offs of CL; risk-identification using a conceptual balance sheets, periodic reporting to higher authorities within a clear system of delegation, a comprehensive information system on CL, etc.)

Typically, this will imply the need to strengthen the strategic analytical units, or the "middle offices", responsible for risk analysis and policy. In the case of the debt management offices it is important that the middle office group not be responsible for operational matters, such as funding, extending guarantee contracts or on-lending to SOE. CL should be one of the most important elements to be analyzed by the middle office staff.

One organizational mechanism which helps promote CL risk management within an ALM framework is to create a Sovereign Risk Management Committee, that would establish basic policies and monitor sovereign risk on a periodic basis, from an overall sovereign perspective. Again, its characteristics would be different depending on how risk is being processed, monitored and managed within the government. A committee of this type might be more important in those cases where risk-management is more delegated and/or where a large public sector means that the layering of different kinds of risks is very complex, and/or where specific sub-national interests are very strong.

In some countries, the debt management office has a significant role to play in monitoring and managing an important part of sovereign risk. This is precisely because of the fact that it directly manages part of the liabilities, is frequently involved in granting guarantees to sub-national government, and has staff with the necessary skills for managing risk. However, it must closely coordinate with the fiscal authorities and the central bank in monitoring the sovereign balance sheet as a whole.

There would probably be a need to coordinate between various government units in order to assure the existence of a comprehensive statistical base that would enable the necessary monitoring on the part of government agencies and supervisory entities. The importance of this base tends to be underestimated, in view of its significance for sovereign risk management. As mentioned before, this may involve statistics from both the public and the private sector.

Needless to say, it is essential for top government officials to give full support to CL risk management within an ALM framework and its policy and organizational implementation. Without Ministerial backing, the whole exercise will be unsuccessful, because it requires significant effort and financial resources for aspects such as information systems improvement, reporting, creation of middle offices and training of their staff in risk-management.

VIII. Examples of CL risk management with elements of sovereign ALM

A. New Zealand

The context is one of fiscal control, and government balance-sheet risk management, and is interesting inasmuch as it forces political accountability and transparency. The Fiscal Responsibility Act of 1994 requires the government to follow a set of principles of responsible fiscal management, under conditions of transparency and accountability including: i) management of the risks facing the government, and ii) achieving and maintaining government net worth, albeit defined in strictly accounting terms.

These balance-sheet risk management objectives were reflected in the organizational reforms of the public sector. The Treasury's operational responsibilities now include, among others, i) liabilities management, ii) monitoring Crown assets, iii) the management and production of a complete balance sheet of the public sector. The Asset and Liability Management Branch, under direct responsibility to the Secretary of the Treasury, advises on government financial policy as it relates to government ownership and balance-sheet interests. It manages the Crown's sovereign debt portfolio, provides advice on the performance and management of ownership risks in SOE and advises on the governance of public sector entities. It is responsible for producing the Financial Statements of the Government of New Zealand. These inform Parliament how public resources are being used, and report the government´s assets and liabilities, together with its revenue, expenses and cash flows, and contingent liabilities and commitments. Both quantifiable and non-quantifiable CL are closely monitored.

Within this framework, the government takes a series of measures to contain moral hazard and limit CL risk to the central government. For example, SOE are required to operate on the basis of principles and procedures contained in the State-Owned Enterprises Act 1986, that promotes efficiency, commercial criteria and autonomy from the central government. The SOE borrow in their own names and on their own credit, in most cases without a guarantee or other form of credit support from the Government. Government policy requires that SOE disclaim in loan documentation the existence of such guarantees or credit supports.

This organizational and policy ALM framework allows CL to be disclosed and analyzed, and generally contained at a sub-national level, as central government intervention is strictly limited. However, the emphasis tends to be on disclosure in accounting terms, and no evaluation is made of expected or unexpected costs, nor of provisioning from the budget and reserve creation. CL are given an accounting treatment and left as an off-balance sheet item, until they are triggered and only then are they incorporated within the balance sheet. Thus, the cost to policy makers is couched more in terms of political scrutiny, and less in terms of financial, budgetary cost.

B. United States

The objectives of the Federal Credit Reform Act of 1990 are those of revealing long-term program costs, to compare the cost of alternative forms of government assistance, to compare the benefit to the borrower vs. the cost to the government, and to make the Department of Treasury ultimately responsible. Thus, there is disclosure and transparency with new loans and guarantees and CL in general. In addition, the Treasury must budget for the estimated present value cost of new obligations, prior to the approval of new CL such as loan guarantees, as well as new direct loans. Thus, policy-makers feel a direct financial, budgetary impact of CL, and these are placed on the same footing as other forms of central government financial assistance.

One of the consequences is that programs are better structured to increase cost-sharing with borrowers, and risk-sharing with creditors. A medium-term horizon is used, and accrual accounting helps direct the attention to the effects of CL in terms of medium-term cash flow risk (expressed in discounted terms).A cash-based system of budgeting creates biases, in terms of just accounting for expected cash outlays associated.

One disadvantage is that the problem of variance around expected costs, the coverage of unexpected losses is not included as part of the cost of a program.

C. The Netherlands

The Netherlands has set a single budget ceiling within each sector for expenditures and guarantees. The sector decides on the form of assistance within the joint ceiling. The objective is to make sector ministries cash-neutral in choosing policy instruments e.g. between direct loans and guarantees, and to minimize the government's risk exposure.

Guarantees and their risk analysis need to be approved by the MoF. The government guarantees are disclosed in terms of face value (in order to disincentive their use), and the full face amount of the government obligation is transferred from the sectoral budget allocation to a central reserve fund.

D. Canada [17]

CL by federal departments and Crown corporations in Canada amounted to nearly $70 billion in 1997-98, representing about 8% of GDP. About two-thirds of the CL relate to loan and loan guarantees, mostly for borrowing undertaken by Crown corporations. The government´s current loan and loan guarantee policy was established in 1986, as a response to significant losses incurred in the early 1980´s mostly due to ad hoc loan guarantee programs which resulted in large cash payouts. The government began to implement accrual accounting with the explicit recognition that allowances need to be established for those cases where expected losses with respect to contingent liabilities could be reasonably estimated.

The policy is based on the following principles:

- *Budgetary recognition of subsidies and concessions*: with respect to loans, any interest-rate subsidy or other concessions are treated as part of budgetary expenditures
- *Demonstrated need:* the sponsoring department must demonstrate that the project could not be financed on reasonable terms and conditions without a government loan or guarantee
- *Satisfactory rate of return:* an economic analysis is made to demonstrate that the project´s expected cash flow is adequate to cover repayment of the guaranteed debt, interest and operating cost and yield a satisfactory rate of return
- *Real private sector equity at risk*: no project is considered for a government guarantee where private equity sponsors are not supplying a substantial portion of funds required from their own resources.
- *Lender risk-sharing*: bankers should be prepared to lend funds under conditions where they would bear at least 15% of the net loss associated with any default
- *Upside benefit:* where the government is requested to bear significant downside risks, considerations should be given quid pro quo on the upside should the project prove to be successful.
- *Cost recovery:* fees are set for loan guarantees to recover the estimated cost of future losses and help cover administrative costs
- *Up-front provisioning* for all loans and loan guarantees: the latter will be provisioned up-front at the time that they are made. The provision will be determined based on the risk assessment. Sponsoring departments are required to fund these provisions from either the fees they charge or from their annual appropriations.
- *Approval of MoF and Parliament*: all new loan and loan guarantee programs and changes to existing programs must be approved by the Minister of Finance. Parliamentary authority is required for all new loan and loan guarantee programs. Such programs are subject to a limit that can only be changed by Parliament.
- *Ongoing review and audit:* Departments and Crown corporations are required to submit regular reports on their CL. These are published on an annual basis as notes to the government´s financial statements. The estimates of the CL and losses are audited annually by the Auditor General of Canada, who is independent of the government and reports directly to Parliament.

E. Colombia

The Constitution of 1991 allowed private capital in public services and infrastructure development, and in order to encourage private sector participation, public entities guaranteed the servicing of projects' financial liabilities, and then proceeded to grant even wider guarantees. Guaranteed risks include demand

[17] Resolving Institutional Problems of Contingent Government Liabilities, Presentation to PREM Seminar Washington D.C., July 14, 1999

or traffic, prices, revenue, cost overruns, inflation, exchange rates, tariff scheme and regulatory frameworks. The disadvantages of this scheme included:

- lack of an established policy over which risks should be guaranteed
- in the first generation of guarantees, private sector parties enjoyed returns higher than corresponded with the risks undertaken
- ***crude methodologies were used to quantify CL and their possible effects for the nation's budget***
- ***the budgetary framework favored the substitution of explicit liabilities by implicit ones. The budgetary period is of only one year, so that the financial impact of guarantees is only reflected partially in the year in which they are given. This is an incentive to use instruments that do not require an immediate budgetary register, and allows the evasion of the real costs of CL.***

By 1997, CL in these sectors summed 1.6% of GDP, equivalent to 20% of that year's total investment in infrastructure. In the last three years, actual guarantee payments have exceeded the budgeted amount by 118%.

A law was passed in 1998 (Law 448) in order to increase the budgetary discipline of these CL, to recognize and value CL, to create the Contingent Fund of Public Entities and to assure that transfers to this Fund had the same priority as debt servicing. Thus, a formal and standardized procedure to value and budget these liabilities is being designed. The General Directorate of Public Credit must approve the methodology for valuing the CL. Public entities must do yearly transfers of resources to the Contingency Fund, according to a specific payment plan, in order to cover expected losses of the CL. The liability value, payment plan and deposits are adjusted to reflect the remaining life of the contract. If the CL were to be called, the entities have access to the accumulated deposits. This scheme thus improves the liquidity of guarantees.

In the interim, the central government must include guarantees within the credit ceiling limits approved by Congress. At the sub-national level, guarantees have to be included in the indebtedness

Colombia's efforts to improve on the management of CL have also included the draw up of an economic balance sheet. Based on Bill Easterly paper[18] which emphasizes on the need to measure the budget deficit looking at the public sector net worth instead of focussing on the change in public sector liabilities, Juan Carlos Echeverry, from the national Planning Department, tests the sustainability of the Colombian fiscal situation by estimating a complete balance sheet for the government, including contingent liabilities[19].

Data of the general balance sheet elaborated by the Nation's General Accountant for 1997 are used as a baseline, and then adjusted for coverage and errors. Some items are recalculated, while others –mainly contingent liabilities- are included for the first time. The public net worth is then computed as the difference between assets and liabilities, desegregating short term assets and liabilities to find a liquidity acid test.

The findings show that a more complete analysis of the balance sheet would be less optimistic than the official estimates: a positive net worth of 62% of GDP according to the official figures, would be substituted by a negative net worth representing 69% of GDP, mainly as a result of the recalculation of pensions. This clearly shows that the fiscal situation in the medium and long term is unsustainable and that drastic structural reforms are needed. However in the short term the situation does not seem to be so critical since short term assets are greater than short term liabilities by 1% of GDP.

[18] See Easterly (1998)
[19] See Echeverry (1999)

Some of the reforms suggested along the lines of this study are the reform of the pension system, particularly the system covering education and health sectors, the creation of the Fund for Territorial Liabilities so that sub-nationals will be obliged to fund and make provisions for their obligations, downsizing the public sector by merging and eliminating entities, and the increase in taxes in order to deal with financial crisis and with natural disasters.

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SESION 4

PAPEL, ALCANCE Y COSTOS FISCALES DE LAS REDES DE PROTECCION SOCIAL

SOCIAL ISSUES IN IMF – SUPPORTED PROGRAMS

by

Sanjeev Gupta, Louis Dicks-Mireaux, Ritha Khemani, Calvin McDonald, and Marijn Verhoeven *

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Preface

As part of its mandate, the IMF seeks to create the conditions necessary for sustained high-quality growth, which encompasses a broad range of elements. These include sound macroeconomic policies, growth-enhancing structural reforms, good governance, and social policies, such as cost-effective social safety nets and targeted social expenditures. Over the years, the IMF and the international community have increasingly recognized that macroeconomic and structural policies have important social implications, which in turn have ramifications for the domestic ownership of economic and reform agendas and promoting sustainable growth. In particular, social safety nets that are aimed at cushioning the adverse social impact of adjustment programs on vulnerable groups have become increasingly important. Also, there has been greater focus on the prioritization of public spending on areas of social policies that promote growth through poverty reduction, specifically with regards to increased access of the poor to education, health, and economic opportunity. The IMF has therefore taken a progressively more active stance on social policies to ensure that they are well integrated into IMF-supported programs and IMF policy advice. A key element of the IMF's involvement in social policies has been collaboration with other relevant international agencies, especially the World Bank, in order to draw upon their social policy expertise.

This paper—the most recent of a series of reviews of the IMF's involvement in social issues undertaken since the late 1970s—reviews the IMF's policy advice in two key areas of social policy: social safety nets and public spending on education and health care. It was initiated as part of the work by the World Bank and IMF to strengthen the poverty focus of adjustment programs in low-income countries, in particular within the framework of the Initiative for Heavily Indebted Poor Countries (HIPCs). This review looks at such social policies in IMF-supported programs in two broad groups of countries. The first group comprises a sample of up to 65 countries that implemented IMF-supported programs between 1985–97. The second group comprises a sample of up to 12 countries that implemented programs under the IMF's Enhanced Structural Adjustment Facility (ESAF), including under the HIPC Initiative during the latter part of the 1990s. The paper pulls together the main lessons from this experience and sets out proposals for strengthening the social content of IMF-supported programs including through mechanisms to strengthen World Bank–IMF collaboration in the social policy area. An earlier version of the paper was discussed by the IMF Executive Board on September 13, 1999; a summary of this Board discussion by the Chairman appears following the review.

Soon after these and other discussions (at the IMF and World Bank) on how to strengthen the poverty focus of adjustment programs in low-income countries, it was agreed at the IMF–World Bank 1999 Annual Meeting to put poverty reduction at the centre of adjustment programs supported by the international community in the poorest countries. To implement this significant shift in policies, poverty reduction was made a central objective of the ESAF which was transformed in December 1999 into the Poverty Reduction and Growth Facility (PRGF); this will also be a key element of the enhanced initiative for debt reduction. A central feature of the PRGF is the Poverty Reduction Strategy Paper (PRSP)—one of the policy recommendations of this review—which articulate a country's comprehensive strategy for poverty reduction and integrate macroeconomic, structural, and social policies. The PRSP would be nationally-owned and prepared through a broad participatory approach.

Overview

This paper reviews the IMF's policy advice in two key areas of social policy: *social safety nets* and *public spending on education and health care.* While the IMF has been helping countries promote sustainable economic growth and, thereby reduce poverty through macroeconomic policy advice, it has also been strengthening its dialogue with member countries on the social implications of its advice. This paper offers preliminary conclusions on how to improve the integration of IMF policy advice on social safety nets and public social spending into program design[1] within a sustainable macroeconomic framework.

In the family of international organizations, the social components of country programs are primarily the responsibility of the World Bank and other organizations, not the IMF. The World Bank has primary mandates, responsibilities, and expertise on social issues. Whenever feasible, the IMF has drawn, and will continue to draw, upon the work of the World Bank and other organizations. Hence, enhanced inputs from and closer collaboration with these organizations are essential. Another important element is more dialogue with civil society groups, in particular labor unions and nongovernmental organizations (NGO)s.

Social safety nets

The design of social safety nets and the timing of their establishment in countries have been influenced by both social protection needs and constraints. The needs reflected the specific adverse social effects of reform measures and the characteristics of affected groups. The constraints reflected the availability of social policy instruments such as old age pensions and unemployment insurance, and administrative and financing capacity. Whenever social policy instruments were available, the foremost challenges have been to ensure their targeting and to increase their financing.

This review identifies three key requirements for strengthening social safety nets in IMF-supported programs:

- more comprehensive ex ante analysis of the likely social impact of key macroeconomic and structural reform measures; such analysis needs to be undertaken before or at the time of program formulation;
- adequate follow-up of performance and monitoring of safety nets during program implementation to ensure that intended poor groups receive adequate support; and
- introducing appropriate social policy instruments before the onset of crises and economic reforms.

IMF staff needs to rely on the expertise of the World Bank and other organizations in conducting the ex ante analysis. IMF staff reports should discuss such analysis and also the performance of social safety nets. When the World Bank or other relevant international institutions are unable to provide needed advice within a suitable time frame, IMF staff should attempt to fill the gap. These situations, however, should be infrequent.

Public Spending on Education and Health Care

On average, in the past decade, education and health care spending has increased—in real per capita terms, as well as in relation to GDP—in countries with IMF-supported programs. For many countries, these increases have been accompanied by improvements in a broad range of social indicators.

[1] For program descriptions see the Glossary at the end of this volume.

Still, countries differ considerably on spending relative to GDP for both education and health care and on the speed of improvement of social indicators, reflecting in part differences in the efficiency of public spending.

There is scope for improving the efficiency and targeting of *existing* spending on education and health care as a means of improving social indicators. This improvement could be achieved through, among other things, strengthening budget formulation and implementation capacity, increasing resources spent on primary education and basic health care, and reducing excessive out-of-pocket expenses borne by the poor in the form of user charges for primary education and basic health care. To consolidate the progress already made, this review identifies some steps that should be taken in programs supported by the IMF for:

- establishing quantitative targets for education and health care spending more systematically, particularly for primary education and for basic health care; these targets should be reported in IMF staff papers for the Executive Board, and efforts should be made to strengthen the monitoring of such spending;
- occasionally setting performance criteria on minimum spending thresholds; and
- in some circumstances, monitoring budgetary allocations for selected key inputs, such as books and medicine (although an excessive level of detail in IMF-supported programs would be neither feasible nor appropriate).

These steps should be taken, in collaboration with the World Bank, by building on the progress that has already been achieved. IMF staff should continue to assess budgetary allocations for social sectors, relying on available World Bank input, in particular timely Public Expenditure Reviews (PERs). To help promote social reform, IMF-supported programs could use as reference points the targets established by the authorities for selected *intermediate* social indicators (e.g., primary and secondary school enrollment rates and immunization rates). Especially where social indicators are failing to improve, despite increases in public spending, IMF staff should report to the Executive Board on discussions with the country authorities, World Bank, NGOs, and other institutions.

World Bank–IMF collaboration

World Bank–IMF collaboration could be significantly improved by better integrating macroeconomic and social objectives, policy measures, and related work agendas. A shared understanding of the key social and macroeconomic issues is essential.

- Such collaboration could take place through the formulating of a poverty reduction strategy together with the country authorities in a participatory process. The main elements of the strategy would be set forth in a Poverty Reduction Strategy Paper (PRSP), which would be endorsed by the government, the World Bank, and the IMF. The PRSP would set out medium-term macroeconomic, structural, and social policies consistent with the government's poverty reduction objectives. An IMF- or Bank-supported program should be consistent with the policy framework contained in the country-strategy paper.
- When timely World Bank input is either not available or insufficient, program design should allow for the fuller integration of relevant social policies at a later stage (e.g., at the time of program reviews), as additional analysis becomes available.

The PRSP should include several components that would facilitate World Bank–IMF collaboration. These components, which would reflect the two institutions' respective operational responsibilities in a country, should contain policy advice, financing needs, and work programs, in particular in the context of IMF-supported programs and World Bank lending operations.[2] Through this process, an iterative dialogue between the staffs of the IMF and the World Bank would be intensified, assuring the consistency between a macroeconomic framework and a cost-effective strategy for sustainable growth with poverty reduction.

The social policy components of the countries' Comprehensive Development Frameworks (CDFs) could also be integrated into their macroeconomic programs. In this regard, drawing upon the advice of the World Bank, the authorities should formulate, at an *early* stage of their macroeconomic programs, comprehensive social strategies that include specific action plans that provide a much-needed road map from objectives to policies.

High-level poverty monitoring units in governments could help strengthen coordination at the local, national, and international levels and collect data for monitoring social progress.

Data and Institutional Capacity

IMF staff should make an effort to identify and highlight data weaknesses in the area of social spending indicators and social protection arrangements. This would help draw the authorities' attention to the urgent need to redress the data weaknesses in collaboration with the World Bank and other international agencies. In this regard, IMF staff should also assess the scope for technical assistance. Greater attention could also be given to inputs prepared by civic groups, NGOs, and donors.

I. Introduction

The IMF's mandate is, among other things, "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income . . . of all members as primary objectives of economic policy."[3] To this end, the IMF promotes sound macroeconomic policies, growth-enhancing structural reforms, and good social policies—conditions for high-quality growth. The IMF has paid increasing attention to these considerations in its policy advice.

This paper explores how attention to social issues can be accentuated. It is one of several papers that respond to the request of G-7/G-8 Finance Ministers at the June 1999 Cologne Summit to the World Bank and IMF to work together to strengthen social policies in the design of adjustment programs to protect the most vulnerable and to develop an enhanced framework for poverty reduction.[4] It looks at two social policy issues that are important for economic reform and growth—social safety nets and public social sector spending. It also identifies ways to better integrate sound social policies into the IMF's policy advice and program design within a sustainable macroeconomic framework.[5]

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2 A more detailed discussion of the proposed Poverty Reduction Strategy Paper is provided in the World Bank–IMF staff paper, "HIPC Initiative—Strengthening the Link Between Debt Relief and Poverty Reduction," which is available on the Internet: http:/www.imf.org/external/np/hipc/hipc.htm. See also the Glossary at the end of this volume.

3 Article I (ii) of the Articles of Agreement of the International Monetary Fund.

4 See also the World Bank paper, "Building Poverty Reduction Strategies in Developing Countries" and the joint World Bank-IMF paper, "HIPC Initiative—Strengthening the Link Between Debt Relief and Poverty Reduction." Both are available on the Internet: http://www.imf.org/external/hipc/hipc.htm.

5 The scope of social policies, and the channels through which macroeconomic policies can have a social impact, cover a broad area. The selective focus of this paper on social safety nets and public spending on education and health care allows in-depth consideration of a limited number of important social policies that are closely linked to the design of economic programs. For

(continued...)

This paper examines the experiences of two sets of sample country groups. The first set comprises large samples of up to 65 countries with programs supported by the IMF, including the countries that implemented Stand-By Arrangements and programs supported by the Enhanced Structural Adjustment Facility (ESAF) from 1985 to 1997; the analysis aims to identify broad patterns and reach general conclusions. The second set comprises samples of 11–12 countries that implemented ESAF programs, including under the Initiative for Heavily Indebted Poor Countries (HIPC), during the latter half of the1990s; the analysis focuses on the use and monitoring of program targets. (See the Glossary for descriptions of these facilities). The availability of data influenced the choice of countries, which may introduce some bias.

To a large extent, the analysis and policy advice on social issues lie outside the areas of IMF expertise. IMF staff relies on inputs from other international agencies, notably the World Bank. Thus, this paper also discusses collaboration with the World Bank and other agencies in the social policy sphere, including on internationally accepted principles, goals, practices, and indicators, such as those developed collaboratively by the Organization for Economic Cooperation and Development (OECD), United Nations (UN), and World Bank.

The paper has five sections. Section II describes the evolution of the IMF's social policy advice. Issues related to social safety nets as a mechanism to mitigate the immediate adverse effects of economic crises and reform programs on poor groups are presented in Section III. In Section IV we set out policy issues concerning the adequate provision of education and health care services—crucial for achieving countries' social development goals. We discuss IMF collaboration with the World Bank and other international organizations in Section V.

II. Evolution of the IMF's Policy Advice

Sound economic policies favor both growth and the poor. The contribution of macroeconomic and structural reforms to long-run economic growth and poverty reduction is now well established. Research has demonstrated that low fiscal deficits and price stability promote economic growth,[6] and economic growth is the most significant single element that contributes to poverty reduction.[7] Macroeconomic adjustment generally benefits the poor.[8] Dismantling product and factor market rigidities helps reduce poverty by increasing not only the supply of essential goods, but also the poor's access to them.[9] In

this reason, the focus is on the expenditure side of the budget, which has offered better opportunities than the tax side for poverty reduction (see Harberger, 1998). Likewise, the paper does not discuss the social impact of the IMF's macroeconomic policy advice, per se, except to the extent it bears directly on the design of social policies; nor does it attempt a broader review of IMF policy recommendations in the social sphere in bilateral and multilateral surveillance.

6 As regards fiscal deficits, see Fischer (1991); Levine and Zervos (1993); Easterly and Rebelo (1993); Bredenkamp and Schadler (1999); and Goldsbrough and others (1996); as regards inflation, see Barro (1995); Bruno and Easterly (1995); Sarel (1996); and Ghosh and Phillips (1998). Macroeconomic stability—lower (and stable) inflation—has also been shown to be conducive to higher long-run growth (World Bank, 1996).

7 World Bank (1996).

8 Demery and Squire's (1996) review of six African countries has shown that macroeconomic adjustment has generally benefited the poor.

9 Sahn, Dorosh, and Younger (1997), in a comprehensive study (based on computable general equilibrium models of 10 sub-Saharan countries) concluded that under structural adjustment programs supported by the IMF and the World Bank, most of the poor experienced small net gains. They also show that structural reforms hurt those reaping rents from distortionary policies who tend to be nonpoor.

addition, based on cross-country studies, there is increasing evidence that lower inflation also enhances income equality (Milanovic, 1994; Bulír and Gulde, 1995; Sarel, 1997; Bulír, 1998; and Guitián, 1998).

A. Two Social Sector Issues

Nevertheless, in the short run, measures needed for macroeconomic stability can adversely affect some poor groups, while helping other such groups. For example, currency devaluations may hurt the urban poor who consume imported grains, while helping low-income smallholders producing export crops in rural areas. Mitigating the adverse effects of reform programs on poor groups should be an important aspect of the IMF's policy advice and program design.

The size and quality of public social spending can affect long-run growth and poverty reduction. The relationship between public social spending, growth, and poverty reduction, however, is complex and dynamic, involving many other factors, including private spending on education and health care. Forging a consensus on a proper balance between macroeconomic stabilization and sound public spending through a participatory dialogue among the government, civil society, and the international community can be facilitated by establishing social and poverty reduction programs that are integrated into a sustainable medium-term budgetary framework.

B. Key Steps in the Evolution

Over the years, the IMF has taken a progressively more active stance on social policies to ensure that they are well integrated into IMF-supported programs and IMF policy advice. The IMF has strengthened the integration of social policies into its operations by establishing the Structural Adjustment Facility (SAF) in 1986 and its successor, the Enhanced Structural Adjustment Facility (ESAF) in 1987, and the Initiative for Heavily Indebted Poor Countries (HIPCs) in 1996 (Box 2.1).[10]

A key element of these new instruments has been the collaborative role of the World Bank. The IMF and the World Bank have collaborated through the Policy Framework Paper (PFP) in the ESAF and through the joint HIPC Initiative. More broadly, the IMF has intensified collaboration with other international agencies that have social policy expertise. IMF staff has participated in international social policy forums relevant to the IMF's economic policy advice. For example, the staff contributed to the discussion at the 1995 World Summit for Social Development in Copenhagen and recently to UN/OECD/World Bank discussions on a core set of international development goals and indicators (Box 2.2). The IMF also has organized conferences on Income Distribution and Sustainable Growth (1995) and on Economic Policy and Equity (1998) (see Tanzi and Chu, 1998; and Tanzi, Chu, and Gupta, 1999). In addition, IMF management and staff have engaged the representatives of civil society groups, including labor unions, NGOs, and religious groups, in a dialogue on social concerns and IMF policy advice. For example, meetings with such groups are now commonplace during staff missions or at headquarters.[11]

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[10] See, for example, IMF (1995) and Gupta and others (1998).

[11] Among the frequent contacts in civil society groups are Oxfam, Friends of the Earth, World Vision, the Swiss Council of Development Organizations, Witness for Peace, Christian Aid, Results International, and Caritas Internationalis. The IMF has organized numerous seminars for academics, labor unions, environmental groups, religious organizations and development NGOs. In 1996, the Managing Director addressed a World Congress of the International Confederation of Free Trade Unions (ICFTU) and in 1997 the World Conference of Labor. In addition, the IMF greatly increased the dissemination of information through press releases, public information notes, and the publication of some staff reports and other studies.

Box 2.1
Evolution of the IMF's Social Policy Advice

Recent Evolution

Specific operational guidance has been provided to the staff of the IMF through Executive Board discussions and guidelines.

- In the mid-1980s, Board discussions were held on poverty, fiscal policy, and income distribution in IMF-supported programs.[12]
- In 1993, the Executive Board considered issues concerning the design of social safety nets and their integration in adjustment programs, and in the mid-1990s the composition of public expenditures.
- In September 1996, the Interim Committee (now the International Monetary and Financial Committee) stressed the need for an enhanced approach to social sector policies in a declaration entitled Partnership for Sustainable Growth. It states that "because the sustainability of economic growth depends on development of human resources, it is essential to improve education and training; to reform public pension and health systems to ensure their long-term viability and enable the provision of effective health care; and to alleviate poverty and provide well-targeted and affordable social safety nets."[13]
- In June 1997, guidelines for improving the monitoring of social expenditures and social indicators were issued to IMF staff. The social indicators to be monitored included the core set of international development goals and indicators laid out in the March 1995 "Copenhagen Declaration on Social Development and Program of Action" of the World Summit for Social Development. Also, several of the recommendations of a recent external evaluation relating to the social aspects of the ESAF are being incorporated in ESAF-supported programs,[14] including through a pilot program for enhanced World Bank–IMF collaboration launched in 1998. Under this pilot program, World Bank and IMF staff work with six countries to make deeper assessments of the social impact of adjustment policies and to address these effects in the design of the countries' IMF-supported programs.
- More recently, especially in the aftermath of the Asian financial crisis, the Managing Director, Michel Camdessus, has stressed the need for a social pillar in the architecture of the international financial system.

Current Developments

The World Bank was requested by the Development Committee in October 1998 to develop general principles of good practice in social policies, and a paper was discussed at the Spring 1999 Meeting of the Development Committee. The President of the World Bank, James Wolfensohn, has also proposed a Comprehensive Development Framework. A social pillar would need to be founded on a strong statement of social objectives by countries in their policy frameworks, supported when needed by external financial and technical assistance.

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[12] See, for example, IMF (1996) and various Development Committee documents.

[13] See IMF (1996).

[14] See IMF (1997) and Abed and others (1998) for the internal review of ESAF.

Box 2.2
International Social Development Goals and Performance Indicators

Goals of Social Development

Since the early 1990s, various global UN conferences have established goals for social policies, as well as for the environment, human settlements, human rights, drug control, and crime prevention. In particular, the Copenhagen Declaration on Social Development (March 1995) laid out a program of action which, among other things, included the goals of eradicating poverty, promoting social integration, and achieving universal and equitable access to education and primary health care.

Key goals of social development are, by the year 2015 to:

- reduce the proportion of people living in poverty by at least one-half relative to 1993;
- achieve universal primary education in all countries;
- make progress toward gender equality by eliminating gender disparity in primary and secondary education (to be achieved by 2005);
- reduce maternal mortality rates by three-fourths and reduce infant and child mortality rates by two-thirds relative to 1990; and
- provide access to reproductive health services to all individuals of appropriate ages.

Indicators for Measuring Progress

Several sets of social indicators have been identified in various forums to assess social development and monitor key social development goals. Examples of such sets of social indicators are:

- the OECD/UN/World Bank core set of working indicators of international development goals;[15]
- the Common Country Assessment (CCA) indicators of the UN Development Assistance Framework (UNDAF);
- the UN/CCA Task Force on Basic Social Services for All (BSSA) indicators; and
- the UN Statistical Commission's Minimum National Social Data Set (MNSDS).[16]

The IMF has been supportive of these efforts.

The OECD, World Bank, and UN, in cooperation with developing countries and bilateral donors, have established the following working set of **core indicators on social development:**

- **Poverty:** share of the population living below $1 a day in purchasing power parity terms; the poverty gap (the resources needed to lift all those below the poverty line out of poverty); prevalence of underweight children under 5 years of age; and the share of the poorest 20 percent in national consumption.
- **Education:** net enrollment rates in primary education; completion rate of fourth grade of primary education; and literacy rate of those between 15 and 24 years of age.
- **Gender equality:** ratio of girls to boys in primary and secondary education; ratio of literate females to males (ages 15 to 24).
- **Health:** infant mortality rate; under-5 mortality rate; maternal mortality rate; percentage of births attended by skilled personnel; contraceptive prevalence rate; and HIV prevalence in pregnant women aged 15 to 24 (for lack of data, currently the overall HIV prevalence rate is used).

In addition, the OECD/UN/World Bank core list includes 6 environment indicators, as well as ten background indicators of development, such as adult literacy rate, total fertility rate, and life expectancy.

The CCA/UNDAF list includes all indicators in the OECD/UN/World Bank core set, but for some development goals, the list has a more extensive scope, including, for example, more indicators on gender equality and women's empowerment, child welfare, and food security. In addition, the CCA/UNDAF list has indicators relating to employment, housing, drug control, and crime prevention.

Compared with the CCA/BSSA and MNSDS sets, the OECD/UN/World Bank list is more extensive and includes a wider range of social development indicators. However, the CCA/BSSA and MNSDS sets also include some indicators not found in the OECD/UN/World Bank list, such as average years of schooling (MNSDS) and access to primary health care services (BSSA).

All these sets are intended to be used flexibly, and need to be adapted to the specific circumstances of the country to which they are applied. Indicators may be added if they capture an aspect of social development not included in the sets, while lack of data may require that some indicators omitted.

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[15] Available via the Internet: http://www.oecd.org/dac/indicators/htm/tables.htm.

[16] These indicators and their definitions are available in the World Bank's World Development Indicators database and in the UN Development Program's (UNDP) *Human Development Reports,* which are available via the Internet: http://www.undp.org/hdro/indicators.html#developing.

III. Social Safety Nets

In countries where the authorities could foresee that reform measures would have a sizable adverse social impact, the policy mix and sequencing have aimed to take this impact into account within a sustainable macroeconomic framework. For instance, IMF-supported programs have aimed to phase out subsidies for food and other items gradually, rather than at once (e.g., Indonesia, 1998; and Senegal, 1994–95). The adverse impact, however, cannot be totally eliminated even with an appropriate policy mix and sequencing. For instance, a change in relative prices that hurts the poor—such as a devaluation, that could adversely impact the urban poor through increasing prices of imported products—may be at the heart of a reform program. A tension may emerge, therefore, between stabilization and social protection objectives.

Social safety nets are a means of easing this tension. IMF staff—drawing on the work of other institutions—has increasingly sought to incorporate social safety nets into adjustment programs. The IMF's Executive Board, following its discussion of social safety nets in 1993, endorsed this approach.[17] More recently, ESAF-supported programs have sought larger budget allocations for social safety nets. There has been an increase in the use of structural benchmarks and performance criteria aimed at securing social protection objectives (Box 3.1).

This review indicates that most IMF-supported programs have incorporated social safety nets, although there is scope for further improvement in their quality and implementation.

- The social safety nets in IMF-supported programs have included new temporary arrangements—such as temporary subsidies and public works programs as well as existing social protection instruments adapted to the needs of target groups—such as pensions and other permanent social security programs (see Chu and Gupta, 1998). Measures designed to foster financial stability, such as the adoption of deposit guarantees (limited or general) and other financial restructuring measures to maximize asset recoveries, to redistribute losses, and to sustain credit to the small and medium-industry segments, also have protected small depositors and vulnerable groups.
- Over time, permanent social protection arrangements (e.g., pensions, unemployment insurance) also have been established in the context of reform programs.
- Family-based safety nets have cushioned income losses during adjustment periods in many countries. For example, in Indonesia, in the wake of the recent crisis, about a fourth of families received informal transfers (Frankenberg, Thomas, and Beegle, 1999). Such informal arrangements have been generally well targeted.[18] Thus the design of public social safety nets has sought not to duplicate the system of voluntary, private transfers.

The timely implementation of social safety nets has been hampered—all too frequently—by a lack of existing social policy instruments. Often these instruments can be speedily adapted to the needs of the new target groups. But sometimes the adaptation is difficult. Countries often have not had the will to reform costly existing social protection mechanisms or to shift social protection priorities. Those segments of the population suffering from the adverse effects of reforms may prove to be different from those protected by the permanent arrangements. In addition, the lack of data and administrative and financial constraints have hampered implementation and monitoring.

[17] The two conferences on income distribution and economic policy organized by the IMF in recent years have also emphasized the need for cost-effective social safety nets during reform periods. See Tanzi and Chu (1998) and Tanzi, Chu, and Gupta (1999).

[18] See Cox, Okrasa, and Jimenez (1997) and Cox, Eser, and Jimenez (1997) for such networks in Poland and the Russian Federation, respectively.

Box 3.1
Strengthening Social Safety Nets in ESAF-Supported Programs, 1994–98

Policy Framework Papers (PFPs) and Memoranda of Economic Policies (MEPs) for 44 countries that had ESAF-supported programs during 1994–98 were reviewed to ascertain what kind of measures had been incorporated to mitigate the adverse social effects of structural adjustment policies. These measures were classified into two groups:

- Budgetary allocations (either unspecified general allocations or quantitative commitments); and
- Measures to strengthen social protection through more specific targeting, better monitoring of the affected population groups, widened coverage of safety net measures, or related reforms.

A significant group of countries have incorporated allocations for social safety nets in their ESAF-supported programs, and the use of structural benchmarks and performance criteria for achieving social protection goals has grown.

- Half the countries had commitments in their PFPs for allocations for financing social safety nets during the program period (on average 3–32 years), with a third of the 44 countries setting these targets in quantitative terms. During the review period, countries also included measures for strengthening the design and coverage of social safety nets; some established targets for the number of vulnerable people to be shielded by social safety nets (Armenia, Guyana, the Kyrgyz Republic, Mozambique, and Nicaragua).
- About three-fourths of countries announced spending on social safety nets in their MEPs during the program period, with 60 percent of the 44 countries specifying quantitative allocations. In recent years, however, the use of quantitative targets with respect to social safety nets has declined. A similar trend is noticeable in the listing of structural measures for strengthening social safety nets. Although it is difficult to pinpoint the reasons for this trend, there are several possibilities. Priorities in programs could have shifted; the monitoring of social safety nets could have become more difficult because of data and other constraints; and in a number of countries, structural reforms with the greatest adverse social impact could have been felt earlier in the program periods. On a country-by-country basis, significantly fewer countries (about one-half) that sought allocations of expenditures on social safety nets in PFPs made the same commitments in their MEPs. Nine countries specified targets for the number of vulnerable to be shielded by social safety nets in MEPs (Albania, Armenia, the Republic of Congo, Haiti, the Kyrgyz Republic, the former Yugoslav Republic of Macedonia, Mozambique, Nicaragua, and Yemen).

Greater use of structural benchmarks and performance criteria for social safety nets in ESAF countries is a recent phenomenon. Structural benchmarks have included, for example, improving the transparency of energy subsidies, replacing generalized subsidies with targeted subsidies, and establishing labor retrenchment funds. Programs for six countries incorporated benchmarks (Azerbaijan in 1996, Cameroon in 1998, the Kyrgyz Republic in 1994, 1995, and 1998, the former Yugoslav Republic of Macedonia in 1997 and 1998, Pakistan in 1995–98, and Yemen in 1997–98). Of these, two countries have included performance criteria for achieving social protection objectives, for example, by strengthening the revenue position and by reforming the benefit structure of the employment and the pension funds (the Kyrgyz Republic in 1994, 1997, and 1998, and the former Yugoslav Republic of Macedonia in 1998).

In most cases, IMF staff has relied largely on the World Bank, and regional development banks to some extent, to take the lead in the design of social safety nets for IMF-supported programs.

- For example, in Indonesia, a targeted rice subsidy and community-based public works programs, designed by the World Bank, were incorporated in the 1998 IMF-supported adjustment program. This was also the case for the public works programs financed by the Asian Development Bank and the World Bank in Thailand in 1998. In Brazil in 1999, the Inter-American Development Bank and the World Bank cofinanced a special adjustment loan for a social protection project that was integrated into the IMF-supported program.
- In some cases, the IMF Fiscal Affairs Department has provided limited technical assistance on social safety nets (e.g., Ecuador and Belarus in 1999). And in 1999, the African Department (AFR) recruited two social policy specialists with backgrounds in sociology to assist the department in incorporating appropriate social safety nets in countries' adjustment programs. To the extent possible, IMF missions have built on the work of the World Bank, regional development banks, other UN agencies, and NGOs.[19] In many cases, program-related missions have also focused on social issues.

A. Design Issues

The design of social safety nets has been influenced, among other things, by the availability of existing social policy instruments. For example, transition economies had a broad range of social instruments that were poorly targeted (e.g., Moldova and Ukraine). A wide range of benefits covered the bulk of the population, including the nonpoor. Thus the principal aim of IMF-supported programs in these countries has been to make spending—for instance, food subsidies—better targeted, rather than to create new instruments. In contrast, low-income developing countries had limited social policy instruments, and the effort there has been to create arrangements that could reach affected population groups (such as transitory subsidies for the urban poor in the CFA franc zone countries in the aftermath of the 1994 devaluation). In general, establishing cost-effective social safety nets would have been easier had well-targeted social policy instruments been already in place before the onset of crises and economic reforms.[20]

The specific adverse effects on and characteristics of target groups have determined the types of social safety net instruments.

- A sharp fall in output, reinforced by a large increase in prices of important staples, can result in a significant real income loss for those poor households who are net consumers of food. This occurred in Indonesia in 1998 and in transition economies in the initial stages of transformation. In these circumstances, income transfers or targeted food subsidies became critical.
- When the prices of essential goods rose in countries where the elderly constituted a high proportion of the population, low-income pensioners needed to be helped through an adequate minimum allowance (e.g., the Russian Federation and Ukraine).
- When there were regional pockets of unemployment, special programs to supplement incomes have been implemented (e.g., community-based public works programs in Indonesia and Senegal).

[19] This approach is consistent with that set forth in the 1993 Development Committee paper prepared jointly by the staffs of the IMF and the World Bank. Executive Directors in the 1993 discussion on safety nets "agreed that the IMF's policy advice through technical assistance on social safety nets should be continued to the extent that staff resources were available."

[20] Ferreira, Prennushi, and Ravallion (1999).

Nevertheless, the selection of target groups has raised fairness issues. To ensure political support for reform, social safety nets have been extended to politically vocal middle-income groups: for example, a subsidy for premium gasoline (in Indonesia, initially in 1998), severance payments for departing civil servants (Ghana and Lao People's Democratic Republic) and for public enterprise employees (Argentina and Bolivia), and food subsidies (Jordan). Unemployment benefits—largely for formal sector beneficiaries—were strengthened in the presence of a large informal sector, where the majority of the poor may be residing (Brazil in 1998).

To identify target groups, IMF staff has generally relied on the national authorities and the World Bank which have provided a measure of the poverty line and household expenditure survey data on household characteristics.[21] The latter, however, are often conducted infrequently with results that are not always timely or comparable across time.[22] Because of these constraints, poverty lines and poverty profiles have typically been unavailable for the year when reform programs were put in place (e.g., Brazil and Thailand).

The weak administrative capacity in many countries has hampered the targeting of benefits, particularly on the basis of incomes. This has meant a greater reliance on programs that have self-targeting features, such as

- public works with below-market wages (e.g., Indonesia, Malawi, Thailand, and Senegal);
- subsidies on commodities consumed by the poor (e.g., inferior rice in Indonesia); and
- shielding of groups that are easily identified as poor (pensioners, the unemployed, single mothers, and children).

Means testing based on wage income has been used in some countries—for the housing subsidy program in Ukraine, for example—but this carries the risk of mistargeting, especially in countries with a large informal sector, and could create disincentives for the supply of labor.

Financial constraints have limited the scope of social safety nets. The need to redress macroeconomic imbalances has typically precluded increasing total public spending; thus, a reallocation within the existing budgetary envelope to better-targeted programs has been necessary (e.g., Brazil).

- In some cases such as Venezuela , eliminating subsidies has freed resources for more targeted social protection programs.
- Significant budgetary savings have often been achieved by reforming social safety nets, such as by replacing generalized subsidies with targeted ones (e.g., rice subsidies in Indonesia).
- External donors, including the World Bank, have played a role in some cases, in particular by funding severance payments for departing civil servants and by providing food aid (e.g., Senegal).
- In transition countries, the large decline in output has increased the demand for social benefits while reducing the availability of financing (Box 3.2).

When the adverse impact exceeded expectations, program targets have been changed to accommodate larger budgetary outlays for social safety nets. Indonesia, Korea, and Thailand raised spending on social protection programs to 5.2 percent of GDP in 1998/99, 2 percent of GDP in 1999, and

[21] The Poverty Assessments prepared by the World Bank have been particularly useful. In some cases, the World Bank and national authorities use different poverty lines (e.g., Belarus). In the design of social safety nets, the usual practice has been to use country-specific poverty lines, rather than international poverty lines defined in terms of U.S. dollars in purchasing power parity terms for daily consumption of an individual.

[22] Less than two-thirds of countries with IMF-supported programs have conducted at least one household or demographic survey, of which the last one in more than half of the countries was conducted before 1996.

2 percent of GDP in 1998/99, respectively, from between ½ percent and 1 percent of GDP in each country before the crisis.

In general, and beyond the context of immediate program requirements, it would be desirable to identify the need for social policy instruments, and advise government authorities to seek necessary assistance from the World Bank and others, in the course of IMF surveillance. Such efforts could, among other things, speed the establishment of cost-effective safety nets if difficulties arise and reform measures need to be undertaken.

Box 3.2
Social Safety Nets: Issues in Transition Economies

Key Issues

Transition economies have been trying to reform expansive, but increasingly ineffective, social protection arrangements, including subsidies, pensions, unemployment benefits, and family allowances. Declining taxes and social contributions have severely weakened the ability of many transition economies to provide the needed benefits.

- The declining social contributions have transformed the earnings-related pensions and other social benefits into virtually flat minimum benefits.
- Offsetting tax obligations of enterprises against obligations of the government has limited the ability of many governments to pay cash benefits. Moreover, these obligations of the government do not necessarily represent spending of high social value.

In many transition economies, the benefits have yet to be fully reformed.

- In Moldova, the Russian Federation, and Ukraine, pension systems have allowed workers to collect benefits at a relatively young age, and workers in certain occupations have been eligible for pensions even earlier. Pensions have been based not only on the number of years of contributions, but also on years spent studying or taking care of a young child.
- A large part of social contributions collected for assisting the unemployed continue to be wasted on low-priority programs and benefits administration; only a small share of the unemployed actually receive assistance in any form.
- Traditional extensive and generous privileges for politically influential groups (judges, parliamentarians, internal security personnel) prevent the targeting of limited resources to the genuinely needy.

IMF Advice

Thus, the emphasis of IMF staff advice has been on improving compliance with tax laws, simplifying the rate structure, and stopping the collection of taxes and social contributions in kind (e.g., Azerbaijan, Moldova, and Ukraine). Some progress in simplificating the social contribution rate structure has been made, but significant change in other areas has been elusive.

In these and other similar cases, IMF staff have called for raising the pension age, eliminating privileged and early pensions and untargeted benefits, targeting social assistance and subsidies, increasing the size and coverage of unemployment benefits, and making social benefits more transparent. Pension reforms are under consideration in many transition countries, but the progress in implementing far-reaching reforms remains slow. For example, despite the emphasis given to pension reform, including the use of performance criteria, in IMF-supported programs in the Kyrgyz Republic, relatively little progress was achieved; a concerted and more comprehensive and resource-intensive World Bank adjustment operation appears to have had more success in pension reform since 1998.

B. Labor Market Implications

Labor market incentives have been a key concern in the design of unemployment benefits. The challenge has been to strike an appropriate balance between social protection and disincentive effects. Though certainly, this balance may differ among countries, depending on social preferences, norms, and other factors. In 1998, because of their concerns about possible disincentive effects, the Korean authorities initially hesitated to broaden the coverage of unemployment benefits. A relatively high wage for participants of public works programs can undermine their effectiveness as a safety net by attracting already employed workers.[23]

Establishing social safety nets, however, can help promote a fundamental labor market reform. Before the financial crisis in 1997, lifelong employment in large enterprises had been an important aspect of social protection in Korea. But it constrained the ability of enterprises to restructure in the face of changing economic conditions. Broadening the coverage of unemployment benefits to 70 percent of the labor force in early 1999 from around 30 percent supported labor market reform aimed at promoting labor market flexibility by providing income transfers to those switching jobs.

C. Monitoring

The staff monitoring of social safety nets has been infrequent. A review of 12 countries with ESAF arrangements during 1994–98 indicates that, although over three-fourths of Policy Framework Papers (PFP) and Memorandum of Economic Policies (MEP) reported on the performance of social safety nets under IMF-supported programs, such monitoring typically occurred only once or twice.[24] The infrequent monitoring of social safety nets may have reflected weak national capacity to monitor the implementation of social policies and their impact on poverty.

The staff's assessment and reporting of the effectiveness of social safety nets have been uneven. In only a third of the 12 countries reviewed did staff papers assess coverage and incidence of social safety nets during the five-year period (e.g., with respect to temporary food subsidies and to fertilizer provision to smallholders in Malawi). For a larger number of countries (more than three-fourths), staff papers reported on the improvements in the benefit structure and financing of social protection mechanisms. In contrast, staff papers on IMF-supported programs for the countries affected by the recent crisis in Asia (Indonesia, Korea, and Thailand) reported extensively on social safety net developments.[25]

IV. Public Spending on Education and Health Care

The relationship between public social spending, social indicators, and poverty reduction is complex and dynamic. How much public social spending reduces poverty depends not only on the amount allocated for education and health care, but also how efficiently these allocations are spent and how well

23 The wages paid to participants are the most critical determinant of overall program cost and the effectiveness of job creation through public works schemes. Experience from a range of countries shows that programs are more effective when the wage is maintained at a level below the prevailing market wage for unskilled labor. See Subbarao and others (1997).

24 Azerbaijan, Bolivia, Georgia, Guyana, the Kyrgyz Republic, the Lao People's Democratic Republic, the former Yugoslav Republic of Macedonia, Malawi, Mongolia, Pakistan, Senegal, and Vietnam.

25 With the support of the World Bank, a few countries have recently established a mechanism to monitor social outcomes on an on-going basis (e.g., the Social Monitoring and Early Response Unit in Indonesia).

they are targeted to the poor.[26] Education and health care indicators are affected not only by government outlays on education and health care but also by private spending, demographic trends, and public spending in other areas such as for sanitation and safe water. Empirical research on the link between increased aggregate public spending on education and health care and improvements in related social indicators has yielded conflicting evidence.[27] Note, also, that today's illiteracy and infant mortality rates are normally the result of yesterday's social policies; poverty reduction reflects past increases in spending on primary education, primary school enrollment, and literacy. Finally, some indicators reflect *intermediate* outputs, not final outcomes. For example, widespread immunization of infants under 12 months against measles does not by itself yield a low infant mortality rate, especially if other variables, such as access to safe water and female education attainment, are relatively poorly developed.[28]

This review suggests that considerable progress has been achieved in strengthening spending policies on public education and health care, but that some areas require further efforts.

- Countries have made considerable progress in establishing comprehensive and structured policy frameworks for such spending; more recently, there have been discernible improvements in targeting and monitoring public spending and positive, albeit modest, developments in related social indicators and outcomes.
- Efforts to raise spending on education and health care have achieved relatively more success in the HIPC decision point countries (Bolivia, Burkina Faso, Côte d'Ivoire, Mozambique, and Uganda) than in other IMF-supported program countries.

Further improvements, however, are needed to address some inadequacies:

- Lack of adequate data is commonplace. Data on the composition of education and health care spending are often not available. Data on subnational government spending are scarce. Education and health achievement indicators are either unavailable or available with a long lag (Box 4.1).
- Policy objectives have not always been clear or articulated in terms of well-defined targets against which progress can be measured, and the definition of targets and monitoring often has changed over time within a single country.

The HIPC Initiative framework has yielded relatively more progress than have other programs, across a more comprehensive range of social sector reforms. The most marked improvements in social indicators during the period under review also have taken place in HIPC countries. No causal association, however, can be established between increased spending and outcomes, because their link is affected by many other factors.

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[26] There are wide disparities in the cost-effectiveness of government spending on education and health care across countries in Africa, and, in general, these countries were found to be less efficient than those in Western Hemisphere and Asia. See Gupta, Verhoeven, and Honjo (1997).

[27] See Mingat and Tan (1998); Filmer, Hammer, and Pritchett (1998); and Gupta, Verhoeven, and Tiongson (1999).

[28] For example, for the latest year for which data are available, Zambia has a higher immunization coverage than Kenya, but also a higher infant mortality rate. In contrast, for a group of 48 program countries for which recent data are available, there is a negative and statistically significant correlation between immunization coverage and infant mortality rate.

Box 4.1
Quality of Social Spending and Indicators Data

Social Spending

Many deficiencies exist in data on public spending on education and health care.

- In general, spending by local governments is not included; this can be a major handicap in countries that have devolved or are devolving expenditure responsibilities to lower levels of the government, particularly those related to basic education.
- In many cases, data coverage in fiscal accounts is limited to current outlays, in part owing to the inability of governments to separate donor-financed capital spending by function.
- In-kind donor contributions to education and health care are not included.
- Data typically become available with a lag, which for some countries can be as long as two to three years.
- Virtually no country has consistent annual series for expenditure allocations within the education and health care sectors (e.g., separating between primary and tertiary education, or preventive health care and curative health care), and the data available in many cases are not consistent with aggregate fiscal data.
- Despite the importance of books and medicine for developments in social indicators, separate data for nonwage and wage outlays in education and health care sectors are available for only very few countries.
- Data on private sector outlays on education and health care are not collected on a regular basis.

Social Indicators

The most serious shortcoming of data on social indicators is that they are generally produced infrequently and with a long lag, or, in many cases, are not collected at all. For instance, data for 1997 are available for only 11 out of 18 indicators of well-being and social development in the working set identified by the OECD/UN/World Bank, and only for a small number of developing and transition countries. Current data for many important indicators are derived from models, rather than from actual observations. For example, for 102 countries, actual observations on infant mortality rates are not available for 1985 or later.

Furthermore, some of the key indicators become available only every five years. In some cases, there is a trade-off between the availability of data on social indicators and their quality. For example, net enrollment rates, which correct for grade repetition, are available for only about half of program countries, whereas gross enrollment rates, which are available for most countries, count all students regardless of age as part of the school-going population, and thus overstating enrollment to the extent students are repeating grades (see Table 4.1). There may also be inconsistencies among data sources and compilation methods, raising questions about data comparability across countries and over time. Because indicators are constructed by using data collected at the national level through censuses, sample surveys, and administrative records, data quality to a large extent depends on the national statistical capacity.

Table 4.1: Improvement in Social Indicators in Member Countries, 1985-97
(Current level and average annual percent improvement; number of countries in parentheses)

	Current Level 1/			Average Annual Percent Improvement							
	Non program Countries[2]	Program Countries	ESAF Program Countries Only	Non program Countries 2/	Program Countries	ESAF Program Countries Only	HIPC Countries Only	Sub-Saharan Africa	Asia and the Pacific	Latin America and the Caribbean	Transition Economies
Education											
Illiteracy rate 3/	15.8 (22)	27.4 (49)	45.5 (21)	3.4 (22)	3.5 (49)	2.2 (21)	2.2 (16)	2.4 (15)	3.1 (8)	2.9 (14)	7.9 (7)
Female	18.6 (22)	32.8 (49)	53.4 (21)	3.6 (22)	3.5 (49)	2.1 (21)	2.0 (16)	2.3 (15)	3.1 (8)	3.0 (14)	8.3 (7)
Gross primary school enrollment rate 4/	104.2 (25)	92.3 (55)	80.9 (25)	0.1 (25)	0.8 (55)	1.0 (25)	0.9 (15)	0.6 (15)	0.5 (10)	0.7 (14)	1.0 (13)
Female	102.8 (25)	88.6 (52)	76.6 (24)	0.3 (25)	0.8 (52)	1.1 (24)	1.2 (14)	1.1 (14)	1.4 (9)	0.5 (13)	0.1 (13)
Male	105.8 (25)	96.5 (52)	88.0 (24)	0.1 (25)	0.7 (52)	0.9 (24)	1.4 (14)	1.0 (14)	0.0 (9)	0.6 (13)	0.8 (13)
Gross secondary school enrollment rate 4/	61.8 (25)	50.5 (53)	30.6 (24)	2.8 (25)	1.1 (53)	0.8 (24)	0.9 (14)	1.2 (14)	2.2 (10)	1.4 (14)	-0.8 (12)
Female	65.0 (24)	49.5 (49)	28.4 (23)	3.2 (24)	1.9 (49)	2.3 (23)	2.8 (13)	3.1 (14)	3.5 (10)	1.2 (10)	-0.5 (12)
Male	62.6 (24)	51.9 (49)	32.5 (23)	2.7 (24)	0.6 (49)	0.2 (23)	0.5 (13)	0.3 (14)	1.6 (10)	1.4 (10)	-0.9 (12)
Net primary school enrollment rate	84.8 (18)	74.6 (31)	58.9 (17)	0.2 (18)	0.7 (31)	0.6 (17)	0.5 (11)	0.1 (10)	0.9 (4)	0.9 (11)	0.4 (4)
Persistence to grade 5	88.5 (21)	75.3 (23)	68.0 (11)	0.5 (21)	1.7 (23)	2.0 (11)	2.9 (8)	2.3 (9)	-0.3 (5)	2.5 (7)	... (0)
Health care											
Life expectancy (in years)	68.1 (33)	63.3 (45)	57.6 (25)	0.4 (33)	0.2 (45)	0.2 (25)	0.1 (12)	-0.1 (13)	0.7 (4)	0.5 (9)	0.0 (16)
Infant mortality rate 3/	31.8 (34)	48.9 (48)	72.8 (25)	1.7 (34)	2.5 (48)	1.5 (25)	1.6 (13)	1.0 (14)	2.7 (5)	3.3 (10)	3.0 (16)
Under-5 mortality rate 3/	40.1 (29)	66.6 (29)	113.2 (14)	3.8 (29)	3.7 (29)	2.9 (14)	2.3 (8)	0.8 (8)	... (0)	3.2 (7)	5.7 (13)
Births attended by skilled staff	78.5 (25)	64.0 (37)	52.4 (18)	6.1 (25)	1.8 (37)	3.2 (18)	0.8 (10)	1.7 (9)	4.2 (10)	-0.1 (11)	-0.3 (4)
Contraceptive prevalence 5/	66.3 (4)	49.3 (14)	36.0 (5)	3.6 (4)	3.1 (14)	5.6 (5)	6.7 (3)	6.9 (3)	2.0 (5)	2.5 (5)	0.0 (1)
Access to health care	94.6 (16)	74.0 (13)	48.7 (3)	1.4 (16)	3.7 (13)	11.2 (3)	4.0 (4)	6.6 (5)	6.2 (2)	0.4 (4)	... (0)
Percent under 12 months immunized											
DPT vaccination	86.8 (33)	82.6 (61)	74.6 (29)	4.5 (33)	4.8 (61)	6.9 (29)	7.3 (16)	5.7 (15)	7.7 (10)	3.8 (15)	3.7 (16)
Measles vaccination	85.0 (33)	83.0 (60)	75.3 (28)	5.4 (33)	4.4 (60)	6.1 (28)	6.8 (15)	4.3 (14)	9.1 (10)	3.3 (15)	2.8 (16)
Other basic services											
Access to safe water	81.7 (27)	66.0 (41)	58.1 (19)	4.1 (27)	2.9 (41)	4.2 (19)	4.0 (12)	4.2 (12)	7.7 (8)	1.6 (14)	-3.5 (5)
Access to sanitation	73.9 (23)	57.6 (37)	41.6 (17)	2.6 (23)	4.4 (37)	6.7 (17)	3.2 (10)	2.7 (10)	14.2 (8)	3.5 (14)	-9.9 (3)

Sources: World Bank, World Development Indicators 1998 and 1999 database.

1/ Latest data available. Mostly refers to 1995-97. Except for life expectancy, which is in years, all the indicators refer to shares of the relevant population groups. See also Box 2.

2/ Nonprogram countries, shown for comparison, included: Angola, The Bahamas, Bahrain, Belize, Bhutan, Botswana, Colombia, Cyprus, Eritrea, Fiji, Grenada, I.R. of Iran, Kuwait, Lebanon, Malaysia, Maldives, Malta, Myanmar, Namibia, Netherlands Antilles, Oman, Paraguay, Qatar, Seychelles, Solomon Islands, South Africa, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Swaziland, Syrian Arab Republic, Tonga, Turkmenistan, and United Arab Emirates.

3/ The annual percent improvement in illiteracy, infant mortality, and under-5 mortality rates refers to a decline in these rates. An annual percent improvement of 3.4 in illiteracy, for example, means that illiteracy rates are falling by 3.4 percent per year.

4/ Gross enrollment rate is the ratio of total enrollment, regardless of age, to the population of the age group that corresponds to the level of education shown. If, for example due to grade repetition, students that fall outside the age bracket for primary or secondary education are nevertheless enrolled, the gross enrollment rate may exceed 100 percent.

5/ Contraceptive prevalence rate is the percentage of women who are practicing, or whose sexual partners are practicing, any form of contraception and is usually measured for women aged 15-49.

A. Aggregate Spending on Education and Health Care

IMF-supported programs have sought to promote universal access to basic social services. Programs have increased public spending for such services in countries where this spending was low, supported high-quality expenditure in these sectors, and protected or sought real increases in these expenditures during adjustment periods when poor households might lack the ability to pay for basic social services. The importance programs have attached to these objectives was reflected in the rising use of quantitative targets, structural benchmarks, and performance criteria aimed at raising education and health care spending (Box 4.2).[29]

Box 4.2
Targets for Public Spending on Education and Health Care in ESAF-Supported Programs, 1994–98

Policy Framework Papers (PFPs) as well as Memoranda of Economic Policies (MEPs) for 44 countries that had ESAF-supported programs during 1994–98 were reviewed to ascertain the extent to which they:

- incorporated targets for budget allocations for education and health care, either in unspecified general or specific quantitative terms;
- called for structural improvements in the provision of social services; and
- monitored changes in, and established targets for, social indicators.

ESAF-supported programs have increasingly sought to raise public spending on education and health care and to implement structural reforms in the sectors. Benchmarks and performance criteria have also been increasingly widely used to achieve increases in such spending.

In PFPs, about 80 percent of the 44 countries sought increases in public spending on education and health care during 1994–98, and a slightly lower proportion (60 percent) set quantitative targets for such increases. Targets were most commonly set once during the period while, on average, ESAF-supported programs were in place in the countries for 3–3½ years during 1994–98. PFPs for around 60 percent of the 44 countries aimed at increased budgetary allocations for primary education and basic health care during the period, and about one-third of these set quantitative increases. All programs called for structural measures to strengthen the provision of social services during the period, for example, by increasing the number of teachers and doctors and enhancing the role of the private sector. About 45 percent of the 44 countries targeted improvements in social indicators in both unspecified and quantitative terms. The most commonly used indicators were primary school enrollment, including, separately for girls, literacy, infant mortality, and immunization rates.

The picture is broadly similar for MEPs with respect to the proportion of countries that committed to increase budgetary expenditures on health care and education. Compared with PFPs, however, a much smaller percentage of countries (about 45 percent) sought increases in budgetary allocations for primary education and basic health care (either unspecified or in specific quantitative terms) and some 16 percent established specific targets for quantitative increases. A lower percentage of countries (30 percent) identified improvements in education and health care indicators as a policy objective. The use of quantitative targets increased by 40 percent during the period under review.

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[29] Notwithstanding the problems with comparability, IMF staff has compiled cross-country data on public education and health care spending. This data set covers 65 countries that are implementing or have implemented IMF-supported reform programs, of which 31 are low-income countries with ESAF-supported programs. The GDP deflator was used to convert nominal expenditures into real terms. In principle, deflating by public sector wages would provide a more accurate reading of real trends in education and health care spending. But such wage data are rarely available for low-income countries. In 10 countries in Africa for which data on public sector wages are available, real per capita spending on education and health care increased, on average, by 2 percent a year under IMF-supported programs—a result consistent with spending trends derived from the GDP deflator.

On a country-by-country basis, commitments to social spending measures was less frequent in MEPs than in PFPs. For example, only about half the countries that sought increases in social expenditures in their PFPs mentioned such increases in MEPs.

In recent years, programs have relied on benchmarks and performance criteria to seek increases in, and strengthen the efficiency of, social spending. To this end, the MEPs of six countries included benchmarks (Armenia in 1996, Azerbaijan in 1997, Cameroon in 1997, Georgia in 1997 and 1998, the Kyrgyz Republic in 1995, 1997, and 1998, and Uganda in 1997), and two countries included performance criteria (Ghana in 1998 and the Kyrgyz Republic in 1998).

Overall, considerable progress was made in increasing social spending during 1985–97. Although the lack of consistent data hinders the assessment of public social spending, program countries, on average, have achieved an increase in social spending:

- For 65 of the 107 countries with IMF-supported programs during 1985–97, government spending on education and health care, on average, has increased both as percent of GDP and in real per capita terms. The share in GDP of spending increased by 0.3 percentage point during the program period (about eight years, on average); the spending increased by 2.4 percent a year in real per capita terms (Figure 4.1).[30]
- In a subset of 29 countries, of which 19 are ESAF countries, that have data on military spending, such spending on average declined during 1990–97, whereas education and health care spending together increased in relation to both GDP and total government spending.

Real per capita social spending has declined in some countries, and the increases have been relatively low in some regions, notably education spending in sub-Saharan Africa.[31] In transition economies, real per capita spending on education and health care has declined considerably. A modest decline of 0.1 of a percentage point in the share of spending in falling GDP masks a larger decline in real per capita terms. In these countries, however, education and health care spending have been historically high and inefficient.

Countries with ESAF-supported programs have shown relatively strong results. In the 31 countries with ESAF programs, the real per capita growth of spending on education and health care over 1985–97 (4.0 percent and 4.9 percent, respectively) has outstripped, on average, that in other program countries.

In 1997, public expenditure on education and health care as a share of GDP in countries with ESAF programs approximated those in other program countries. In HIPCs, spending levels remain below those in other program countries in part because of very low initial levels (Figure 4.2). Education and health care spending as a share of total government spending—indicative of the priority assigned to these types of spending—shows the same pattern.

[30] See Gupta, Verhoeven, Yamada, and Tiongson (1999).

[31] The countries where spending on education as a share of GDP declined are the Republic of Congo, Côte d'Ivoire, Guinea-Bissau, Madagascar, Mali, Mozambique, and Nigeria. In health care, the Comoros, Guinea-Bissau, Nigeria, and Zambia experienced a decline in spending as percent of GDP. The countries where real per capita spending on education declined are the Comoros, Côte d'Ivoire, the Republic of Congo, Kenya, Madagascar, Mali, Nigeria, and Sierra Leone. In part, this reflected cuts in salary from a high level (e.g., Côte d'Ivoire). In health care, the countries where real per capita spending on health care declined are the Comoros, Côte d'Ivoire, Kenya, Madagascar, Nigeria, and Zambia.

Figure 4.1. Changes in Education and Health Care Spending in Selected Countries with IMF-Supported Programs, 1985-97

(Average change between preprogram year and latest year in percent of GDP; number of countries in parentheses)

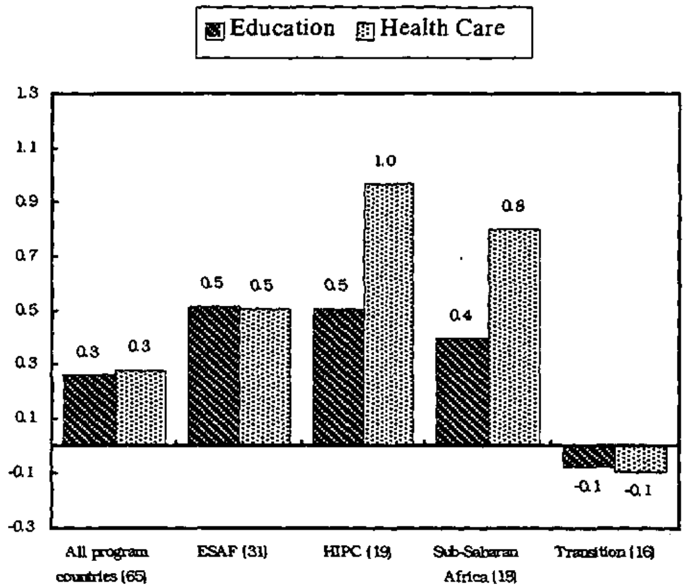
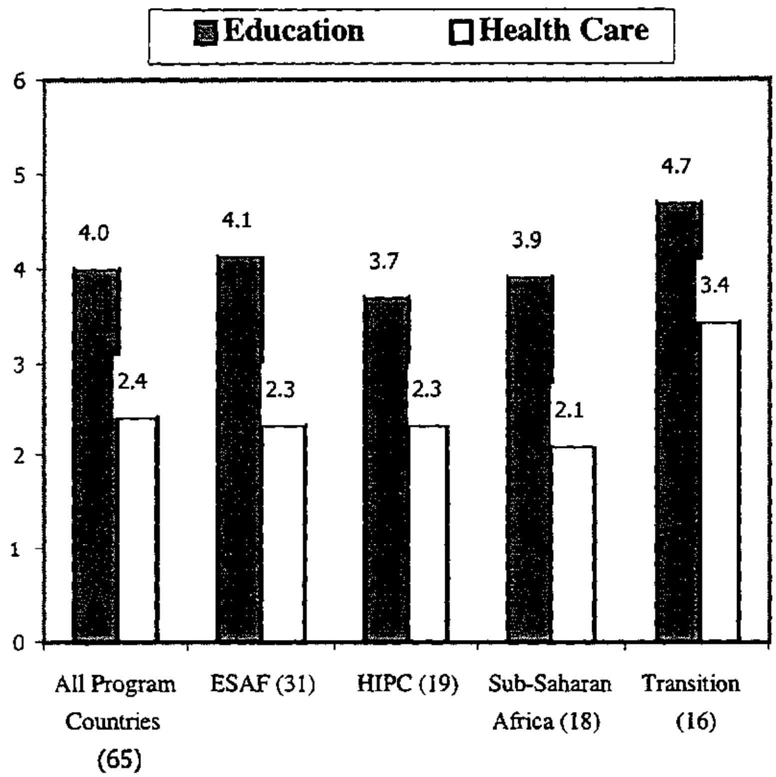


Figure 4.2. Spending Levels on Education and Health Care in Countries with IMF-Supported Programs, 1997

(In percent of GDP; number of countries in parentheses; latest year for which data are available)[1]



Sources: National authorities; and IMF staff.

[1]Mostly 1997.

B. Composition of Spending

Available data for 1985–97 suggest that budget expenditure shares shifted, on average, from current to capital outlays in both ESAF countries and HIPCs, and more so than in other program countries. Whether this led to an increase in such key components in the delivery of education and health care as books and medicine, however, is unclear because available data for these outlays are reported with other types of spending under other goods and services. In all program countries, average spending on other goods and services fell during the period under review.

Although many programs have sought to improve the allocation of budget resources within the education and health care sectors, more can be done. On average, program countries have devoted a relatively large share of their education budget to tertiary education and even a larger part of health care outlays to curative services (Figure 4.3). This suggests that low-income households would benefit from a shift in budgetary resources toward primary education and basic health care.[32]

C. Impact on Education and Health Indicators and Implications for Poverty

On average, the education and health care indicators in the OECD/UN/World Bank working set of core indicators for measuring social development have improved for program countries.[33] But there are important exceptions. In sub-Saharan Africa, average life expectancy has declined, reflecting the toll of HIV and conflicts (Table 4.1). Improvements in social indicators in ESAF countries and HIPCs have not been commensurate with the spending increases. Progress in improving infant mortality and primary and secondary enrollment has been slower in these countries than in other program countries. Transition economies have experienced declines in enrollment rates in secondary education and immunizations; reforms in these two areas have been slow, thus increasing the risk that the declines in spending may lead to a permanent setback in social indicators.[34]

Weak administrative capacity to formulate and execute the budget has reduced the impact of education and health care spending on social indicators. In particular, the capacity to spend resources efficiently can vary at different levels of government, and is likely to be lacking at lower levels of government, at least initially, during a period of devolution of expenditure responsibilities.[35] The allocation of budgetary resources within the social sectors (e.g., between primary and tertiary education) is also important, as is the presence of corruption, which can distort the composition and level of social spending.[36]

Although improvements in social indicators reflect a country's social development, they have not been necessarily translated into reduced poverty, which in itself is multidimensional. For example, the poor tend to be less educated and less healthy than the nonpoor.[37] For targeted spending, to have a considerable payoff, however, *the benefits from improved basic social services have to be accompanied by income-earning opportunities.*

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[32] See World Bank (1993 and 1995); and Gupta, Verhoeven, and Tiongson (1999).

[33] As yet, there is no consensus in international forums on the precise social indicators to be used for assessing development and social performance. As noted in Box 2.1, there are at present four sets of indicators in use.

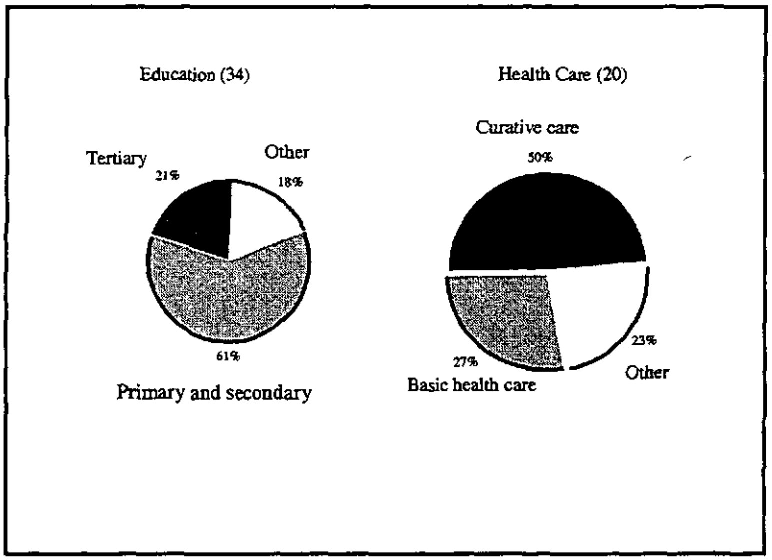
[34] For a discussion of the reasons for the slow pace of reforms in education and health care spending in transition countries, see Gupta (1998).

[35] This has been an issue during the decentralization of government in Ethiopia, see Ter-Minassian (1997, Chapter 20).

[36] For example, if budget allocations in the health sector are made on the basis of the number of beds in a hospital, hospital administrators and doctors may increase the number of beds and keep them occupied, squeezing allocations for medicine. See also Tanzi (1998) and Mauro (1998).

[37] See Anand and Ravallion (1993) and Bidani and Ravallion (1997).

Figure 4.3. Allocation of Education and Health Care Spending in Countries with IMF-Supported Programs, 1994
(In percent of total education and health care spending; number of countries in parentheses; latest year for which data are available)[1]



Sources: IMF, Government Finance Statistics database; World Bank, *Public Expenditure Review* and *Poverty Assessment*, various issues; and IMF staff estimates.

[1]Mostly 1994.

Data for 29 program countries show that the targeting of education and health care spending could be improved, particularly in sub-Saharan Africa and in the transition economies (Figure 4.4). The poor's access may be constrained by out-of-pocket costs for (both formal and informal) using public services, excessive distance to the nearest school or health center, poor quality of public services, and gender bias. For sub-Saharan Africa,

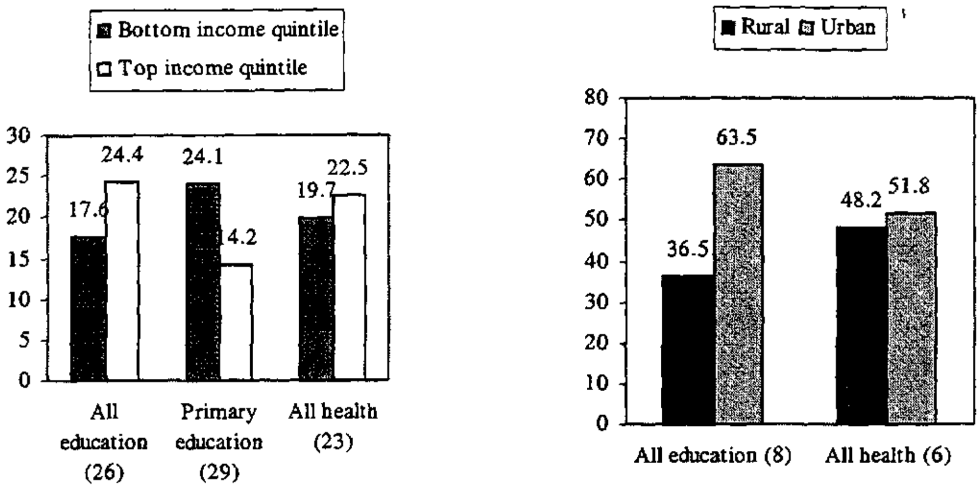
- 14 percent of total spending on public education and 12 percent of health care spending, on average, accrue to the poorest fifth (quintile) of households compared with 30 percent for the richest quintile for both. These gaps widen for spending on secondary and tertiary education and hospital care;
- spending on primary education is somewhat better targeted than that on secondary and tertiary education, and the targeting of public spending on education and health care is improving in some countries (e.g., Côte d'Ivoire and Malawi).

Targeting has a geographical dimension. For example, government public policy choices with a pro-urban bias reduce the access to vital social services for the poor, most of whom live in rural areas. Data on the geographic distribution of education spending were available for only 10 countries with IMF-supported programs, and show that education spending, on average, has disproportionately favored the urban population, particularly spending on secondary and tertiary education.[38] A similar urban bias is discerned from limited data on health care spending for six countries.

[38] The rural population in Albania and Ghana, however, receives as much as 70 percent of the benefits from public spending on primary education. Furthermore, the incidence of education spending has improved over time in favor of the rural population in Malawi. See also Davoodi and Sachjapinan (forthcoming).

Figure 4.4 Benefit Incidence of Public Spending on Education and Health Care in Countries with IMF-Supported Programs, Early 1990s

(In percent of total spending; number of program countries in parentheses; latest year for which data are available)



D. Experience with Program Targets, Conditionality, and Monitoring in ESAF Countries

A review of 11 countries with ESAF arrangements illustrates a range of approaches and success with public spending on education and health care.[39] It is difficult to establish any clear links between meeting benchmarks, performance criteria, and prior actions, on the one hand, and improved access to basic social services, on the other hand. Social indicators in ESAF countries, with the exception of the transition economies (Armenia, Georgia, and the Kyrgyz Republic), were generally poor at the outset of their programs. In nontransition countries, programs emphasized reorienting expenditures to raise spending on education and health care; in Bolivia, Lao People's Democratic Republic, and Uganda, deficit and/or overall expenditure levels were also programmed to rise as a share of GDP, in part to raise spending on education and health care. In the transition economies, where existing high and inefficient levels of education and health care spending tottered on a collapsing revenue base, programs emphasized quality and efficiency improvements.

In the nontransition countries the program objectives for education and health care spending were set in the context of longer-term goals drawn from the authorities' strategic plans for poverty reduction.[40]

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[39] The countries were selected to cover a range of social policy strategies and progress in implementing policies, with a view to identifying ways of strengthening the social content of IMF-supported programs. The ESAF arrangements reviewed cover the last five years, during which operational staff guidelines on public social spending were issued. The countries include five heavily indebted poor countries that have reached their decision point under the HIPC Initiative: Bolivia (with the three-year ESAF arrangements starting in 1994 and 1998); Burkina Faso (1998); Côte d'Ivoire (1998); Mozambique (1996); and Uganda (1997). Other countries included in the review are Armenia (1996); Georgia (1996); Kyrgyz Republic (1994 and 1998); Ghana (1995 and 1999); Lao People's Democratic Republic (1993); and Malawi (1995).

[40] In some cases, strategic plans specifically for the education and/or health care sectors were also formulated.

- In several cases, the strategic plans were formal national government plans prepared in collaboration with the World Bank and other development partners (e.g., Bolivia, Côte d'Ivoire, Ghana, Malawi, and Uganda).
- In only a few countries were quantified long-term goals for social outcomes included explicitly in IMF-supported programs, for example, doubling the general literacy rate and increasing life expectancy to 57 years (Burkina Faso).
- For the HIPCs that reached the decision point (Bolivia, Burkina Faso, Côte d'Ivoire, Mozambique, and Uganda) and Ghana (1999), the use of quantitative goals for indicators was significantly expanded (see Tables 4.2 and 4.3). In these cases, goals established for education and health care indicators were broadly in line with the OECD/UN/World Bank core set, with adjustments made for the authorities' specific objectives and local conditions.
- At the outset of the arrangements, the transition economies did not have overall poverty reduction plans, although for Armenia and Georgia poverty assessments had been completed by the World Bank at about the same time. In general, goals were cast in qualitative terms. For example, the long-term goals for spending on education and health care included a higher standard of living, development of human capital, and alleviation of poverty (Bolivia); better provision of social services by enhancing the efficiency of social expenditures (Georgia); improving basic education and health care and human resources (Ghana); and providing adequate funding for human development and improving the living standards (Lao People's Democratic Republic).

All of the programs reviewed included measures to improve fiscal governance. In general, these reforms addressed general expenditure management issues and covered the setting of budgetary spending allocations and priorities, expenditure controls, and reporting, as well as transparency.[41] In Mozambique, reforms included the publication of budget plans and outcomes.

Programs often focused on improving cost-effectiveness and spending composition.

- To this end, programs often included measures to reduce the cost of delivery of social services (e.g., reducing excessive numbers of teachers) and to improve the quality of spending (e.g., improving the school curriculum and introducing second shifts in schools to overcome capacity constraints on the feasible number of hours of teaching).
- Program targets for public spending sought to reorient expenditure composition toward education and health care, and, in particular, protect such spending during fiscal adjustment. Most of the earlier ESAF-supported programs did not include quantitative budget targets for education and health care spending at their outset, but these were introduced at a later stage (Table 4.4). This in part reflected the introduction in 1997 of staff operational guidelines on social spending. All of the programs of the heavily indebted poor countries that had reached their decision points under the HIPC Initiative have included quantitative targets. In the transition economies, part of the strategy for increasing access to education and health care services has been to involve the private sector.

The scope of spending targets that could be monitored was constrained. The constraints included a lack of data on the intrasectoral allocation of education and health care spending, incomplete coverage of these sectors, and lags in the availability of data. Quantitative spending targets and benchmarks singled out education and health care spending as priorities to be protected from cuts (Bolivia, Kyrgyz Republic, Malawi, and Uganda), or aimed at redirecting public spending in favor of education and health care (Ghana and Malawi) (see Table 4.4). Because the link between expenditure on education and health care and final outcomes is complex and uncertain, programs monitored actual spending and developments in intermediate social indicators such as the hiring or firing of teachers and consolidation of schools (Armenia), increasing water supply and number of classrooms created (Côte d'Ivoire), reducing of stays in

[41] In the Kyrgyz Republic (1998) and Burkina Faso (1996), some of the reforms were directly targeted at social spending.

hospitals (the Kyrgyz Republic), and increasing the share of textbooks in the budget (Malawi). Monitoring was also undertaken with a view to assessing the impact of policies on the provision of social services. Program documents also have included qualitative assessments of progress.

Table 4.2
Social Development Indicators, Selected ESAF Countries 1/

Indicators	HIPC Decision Point Countries				Other ESAF Country
	Bolivia	Burkina Faso	Mozambique	Uganda	Ghana
Education					
Admission and repetition rates for primary schools		X	X		
Gross/net enrollment ratios for primary and/or secondary schools	X	X		X	X
Primary school completion ratios	X			X	
Gender ratios (to increase ratio of girls to total pupils enrolled in primary schools)	X	X		X	
Book/pupil ratio		X			
Cumulative number of schools benefiting from participation in quality improvement programs	X				
Health					
Life expectancy					X
Fertility rate					X
Infant and maternal mortality rate					X
Child and/or pregnant woman vaccination rates	X	X		X	
DPT vaccination coverage	X		X		
Childhood malnutrition rate					X
Access to clean water				X	
Utilization rate of health centers		X			
Proportion of health posts staffed exclusively with untrained personnel			X		
Proportion of houses receiving measures against endemic diseases (e.g., chagas, malaria)	X				

1/ The countries included are a subset of the 11 ESAF countries for which the experience on program targets, conditionality, and monitoring was reviewed.

Table 4.3
Monitoring Arrangements, Selected ESAF Countries 1/

Ghana: A broad-based Technical Committee on Poverty comprising officials from various ministries and government departments, donors, and NGOs was established in 1997 and meets regularly. The committee collects and disseminates information on poverty reduction programs. As part of this Continuous Poverty Monitoring System, a pilot survey has been undertaken to provide a systematic and frequent update on key poverty indicators. Also, donor committees meet frequently on health and education issues to coordinate, exchange information, and monitor programs.	***Malawi:*** A governmental poverty and social policy monitoring unit was established in 1995 to monitor core social indicators to be presented to donors and at Consultative Group meetings.	***Uganda:*** A poverty monitoring unit including education, finance, and health ministry officials was established in 1998 and made responsible for collecting poverty and social sector information at the local level. Health districts collect quarterly data on health-related indicators and report them to the sector monitoring unit. Expenditure tracking studies were undertaken to identify obstacles that prevented budgeted expenditures from reaching their intended use.

1/ The countries included are a subset of the 11 ESAF countries for which the experience on program targets, conditionality, and monitoring was reviewed.

A number of innovations have strengthened monitoring.

- The introduction of explicit targets has contributed to improved monitoring of developments. The staff reports on programs of the HIPCs that had reached the decision point (Bolivia, Burkina Faso, Côte d'Ivoire, Mozambique, and Uganda) have systematically covered developments relating to spending targets and social outcomes. In the other countries, the onset of improved monitoring also has reflected the issuance of the staff guidelines on social spending. But significant weaknesses remain in the quality of reporting in some countries. For instance, definitions of targeted spending as set out in the initial request for the ESAF arrangement and those that were subsequently monitored have sometimes been different. As noted earlier, information on actual spending was typically available only with a considerable time lag, which meant that targets had to be based on partial estimates for the preceding year(s). As a result, a clear picture of spending developments and their impact on social indicators emerged only after the passage of several annual programs.
- In more recent ESAF-supported programs, formulating a clear framework in program documents that integrated social spending targets with a time path of specified indicators and outcomes improved the focus and monitoring of social policy. Such frameworks were used in the case of HIPCs that had reached the decision point and in Ghana's program (1999). In these cases, the authorities explicitly noted their commitment to education and health care output targets in the Memorandum of Economic Policies (MEP), reinforcing the emphasis given to social issues in the Policy Framework Papers (PFP). The advantages of a well-defined framework also carried through to more focused, comprehensive, and forward-looking assessments of education and health care sector developments. In other countries, improved monitoring of education and health care spending is evident in programs approved after 1997, following the introduction of the staff

guidelines on social spending, and program documents provide more specific information on related developments and report spending on education and health care at a disaggregated level.

- In the HIPC decision point countries and Ghana, information to monitor social developments was drawn from a wider variety of sources, including bilateral donors (Burkina Faso and Ghana). These arrangements also made effective use of information from internal reviews conducted at the local government and community levels. Also, in several countries, poverty monitoring teams and units were set up (examples are given in Table 4.3).

In specifying public spending targets and policy measures and in monitoring, IMF staff collaborated with the World Bank and regional development banks. The World Bank provided policy analyses for many countries. Except for Burkina Faso and Georgia, however, comprehensive World Bank Public Expenditure Reviews were not available at the time of the initial request for an ESAF arrangement to guide budget policy. Thus, it was not always possible to ensure that budget allocations for education and health care were in line with an appropriate overall composition of expenditures. Expenditure reviews have since been undertaken or are scheduled to commence in 1999 in all 11 countries.

Conditionality[42] was attached to public spending targets and to key reforms for which timely implementation was essential to the success of the program.

- Conditionality was used sparingly, and primarily took the form of benchmarks (Table 4.5). Performance criteria and prior actions have rarely been used. For the most part, conditionality was applied to minimum levels of budget spending with a view to protecting spending on education and health care from the pressure of overall spending restraint, in parallel with World Bank programs to improve the quality of social sector spending (Georgia and the Kyrgyz Republic), or to ensure that additional resources were not diverted to other uses (Uganda).
- Conditionality was used to encourage the timely completion of sector and national poverty reduction strategies and action plans, which were prerequisites for establishing a clear operational strategy for improving access to social services over the medium term. In Côte d'Ivoire a prior action on adopting an antipoverty national plan was introduced to provide stronger evidence of the authorities' commitment to strengthening spending on education and health care, an area in which there had been slippage and an unmet benchmark in the previous ESAF arrangement. Establishing performance criteria on education and health care spending in the Kyrgyz Republic and Uganda programs was combined with measures to ensure the quality of such spending.

[42] Policy measures that members intend to follow as a condition for the use of IMF financial resources.

Table 4.4
Public Education and Health Care Spending Targets, Selected ESAF Countries 1/

Country 2/	Quantified Expenditure Target	Definition	Monitoring 3/	Comment
Transition Economies				
Armenia (1996)	Yes	Current health and education expenditures in percent of GDP.	Yes	Quantitative target specified and monitored from the second annual arrangement.
Georgia (1996)	Yes	Social expenditures in percent of GDP (1996). Budgetary appropriations for health and education (from 1997).	Yes	Quantitative targets specified in the reports but definitions differ across reports. Reports include mostly qualitative discussion of social expenditure developments, but without reference to previously specified targets.
Kyrgyz Republic (1994)	No	---	---	---
Kyrgyz Republic (1998) 4/	Yes	Health and education expenditures in percent of GDP and total spending.	Yes	---
HIPC at Decision Point				
Bolivia (1995)	Yes	Health and education expenditures in percent of GDP.	Yes	Quantitative target specified and monitored from the third annual arrangement.
Bolivia (1999)	Yes	Health and education expenditures in percent of GDP.	Yes	---
Burkina Faso (1996)	Yes	Health and primary education expenditures in percent of GDP.	Yes	---
Côte d□Ivoire (1998)	Yes	Health and education expenditures in percent of GDP.	Yes	---
Mozambique (1996)	Yes	Current expenditures on health and education in percent of GDP.	Yes	Quantitative target specified and monitored from the second annual arrangement.
Uganda (1997)	Yes	Health and education expenditures in percent of GDP.	Yes	---
Other ESAF Countries				
Ghana (1995)	Yes	Health and education expenditures, excluding foreign financed capital expenditures, in percent of GDP.	Yes	Target specified and monitored from the second annual arrangement.
Ghana (1999)	Yes	Health and education expenditures, excluding foreign financed capital expenditures, in percent of GDP.	Yet to be reviewed	---
Lao People's Democratic Republic (1993)	No	---		---

Country 2/	Quantified Expenditure Target	Definition	Monitoring 3/	Comment
Malawi (1995)	Yes	Current expenditures on health and education, in percent of GDP.	Yes	Quantitative target specified and monitored from the third annual arrangement. Definition of targets differs across reports. Qualitative discussion of social expenditure and outcome developments, including with reference to previously specified quantitative target.

Source: IMF staff reports.
1/ A program is defined to have a quantitative target when either the staff report, MEP, and/or PFP provides a projection for the category of public spending. This is a broader coverage than used in Box 6, which is restricted to MEPs and PFPs.
2/ Year of approval in parentheses.
3/ Defined as a reference and/or a discussion of the developments with respect to the quantitative target specified in the request for the ESAF arrangement or subsequent annual arrangements.
4/ Program has performance criteria set in nominal terms as a floor on expenditures on health and education.

Table 4.5
Social Policy Conditionality (Prior Actions, Performance Criteria, and Benchmarks)
Selected ESAF Countries 1/

Country	ESAF Arrangement 2/	Policy Measure	Type of Conditionality	Observance
Armenia	ESAF. 3 (1998)	Develop and approve a three-year strategic plan for the health sector by end-September 1999.	Benchmark	Review pending
Côte d'Ivoire	ESAF. 1 (1998)	Adopt a national plan to fight poverty.	Prior action	Met
Georgia	ESAF. 1 (1996)	Reduce number of budgetary positions, primarily in education, by 10,000 by September 1996.	Benchmark	Met
	ESAF. 2 (1997)	Minimum amount of health expenditures of the republican government cumulative from January 1, 1997.	Benchmark	Not met
	ESAF.3 (1998)	Minimum amount of health expenditures of the republican government.	Benchmark	Not met
Ghana	ESAF.2 (1995)	Complete medium-term expenditure framework (MTEF) for priority sectors of education, health, and roads.	Performance criteria	Met
Kyrgyz Republic	ESAF.1 (1998)	Cumulative floor on budgetary expenditures separately on health and education beginning April 1998. 3/	Performance criteria	Waived 4/
Mozambique	ESAF.3 (1998)	Complete National Poverty Assessment and Poverty Action Plan by end-1998.	Benchmark	Met
Uganda	ESAF.1 (1997)	Minimum amount of nonwage expenditures on priority program areas in health and education.	Benchmark	Met
	ESAF.2 (1998)	Minimum amount of nonwage expenditures on priority program areas including universal primary education component of domestic development expenditures.	Performance criteria	Review pending

Source: IMF staff reports.
1/ Social policy conditionalities were used in only 7 of the 11 ESAF countries.
2/ Year of approval shown in parentheses; suffix indicates the program year (1 to 3).
3/ Program targets are set in terms of expenditures as a percent of GDP.
4/ Prior actions on the level of spending in the quarter following the test date were set as conditions for completing the mid-term review, of which that on health was met. In addition, measures to strengthen overall expenditure management were to be introduced and the authorities undertook to ensure that spending on education and health care would be kept at least constant in real terms throughout 1999.

V. Collaboration with the World Bank and Other International Agencies

The IMF is concerned with the social dimensions of its economic policy advice. The analysis and policy advice on social issues, however, are to a large extent outside the principal areas of IMF expertise. Between the Bretton Woods institutions, the primary responsibility for social policies lies with the World Bank, and IMF staff rely upon the World Bank in this area. Other international institutions, such as regional development banks and UN agencies (e.g., International Labor Organization, United Nations Development Program, and World Health Organization), the donor community, NGOs, and civil society, on a country-by-country basis, also can provide valuable inputs.

World Bank and IMF staffs have well-established procedures for collaboration, including on social sector issues, in support of members' efforts to achieve sustainable growth and poverty reduction.[43] On social sector issues, IMF staff looks to the World Bank for inputs on social sector policy goals, analysis, reforms, and their budgetary cost, as well as data on social indicators. An iterative interaction between the staffs of the IMF and the World Bank ensures the consistency of the overall macroeconomic framework, including notably the fiscal envelope, with sustainable, cost-effective social policies and strategies for poverty reduction.

Frequent interaction between the staffs of the World Bank and the IMF on social issues takes place through several channels.

- In addition to exchanges at headquarters, including through the review process, IMF missions to program countries have usually involved parallel World Bank missions or the participation of World Bank staff (and vice versa), as well as in-field consultations with resident representatives. In ESAF countries, overlapping missions are the norm.
- In ESAF-supported programs, the PFP includes a separate section on poverty and social sector issues.
- Reflecting the joint nature of the HIPC Initiative and its specific emphasis on achieving social improvements and development, collaboration is intensive in HIPCs, particularly as they approach their decision points under the Initiative.
- In the fall of 1998, a pilot program for enhanced World Bank–IMF collaboration in low-income (ESAF/IDA) countries was launched in six countries (Cameroon, Ethiopia, Nicaragua, Tajikistan, Vietnam, and Zimbabwe). The pilot includes a specific focus on social sector issues; in particular, it is envisaged that the World Bank would not only identify measures to mitigate adverse effects on the poor and vulnerable, but also assess the social impact of program design more broadly, ex ante and ex post.
- Periodically, joint institution-wide, forward-looking reviews of work plans and priorities in public sector work are carried out. These reviews aim, among other things, to coordinate IMF and World Bank public sector work and to ensure the timely availability of public expenditure analyses.
- At the general policy level, the IMF's Fiscal Affairs Department and their World Bank counterparts in the Poverty Reduction and Economic Management and Human Development

[43] Collaboration between the World Bank and IMF has been periodically reviewed and staff guidance notes on collaboration in certain policy areas have been issued.

Networks have recently initiated regular senior-level meetings to coordinate work programs and to help resolve collaboration issues that may arise.

The importance of social sector issues for the IMF has led to a strengthening of collaboration with the UN system and regional development banks. For example, in the area of labor market and related social policy reform, guidelines were issued in 1996 to IMF staff on collaboration with the International Labor Organization (ILO) that provide for more systematic contacts between staff at the country level, especially through resident representatives. Also, pilot countries were selected for enhanced IMF-ILO collaboration, and interaction on general policy issues has been increased, most recently in the context of the Asian crisis.[44] In late 1998, the World Health Organization (WHO) and the IMF strengthened collaboration on health-related issues in low-income countries.

World Bank–IMF collaboration in the social area, however, has not always been seamless. In part, this reflects a mismatch between the timetables adopted for World Bank and IMF work programs and the operational methods of IMF- and World Bank-supported programs, which, in some respects, are not well-attuned to each other since IMF-supported programs are typically formulated under relatively tight deadlines, often demanded by a crisis situation.

- The pressing country requirements can, unfortunately, cut across the grain of the longer time-frame of preparatory work, including a broad participatory approach for social policy formulation. This highlights the importance of an ex ante dialogue and ongoing policy analysis and recommendations in the social policy area.
- Sufficient time is also not always available to collect information to develop well-targeted social sector reforms.
- On occasion, World Bank input has not been available within the time-frame required by the countries' circumstances, and the IMF staff and the country authorities have devised policies as best they could. In such cases, the focus has tended to be on mitigating the adverse impact on vulnerable groups through specific social protection mechanisms, rather than in terms of program design based on ex ante social assessments.

From an IMF perspective, more World Bank involvement, including in monitoring and following up on social sector issues, would be desirable, particularly for ESAF countries. The World Bank has shifted away from comprehensive Public Expenditure Reviews (PERs) toward a sequence of more in-depth sector-specific expenditure reviews, which are useful in their own right, but do not provide a comprehensive analysis of budget priorities. The World Bank staff understandably focuses their work programs on the Country Assistance Strategies (CAS's) and their own lending operations. Thus, the PFP is not regarded as a priority in the work agenda of World Bank staff. It is no longer discussed by the World Bank's Executive Board and is generally not directly relevant to World Bank's operations, which contrasts with the role of the PFP at the IMF. This difference has created gaps in needed inputs for ESAF-supported and other programs and has, in some cases, led IMF staff to work with the authorities to fill the gap through IMF technical assistance.

The most recent internal assessment of the World Bank's support of poverty reduction found that, relative to past benchmarks, performance has been good (World Bank, 1999). At the same time, it raised many of the same concerns noted above.[45] As a result, mechanisms for more active monitoring of

[44] IMF senior staff have participated in the high-level tripartite ILO meetings in Bangkok in 1997, 1998, and 1999, and, in May 1998, the IMF organized a seminar with the ILO to improve the staff's understanding of core labor standards and the ILO's role in setting and monitoring these standards.

[45] The World Bank report underscored three points: (i) only somewhat more than half of the Country Assistance Strategies prepared in FY1998 were judged fully satisfactory in their integration of poverty issues into the framing of a forward-looking strategy; (ii) progress in completing poverty assessments has at times been slow, reflecting a greater use of participatory and consultative methods, staff resource constraints, and the degree of domestic political commitment; and (iii) much less

(continued...)

developments in these areas are being implemented. Various World Bank initiatives should contribute to a better and more systematic integration of social sector issues in World Bank lending operations and hence in IMF-supported programs:

- developing the Comprehensive Development Framework (CDF), which includes countries' social sector objectives and policies;
- strengthening the poverty focus in Country Assistance Strategies;
- preparing social and structural policy reviews;
- improving the delivery of Public Expenditure Reviews and their synchronization with countries' budget processes;
- implementing the joint ESAF/IDA pilot scheme; and
- developing and implementing the Principles and Good Practices in Social Policy.

World Bank–IMF collaboration in the poverty reduction and social policy area could be strengthened by the formulation, together with the authorities, of a Poverty Reduction Strategy Paper (PRSP) through a participatory process. The PRSP would aim at ensuring the consistency between a country's macroeconomic, structural, and social policies, and the goals of poverty reduction and social development. It would

- be owned by the government and endorsed by the Boards of the World Bank and the IMF as a basis for the institutions' operations;
- include a macroeconomic framework and structural and social policies consistent with the poverty reduction and social goals;
- set out technical assistance needs and expected providers; and
- identify overall external financing needs.

When all these elements are available in the PRSP, it could replace the Policy Framework Paper (PFP), and provide a framework for World Bank and IMF lending operations for the country.[46] While the PRSP might be prepared every three years, there would be annual updates.

A. Postscript

Following the Executive Board's consideration of this and other papers, important changes were made to the ESAF to give the goal of poverty reduction greater prominence, and improve its effectiveness as a policy instrument to favor growth and reduce poverty.

The key change is that the complementarity of macroeconomic, structural, and social policies will be given greater recognition. These policies would be articulated in a Poverty Reduction Strategy Paper (PRSP) which would integrate these policies in a mutually reinforcing manner. Many of the recommendations for strengthening the design and implementation of social policies, particularly in efficiency and targeting of public spending would feed into the PRSP. Importantly, the PRSP prepared in collaboration with the IMF and World Bank, will be nationally owned: the preparation would be government-led based on an open consultative process, including with civil society. The PRSP would also serve as the vehicle for strengthened IMF-World Bank collaboration. Reflecting these changes, the ESAF was transformed in December 1999 into the Poverty Reduction and Growth Facility.

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progress has been made in evaluating the impact of specific interventions (only 13 percent of Country Assistance Strategies include monitorable poverty benchmarks that were time-bound and output- or outcome-oriented).

[46] A more detailed description of the proposed process and the PRSP is provided in the Bank-Fund paper, "HIPC Initiative—Strengthening the Link Between Debt Relief and Poverty Reduction," which is available on the Internet at http://www.worldbank.org/hipc/hipc-review/hipc-review.html.

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IMF Executive Board Discussion
(Chairman's Summing-Up, September 19, 1999)

Directors considered that the IMF's primary role is to promote macroeconomic stability and structural reforms necessary for achieving sustainable and rapid growth. They underscored the crucial importance of economic growth for poverty alleviation, but also recognized that the IMF must be sensitive to the social implications of its policy advice. In particular, Directors noted that IMF-supported programs have sought to help members address the potential adverse impact on vulnerable groups of their adjustment and reform efforts as well of exogenous shocks, and that such efforts in turn can make a vital contribution toward sustaining economic reforms and protecting living standards. They also observed that sound macroeconomic policies, coupled with effective social and infrastructure spending, foster faster long-term growth. In light of these considerations, Directors observed that social safety nets and appropriately targeted productive public spending, particularly in the social area, can provide critical support for the success of members' adjustment and reform programs.

Broader requirements for improving living standards were also discussed, including promoting faster growth and employment creation and better integrating poorer countries into the international economic system. In addition, Directors suggested that the international community should work to improve these countries' access to industrial country markets, as well as to halt the excessive flow of weapons to developing countries. Directors stressed the importance of good governance, transparency, and accountability for ensuring the effective use of public resources.

Directors discussed the role of the IMF with regard to social policies. Recognizing the need for mutually reinforcing macroeconomic and social policies, they underscored the importance of more closely integrating, with the help of the World Bank, social issues and poverty concerns into IMF-supported programs. Directors agreed that greater attention to social issues was necessary in the context of low-income countries, including HIPCs, where structural reforms are particularly critical. With regard to other countries, a variety of views was expressed on the degree and modalities of IMF involvement in social issues. Some speakers attached importance to these issues in countries other than low-income countries, pointing to the recent experience in the Asian crisis countries and elsewhere. However, a number of Directors, while concurring that IMF-supported programs should encompass members' social policies and poverty reduction efforts, cautioned nevertheless that the IMF should not allow its primary mandate to be diluted. They viewed the World Bank as taking the leading role in developing adequate social safety nets and effective social policies, and the IMF as contributing to poverty reduction mainly through its support of economic policies that provide a conducive environment for sustained growth.

All Directors emphasized that, as regards social issues, the World Bank and other relevant international organizations have the primary mandate and expertise. In this connection, they noted, for example, that the relationship between public social spending, growth, and poverty is complex, and that it is therefore critical to ensure that spending is used productively. Several Directors cautioned that the IMF did not have the panoply of expertise needed to assess the quality of social spending and related issues. Directors, therefore, underscored that the social components of countries' IMF-supported programs should draw, to the fullest extent possible, on the work of the World Bank and other relevant institutions. Some Directors were of the view that when timely inputs from these institutions on essential social components of IMF-supported programs were not available, IMF staff would necessarily have to provide policy advice to the extent feasible. Many other Directors were skeptical about such IMF involvement, particularly if it were to require additional staff expertise. All Directors suggested that, to facilitate such cooperation, these institutions should be encouraged to provide more timely input. Overall, Directors agreed that more intensive cooperation between the IMF and the Bank is essential, proceeding along the lines of these institutions' respective responsibilities and comparative advantages, and thus avoiding duplication of efforts. They welcomed therefore the recent enhanced IMF-Bank cooperation, pointing to the Enhanced Structural Adjustment Facility/International Development Association (ESAF/IDA) pilot program and the preparation of the reports for this discussion.

Turning to specific issues in the area of social policies, Directors noted the scope for further improving the quality and implementation of social safety nets, through comprehensive ex ante analyses and monitoring, relying on the expertise of the World Bank and other organizations. Several Directors recommended that the staff should assess, in the course of surveillance, the adequacy of social policy instruments, the performance of social safety nets, and the potential social ramifications of macroeconomic and financial policies. Many others, however, cautioned that this should not detract from the appropriate focus of Article IV surveillance. We will have to come back to this matter on the occasion of the biennial review of surveillance.

Spending on education and health care has increased in real per capita terms and in relation to GDP in most countries with IMF-supported programs during the past decade. While this has been accompanied by an improvement in a broad range of social indicators, Directors noted the diversity in outcomes caused by the differences in the effectiveness of social spending. Although some cautioned that too much emphasis on the absolute amount of social spending could send the wrong message, Directors more generally stressed the importance of efficient and well-targeted spending for ensuring that gains in social indicators are commensurate with spending increases. Further improvements in these areas could be achieved, inter alia, by strengthening a country's budget formulation and implementation capacity.

The establishment of national quantitative targets for poverty reduction—consistent with the International Development Goals for 2015 to which countries have subscribed—could also prove beneficial, especially if the higher targeted spending is used productively. Directors suggested that, in setting targets, spending needs in priority areas for poverty reduction other than health, education, and social safety nets—such as basic sanitation, rural roads, and access to clean water—should also be taken into account; such priority spending may contribute as much or more to poverty reduction. Some Directors thought that core labor standards had a valuable contribution to make to the achievement of these targets, while other Directors were concerned that this issue is outside the IMF's main areas of responsibility. We will come back to this issue after further consultations with the World Bank and the ILO.

Directors considered that in countries where social spending is so low as to be a critical area of weakness, structural benchmarks could continue to be used selectively to protect social spending and to promote key institutional reforms. While many Directors thought that such benchmarks should only be used in ESAF-supported programs, some other Directors saw the value in applying performance indicators (performance criteria and structural benchmarks) to a broader range of IMF-supported programs. In establishing such structural benchmarks, IMF staff will rely on inputs from the World Bank and others to ensure, inter alia, the targeting and quality of spending.

Directors noted with concern the widespread poor quality of data on social spending, social indicators, and social protection arrangements, which inhibited the design and implementation of effective social programs. They saw an urgent need for country authorities to identify weaknesses in data and data collection, and to make data improvements in collaboration with the World Bank, other international agencies, and civil society.

Glossary

Benchmarks. In the context of IMF-supported programs, a point of reference against which program implementation is monitored. Benchmarks are not necessarily quantitative and frequently relate to structural variables and policies.

Comprehensive Development Framework (CDF). A holistic approach to development developed by the World Bank and implemented on a pilot basis since early 1999. The CDF highlights the interdependence of all elements of development—social, structural, human, governance, environmental, economic, and financial—and stresses ownership by the country and partnership with government, civil society, assistance agencies, and the private sector.

Conditionality. Economic policies that members intend to follow as a condition for the use of IMF resources. These are often expressed as *performance criteria* (e.g., monetary and budgetary targets) or *benchmarks*, and are intended to ensure that the use of IMF credit is temporary and consistent with the objectives of adjustment program designed to correct a member's macroeconomic and structural imbalances, and promote stronger growth and external payments viability.

Country Assistance Strategy (CAS). The central vehicle for World Bank Executive Board review of its assistance strategy for International Development Association (IDA) and its borrowers. The CAS document describes the strategy based on an assessment of priorities in the country and indicates the level and composition of assistance to be provided based on the strategy and the country's portfolio performance.

Enhanced Structural Adjustment Facility (ESAF). This facility, established by the Executive Board in 1987 and extended and enlarged in February 1994, is the principal means by which the IMF provides financial support, in the form of highly concessional loans, to low-income member countries facing protracted balance of payments problems and loans and grants under the HIPC Initiative. In late 1999, the ESAF was succeeded by the *Poverty Reduction and Growth Facility (PRGF).*

ESAF/IDA pilot project. Program for enhanced World Bank–IMF collaboration in low-income (ESAF/IDA) countries, including a specific focus on social sector issues in six countries—Cameroon, Ethiopia, Nicaragua, Tajikistan, Vietnam, and Zimbabwe.

Heavily Indebted Poor Countries (HIPC) Initiative. Initiative designed to provide exceptional assistance to heavily indebted poor countries following sound economic policies to help them reduce their external debt burden to sustainable levels. In the second half of 1999, the Initiative was strengthened to provide deeper and faster debt relief through the Enhanced HIPC Initiative.

Memorandum of Economic Policies (MEPs). Document prepared by a member country describing the policies that it intends to implement in the context of its request for financial support from the IMF.

Performance Criteria. Macroeconomic indicators such as monetary and budgetary targets that must be met for the member to qualify for phased purchases under *Stand-By Arrangements* in the upper credit tranches, Extended Fund Facility (EFF), and *Enhanced Structural Adjustment Facility Arrangements* (ESAF).

Policy Framework Paper. Document prepared by a member country in collaboration with the staffs of the IMF and the World Bank and updated annually, which describes the authorities' economic objectives, macroeconomic and structural policies for a three-year adjustment program supported by resources under the *Enhanced Structural Adjustment Facility* (ESAF), as well as associated external financing needs and major sources of financing.

Poverty Reduction and Growth Facility (PRGF). The IMF's successor arrangement to the *Enhanced Structural Adjustment Facility* (ESAF). In the PRGF, poverty reduction is a key element of a renewed growth-oriented economic strategy. The cornerstone of the new approach is a nationally owned, comprehensive, *Poverty Reduction Strategy Paper* (PRSP).

Poverty Reduction Strategy Paper (PRSP). The central document in the new *Poverty Reduction and Growth Facility* (PRGF) and will identify priorities for public action to achieve the greatest impact on poverty reduction. It will also address the critical, and often complex issues related to enhancing good governance and supporting transparency in policy making. The PRSP will be country driven, being prepared by the authorities with assistance from the World Bank and the IMF, and reflect the outcome of an open, participatory process involving civil society, relevant international institutions, and donors.

Public Expenditure Review (PER). The major vehicle for the World Bank to analyze public sector issues, and general public expenditure issues in particular, as part of its economic and sector work with its member countries. PERs help countries establish effective and transparent mechanisms to allocate and use available public resources in a manner that promotes economic growth and helps in reducing poverty.

Stand-By Arrangements. Stand-By Arrangements give member countries the right to draw up to a specified amount of IMF resources during a prescribed period (usually 12–18 months, although they can extend up to three years). The release of drawings is conditional upon meeting performance criteria and the completion of periodic reviews.

ECONOMIC SHOCKS, SAFETY NETS AND FISCAL CONSTRAINTS: SOCIAL PROTECTION FOR THE POOR IN LATIN AMERICA

by

Norman Hicks and Quentin Wodon *

World Bank

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Abstract

Confronted with recurrent macroeconomic shocks, governments in Latin America and the Caribbean have increasingly been concerned about establishing or strengthening systems of social protection and safety net programs. The goal of these programs is to help mitigate the impact on the poor of shocks before they occur, and to help the poor cope with the shocks once they have occurred. In this paper, we focus on publicly funded or mandated safety nets functioning as risk-coping mechanisms. The paper reviews the characteristics of a good safety net against the main types of safety nets currently in place. In general, it finds that no single program meets all of the criteria in terms of efficiency and effectiveness, although some are better than others. Finally, what has been the actual record in terms of protecting the poor through targeted public spending during crises? The paper finds that because of fiscal constraints during a crisis, social spending is often pro-cyclical when ideally it should be counter-cyclical.

I. The context: Persistent poverty and vulnerability to shocks

The Latin America and Caribbean Region (LAC) has been plagued by macroeconomic shocks over the last twenty years, with serious consequences for the poor (e.g. Glewwe and Hall, 1998; Lustig, 1995, 1999; Ganuza et al., 1999.) Macroeconomic shocks are so-called "covariant" shocks (Holzmann and Jorgensen, 1999) which affect the real incomes of a large share of the population, typically through a reduction in both real hourly wages (via inflation) and the number of hours worked (via unemployment or underemployment.) Beyond these income effects which may vanish once growth resumes, macroeconomic shocks may also have longer term consequences. For example, the reduction in the quantity and quality of public health care due to budgetary cuts during a crisis may induce irreparable damage. Also, when coping with a crisis, parents may send their children to work in order to compensate for their own loss of income[1]. If there is substitution between child labor and schooling, and if the children do not return to school at a later stage, they will incur long term wage losses due to their lower endowment in human capital (Wodon and Siaens, 2000.) All this may help explain why De Janvry and Sadoulet (1999) find evidence that the increase in poverty that follows a macroeconomic shock may be larger than the subsequent reduction in poverty with growth.

There are signs that the reforms enacted in many countries of the region in the 1990s have been bearing at least some fruits. Wodon et al. (2000) estimates that in 1996, slightly more than one third of the LAC population (36.7 percent) was poor (i.e., not able to afford basic food and non food needs), and one out of every six person (16.1 percent) was extremely poor (i.e., not able to afford basic food needs.) This

[1] The impact of adult wages on child labor has been discussed among others by Basu and Van (1998.) In testing their theory, Ray (1998) finds that higher wages for adults reduce the probability that children will be working in Peru, but not in Pakistan. Psacharopoulos (1997) finds that the impact of household income on schooling and child labor is significant in Venezuela, but less so in Bolivia. In Peru, Patrinos and Psacharopoulos (1997) find an impact of family income on a measure of age-grade distortion for children, but no impact on child labor. Jacoby and Skoufias (1997) find that child labor helps smooth rural incomes in India. For Peru, Ilahi (1999) finds a gender bias. Although the educational attainment of boys and girls are the same on average, the schooling of girls is more sensitive to shocks such as changes in adult female employment or the sickness of household members.

represents a progress versus 1992 when the incidences of poverty and extreme poverty were both higher. However, the absolute number of the poor has not been reduced as much due to population growth. Moreover, if the comparison is made with 1986 instead of 1992, the numbers of the poor and extreme poor in 1996 have risen considerably (see Lustig and Arias, 2000, for a survey of poverty estimates.) Projections of further poverty reduction between 1996 and 1998 using elasticities of poverty reduction to growth and actual levels of growth observed in LAC suggest only limited gains in percentage terms, with the numbers of the poor and extreme poor remaining constant[2].

Table 1
Population and number of poor and extreme poor in LAC, 1986-1998

Year	*Population (millions)*	*Share (%) of population poor*	*Number of poor (millions)*	*Share (%) of population extremely poor*	*Number of extreme poor (millions)*
1986	407.38	33.75	137.49	13.32	54.26
1989	430.98	38.26	164.89	17.59	75.81
1992	454.65	39.65	180.27	18.65	84.79
1995	478.21	36.92	176.56	15.94	76.23
1996	486.06	36.74	178.58	16.10	78.26
1998*	501.87	35.83	179.84	15.55	78.05

Source: Wodon et al. (2000.) Poverty numbers for 1998 are based on projections, not surveys.

Apart from having suffered from macroeconomic instability and high levels of poverty, Latin American households have also been affected by the forces of globalization. The move towards greater openness has generated substantial benefits in many countries of the region, but it has also facilitated the transmission of international shocks and, as importantly, it has accelerated the adjustment of the region's economies to the requirements of international competition. Openness may have resulted in a reduction in employment security (Rodrick, 1999) and in widening wage differentials between better and less skilled workers[3]. While the current changes in labor markets should ultimately bring net positive aggregate gains, they may also induce idiosyncratic (i.e., household specific) shocks for the individuals loosing their jobs at a time when the region has not yet fully developed systems of social protection.

It should not be surprising under these circumstances that there is a malaise in the region. While average levels of real per capita incomes have risen in a majority of LAC countries in the 1990s, this may not yet have been translated into improvements in subjective perceptions of welfare. Table 2 presents the results of a 1999 opinion survey conducted by the Wall Street Journal in fourteen LAC countries. Almost two thirds of the respondents believe that their parents had a better life than themselves. Less than half believe that their children will have a better life than themselves. This pessimism probably reflects both a feeling of economic insecurity and the relative lack of progress in reducing poverty observed over the last two decades and documented above.

[2] The LAC region has performed better in terms of non-monetary indicators of well-being, with improvements for adult illiteracy, infant mortality, life expectancy, gross secondary school enrollment, and access to safe water.

[3] A convincing body of empirical evidence is lacking on many of these issues. Lustig and Arias (2000) argue for example that there have been widening returns to skills, but Gill (1999) suggests that the empirical evidence is still very much mixed. See for example Fajnzylber and Maloney (1999.)

Table 2

Subjective perceptions on changes in living standards in LAC

	Better	*Same*	*Worse*	*NA*
Taking everything into consideration, would you say that your parents lived better, the same, or worse than how you live today?	61.2%	22.0%	14.4%	2.4%
And regarding your children, do you believe that they will live better, the same, or worse than how you live today?	46.1%	20.7%	22.0%	11.2%

Source: 1999 poll, Wall Street Journal, quoted by Rodrick (1999.) NA = No answer.

There are no easy answers to the difficulties and uncertainties faced by poor households in Latin America. Macroeconomic policies promoting stable and broad-based economic growth certainly help in reducing poverty, but they are not enough. This is why governments in the region have increasingly been concerned about establishing or strengthening systems of social protection and safety net programs that help mitigate the potential impact of economic shocks before they occur, and help the poor cope with these shocks after they have occurred. In this paper, we focus on publicly funded or mandated safety nets functioning as risk-coping mechanisms. What are the characteristics of good public safety nets? What are the main types of safety nets currently in place in LAC countries? Which programs should be protected or expanded during economic crises? Finally, what has been the actual record in terms of protecting the poor through targeted public spending during crises? This paper provides tentative answers to these questions. Section 2 of the paper introduces the reader to the main concepts used in the literature on social protection and safety nets within the context of the various ways in which households are affected by, and respond to shocks. Section 3 presents the main types of programs currently in place, with their respective strengths and limits. Section 4 uses the experience of Argentina and Mexico to assess the actual record in protecting the poor through safety nets during crises. A brief conclusion follows[4].

II. The goal: Designing good safety nets and social protection systems

A recently drafted World Bank Social Protection Strategy Paper (World Bank, 1999a; see also Holzmann and Jorgenson, 1999) places social protection in the context of social risk management. It makes the point of dividing social risk management strategies into three types: risk reduction, risk mitigation and risk coping. Under *risk reduction* fall macro economic management, regulations, and institutional development policies that help prevent crises from occurring. While these prevention policies are important, they are too general to be part of the social protection system which consists mainly of mitigation and coping strategies. *Risk mitigation* strategies are developed before a shock to reduce the impact of the shock once it occurs. They include for example income diversification and insurance mechanisms, both formal and informal. *Risk coping strategies* are implemented after a shock to deal with the impacts of the shock not covered by risk mitigation policies. Table 3 from Gill (1999) provides an overview of some of the main government and private sector policies.

[4] Several authors have recently reviewed the literature on social protection, safety nets, and crises. This includes among others Klugman (1999) for safety nets, Dar and Tzannatos (1999) for active labor market programs, Karni (1999) for unemployment insurance, and Ezemenari and Subbarao (1999) for social assisatnce. The Inter-American Development Bank (in February 1999) and the World Bank (in June 1999) have held conferences on the topics.

Table 3

Classifying Government and Private Risk Management Measures

Nature of Policy	*Government Led*	*Private sector Led*
Mainly Prevention (risk-reducing) - regulatory - or taxpayer funded - universal	- Macroeconomic policies - Financial regulations - Infrastructure investments - Labor-related regulations - Human capital investments	- Infrastructure investments - Human capital investments - Portfolio diversification
Mainly Insurance (risk-mitigating) - inter-temporal transfers - premium funded - non-poor and poor	- Unemployment insurance - Severance funds - Job protection statutes - Public work guarantees	- Individual savings - Sale of assets (e.g. land) - Labor force participation
Mainly Assistance (risk-coping) - within period transfers - taxpayer funded - targeted: focus on poor	- Public work programs - Means-tested cash transfers - Conditional cash transfers - Commodity transfers	- Inter-household transfers - Community solidarity - Support from NGOs - Public-private partnerships

Source: Gill (1999.)

In this paper, we focus on publicly provided or mandated instruments for assisting private individuals in coping with shocks (the bottom cell in the middle column in Table 3.) This does not mean that we do not take into account private coping strategies[5]. There are of course linkages between private and public coping strategies (see e.g. Ezemenari, 1997, for transfers.) As mentioned in the introduction, some private short-term strategies may have permanent effects that make it difficult to reduce poverty in the longer term. This is the case when the nutrition of certain family members suffers. It is also the case when children are put to work. Although the substitution effects between work and schooling are likely to be partial due to the possibility for the parents to reduce the time devoted by the children to leisure (Ravallion and Wodon, 2000a), it has been estimated that on average, for six Latin American countries, the reduction in the probability of going to school when a child is performing paid work varies from 21 to 67 percent depending on the sample (Wodon and Siaens, 2000; the estimates include controls for a wide range of other variables affecting the decision to go to school and/or to work, so that they are net marginal effects.) This substitution between work and schooling reduces the human capital endowment of working children to the extent that working children may expect on average a loss of about 7 percent of their discounted life-time earnings when they are put to work even after taking into account their positive earnings when working as children and the higher level of experience accumulated because of work at an early age. Clearly, the magnitude of the long term losses due to child labor calls for the design of programs that help parents keep their children in school, especially during economic crises.

More generally, publicly funded or mandated social protection programs and safety nets represent an attempt to protect the poor against the risks that arise from shocks, whether the shocks are foreign or domestically induced, and whether they are covariant or idiosyncratic. As already mentioned, an economic crisis produces a *covariant shock*, whereby many people are affected at the same time. But even in

[5] To cope with the income losses induced by shocks, the poor adopt a wide variety of coping strategies. These may include moving from formal to informal sector employment; working longer hours and/or working at a second job; promoting the labor force participation of additional family members such as spouses and children; selling (or consuming in the case of farmers) productive and other assets, including stocks; migrating temporarily or permanently in order to search for employment opportunities; reducing consumption patterns, including restricting the food intake of family members, taking children out to school to reduce education expenditures, or postponing health care expenditures; relocating and/or restructuring households, for example by having several families living under one roof; drawing on outside help both in kind and in cash, including support from local communities, friends and relatives, and private institutions such as NGOs (this in turn highlights the role of social capital.) One interesting paper about the gender dimension of these strategies is Cunningham (1998.)

normal times, households can be affected by *idiosyncratic shocks* such as a death, an illness, or a loss of employment. One should differentiate between the social safety nets which should be in place at all times to deal with idiosyncratic shocks, and the programs which are specifically designed to help large numbers of poor people suffering from temporary adverse covariant shocks (World Bank, 1999a.)

There are typically more mechanisms available for coping with idiosyncratic as opposed to covariant shocks, and the fiscal implications of both types of shocks are clearly different. However, even among the programs designed to deal with covariant shocks, one can identify a number of alternatives. These include:

- Emergency employment programs involving public works, often using labor intensive methods, commonly called workfare;
- Social funds, which establish special programs, usually in rural areas, for financing small scale public works identified by local community groups;
- Nutrition and food interventions, particularly those targeted at vulnerable groups such as children and pregnant women. These may take many forms, including food distributions, food stamps, and food served in schools or community kitchens;
- Systems of direct cash grants targeted to the poorest, which may be conditioned on favorable behavior (such as school attendance and/or health center visits);
- Other instruments, such as pensions and unemployment insurance, including systems of mandatory severance payments upon termination.

Another way to organize the discussion is to look at the programs in terms of the age groups they serve, on the basis of the fact that the different age groups have different needs.[6] People in the youngest age groups generally are at greater nutritional risk than other groups, while for adults, the principal problem may be one of employment. For the elderly, the critical problems are maintaining sufficient income to meet basic needs, and to have adequate health care access.

Within Latin America and the Caribbean, at present almost all countries have some mix of the above programs in varying degrees. However, very few if any programs completely fulfill the criteria of an ideal safety net which should have the following characteristics[7]:

- It should be based on a sound analysis of who is likely to be affected the most by crises, and what kinds of coping mechanisms are normally used by those affected;
- It should provide sufficient coverage of the population to be reached, particularly the most vulnerable and excluded groups;
- It should be well targeted to the poor, with clear eligibility and termination rules, so that access is simple and predictable;
- It should be supervised by well functioning institutions already in place;
- It should be counter-cyclical (i.e. receive more funding when there is an economic crisis), and in some cases implemented automatically according to pre-agreed triggers such as a rise above some level in unemployment or poverty;
- It should be fiscally sustainable;
- It should be able to provide benefits quickly, with as large as possible a share of the costs resulting in net increases in incomes;

[6] This idea comes from Ana-Maria Arriagada. See Appendix table for details.
[7] For a fuller discussion of criteria see Grosh, 1995.

- It should complement, not substitute for, private safety net programs and other social protection mechanisms;
- It should be scaled back when the crisis is over.

III. The tools: Types of safety nets and social protection programs

A. Workfare programs

Workfare programs provide employment through specifically designed public works projects. The classic example is Trabajar in Argentina. In this program, projects are identified by local governments, NGOs and community groups, and can provide employment for no more than 100 days per participant. Project proposals are reviewed by a regional committee, and projects with higher poverty and employment impacts are favored[8]. Workers hired by the project are paid by the Government, specifically the Ministry of Labor. The other costs are financed by local authorities. Example of eligible projects include the construction or repair of schools, health facilities, basic sanitation facilities, small roads and bridges, community kitchens and centers, and small dams and canals. These activities are fairly similar to those financed by social funds (see below.) One of the differences between a social fund project and a workfare project is that the workfare project is likely to be supervised by local authorities, rather than by independent agencies, and construction is typically not contracted to the private sector, but is carried out by the sponsoring agency, which can include local and provincial governments, private groups, and national organizations. Another difference is that workfare programs have the generation of employment and income as their priority, while social funds focus more on the quality of the infrastructure produced.

The projects are limited to poor areas as identified by a poverty map. Moreover, wages are set to be no higher than 90 percent of the prevailing market wage, so that the workers have an incentive to return to private sector jobs when these are available. Thus, the program involves self targeting apart from geographic targeting. Overall, targeting of the poor under Trabajar II (the second round of the project) has been reported to be quite good, with 75 percent of the funds reaching the bottom 20 percent of the income distribution, and 40 percent reaching the bottom 5 percent. However, the supply of jobs in the program depends on budgetary allocations as well as the ability of local communities to identify viable projects. As good as it is, Trabajar has provided employment to no more than 1 or 2 percent of the labor force, at a time when unemployment has ranged from 13 to 18 percent of the labor force.

Large workfare program have also been implemented by the Government of Chile during the period 1975-88. The objective of these programs was to absorb workers displaced from the public sector, and to reduce unemployment during the adjustment period. As for Trabajar, these programs provided employment in emergency public works, including maintenance and repairs to roads and schools, construction of parks, forestry projects, etc. The programs were administered by municipalities, and were gradually built up to a peak in 1983, when they employed about 13 percent of the total work force (over 500,000 workers), while the unemployment rate was at 17 percent. The programs were gradually reduced as private sector employment increased, and finally phased out completely in 1988. The two largest

[8] In a recent reform of Trabajar, several steps were taken to improve the performance of the program. The focus of the reform was placed on increasing community participation and funding in the choice of the projects to be financed. Trabajar now works in collaboration with local community groups, NGOs, and municipalities who present projects for selection. Projects must first be approved for technical feasibility. Next, they are selected on a points basis. More points are awarded to projects located in poorer areas, yielding larger public benefits, benefiting from well-regarded sponsoring community groups or NGOs, and reducing labor costs below the minimum wage. These new features have improved targeting both at the geographic and individual levels. The involvement of local groups has also improved the quality of monitoring and feedback for the projects.

programs offered manual labor at very low wages to ensure self targeting. Most of the workers were unskilled, and they received one-fourth of the then current minimum wage (about one-half of the market wage.) One out of every four participant was a women. However, while the program was considered successful in terms of reducing poverty and the social impact of unemployment, the quality of the public works produced was notably low, particularly as the program expanded in size. In addition, it is not clear that all the workers in the program would have been unemployed without the program. An evaluation found that 32 percent of the participants had no work experience prior to participating in the program, and 46 percent had retired voluntarily before joining the program. Many of those with no experience were women who went to work for the first time (Universidad de Chile, 1992.)

The advantages of workfare programs include their ability to expand quickly during a crisis, once the basic mechanisms have been established, and to reach the poor through area targeting and, within poor areas, through self targeting thanks to the low wages. But a problem with these programs is that the cost of generating one dollar in additional income for the poor through public works is typically large, in the range of three dollars or more. To understand why, the measure of cost effectiveness and its decomposition proposed in Box 1 are useful.

BOX 1

MEASURING THE COST-EFFECTIVENESS OF PUBLIC WORKS

Following Ravallion (1999), assume that without public works, an individual has a probability F* to find employment at market wage W*. Expected earnings are F*W*. With public works, the individual earns the public works wage W. If the individual can continue to search for private or self-employment while participating in public works, with probability F of finding such employment, the expected wage with public works is FW*+(1-F)W. The net wage benefit from the program for the worker is NWB = (1-F)W - (F* - F)W*. If the worker gets unemployment benefits or a subsistence allowance S, the wage benefit is reduced to NWB = (1-F)W - (F* - F)W* - (1-F*)S. If the program costs G to the Government per worker employed, a measure of cost effectiveness is the share of public expenditures transferred to workers as wage gain NWB/G. This measure can be decomposed as follows:

$$\frac{NWB}{G} = \underbrace{\frac{C}{G}}_{\substack{\text{budget}\\ \text{leverage}}} \underbrace{\frac{(W+L)}{C}}_{\substack{\text{wage}\\ \text{share}}} \underbrace{\frac{W}{(W+L)}}_{\substack{\text{targeting}\\ \text{performance}}} \underbrace{\frac{NWB}{W}}_{\substack{\text{proportionate}\\ \text{wage gain}}}$$

The determinants of cost-effectiveness are a) the leverage ratio C/G, where C is the total cost per worker including community funding; b) the wage share (W+L)/C, where W stands for wages paid to the poor and L stands for leakage due to wages paid for the non-poor; c) the targeting performance W/(W+L) which is the percentage of wages reaching the poor; and d) the proportionate wage gain NWB/W. This model can be extended to take into account the benefits of the infrastructure built by public works, but these benefits are not as immediate. [See the text for a discussion of the limits of this measure estimate of cost effectiveness.]

The measure of cost effectiveness used is the share of total program costs which reaches the poor through net increases in earnings. This share is a function of four parameters: the proportionate wage gain, the targeting performance, the wage share, and the budget leverage. A reasonable value for the proportionate wage gain may be 0.5 because the workfare wages are low and the poor typically find some other way to generate resources, for example through part-time informal employment when they do not have access to the programs. Because of the self-selection involved and the priorities given to poor areas, targeting performance may be good, at about 0.8. The wage share can often be obtained from administrative records by multiplying the number of work days created by the program by the wage rate, and dividing this amount by the total cost of the program. In many cases, the wage share will not exceed 0.7. Finally, when the program is almost entirely financed by the federal state (even though project selection may be done at the local level), the budget leverage is equal to one (in the case of Trabajar, there is budget leverage, but while this saves money for the central government, it still has to be paid by local governments.) The measure of cost effectiveness is obtained by multiplying the various parameters[9]. It thus typically costs three or more dollars to the national or federal government to transfer one dollar to the poor in additional wages.

The notion that it costs three or more dollars to transfer one dollar of income to the poor through workfare could be challenged, in that the benefits could be higher for two reasons[10]:

[9] In our illustrative examples, this measure would be equal to 0.5*0.8*0.7=0.28, in which case the total cost of generating one dollar in net additional wage earnings for program participants is 1/0.28=3.6 dollars. For an example of the econometric methods that can be used to measure with some precision the net wage benefit of workfare programs using household surveys (i.e. the parameter NWB/W), see Jalan and Ravallion (1998.)

[10] For a fuller discussion of these points, see Maloney (2000.)

- First, the method presented in Box 1 does not take into account the benefits of the public works themselves, which can be substantial if the workers are put to good use. The problem, however, is that these benefits will be enjoyed during the whole life of the infrastructure built, while what the poor need in times of crises is immediate income support. If the poor have high discount rates (which they do in general, but especially in times of crisis when their resources do not provide for basic subsistence), the discounted value of the benefits generated by the public works may be quite low. Moreover, since the emphasis is on job creation rather than investments, there may be a bias toward "make work" or prestige projects that may not be highly valuable. This may be particularly true in a crisis, when a rapid expansion of the program exhausts the backlog of viable projects.
- Second, the method presented in Box 1 assumes that only the net proportionate wage gain must be taken into account for measuring the program's impact. But in periods of high unemployment, it could be argued that at least part of the difference between the public works wage and what the program participant would have earned by himself without the program will be available as earnings for another worker who does not participate in the program and who is also underemployed. At the extreme, the whole wage rate could be taken into account in the cost-benefit analysis, which would greatly enhance the cost-effectiveness of such programs.

On the other hand, arguments could also be put forward to argue that the net transfers to the poor are lower than predicted by the decomposition in Box 5. For example:

- First, since workers are paid by local authorities, the opportunities for corruption and political bias are more pronounced. With Trabajar, there remains some evidence of political influences in the choice of participants and gender discrimination (few women are selected in some areas.)
- Second, the poorest communities may not always be well positioned to submit proposals for projects and/or to contribute to non-wage costs. In this case, the targeting performance of the program may suffer, because the contribution of geographic targeting to overall targeting performance will be reduced.

Apart from Argentina and Chile, the experience of Mexico is also valuable for the assessment of the strengths and limits of workfare programs. Mexico's rural areas the Programa de Empleo Temporal (PET) provides off-season temporary employment below minimum wage through public works. Employment is for up to 88 working days at 90 percent of the minimum wage. In 1999, 93 million work days and one million jobs were to be created. PET is an example of a program which functions in normal times rather than only during crisis, although it is restricted to certain periods of the year only. As expected, the projects are labor intensive. Examples include irrigating land, paving roads, clearing land, improving housing, and installing water and sewerage systems. The data suggests good targeting, with the participants being poor and needing the temporary jobs more than non-participants because they do not benefit from occupations that keep them employed all year long. Yet, the program does not reach the smallest (and probably poorest) rural communities. On average, PET communities are almost twice as large as non-PET communities. PET communities have better access than non-PET communities to electricity (74 versus 60 percent), public phones (33 versus 19 percent), pre-schools (81 versus 67 percent), primary schools (89 versus 82 percent), and tele-secondary schools (22 versus 11 percent.) Part of the problem may be due to the higher (e.g., administrative) cost of reaching very small rural communities.

One might also consider job training programs as a safety net, particularly if they can be modified during a time of crisis. In Mexico, the Probecat program was implemented in 1986 as a response to the growth in unemployment that followed the 1982 debt crisis and the subsequent structural adjustment policies. Today, the program provides training to close to 500,000 beneficiaries per year in urban areas. A new evaluation of the program suggests however that it does not have a statistically significant impact on employment and wages (Wodon and Minowa, 1999; see Revenga et al., 1984 and STPS, 1998, for previous evaluations.) These disappointing results are not that surprising, because most retraining programs in OECD countries have been found to have limited impacts. One reason for this may be that the training is provided for too short a period of time (a few months) in order to provide skills valuable in the long run. Some job training programs may in fact function as safety nets by providing temporary relief for the unemployed with a self-targeting mechanism not unlike that of public works programs since participants typically receive only the minimum wage. It is probably better to choose one goal or the other (training versus social protection), rather than trying to meat both goals with a single program.

B. Social investment funds

Social investment funds (SIFs) were the original World Bank response to the social aspects of adjustment programs, and some of the earliest funds (e.g., Bolivia's Emergency Social Fund created in 1991) were designed primarily to provide employment (Jorgensen, Grosh and Shacter, 1992.) In fact, SIFs were started in part to avoid the problems associated with emergency public works (workfare) programs. Yet almost all SIFs now have evolved into programs designed to provide small scale social and infrastructure, particularly in rural and poor areas, using projects generated and executed at the local level. Therefore, social funds are not safety nets per se. Note that unlike workfare programs, some social funds also finance programs that do not involve construction or maintenance, such as nutrition programs, technical assistance and micro credit. When construction work is involved, it is not rare to see social funds using a skilled manpower paid at market wages. This is because the quality of the infrastructure built is considered as more important than the provision of employment for the poor. This is the case with the Honduras social fund which originated from the transformation of an employment generation program in the early 1990s but does not consider the objective of employment creation as its main priority nowadays. On the other hand, most social funds are usually targeted to poor areas through the use of a poverty map (or, in some cases, through the use of a map of non-satisfied and non-monetary basic needs.)

While both workfare and social fund programs build projects in the public sector, there are important differences. The social fund finances the material and labor costs of a project, although some local labor may be donated as a community contribution. This varies across SIFs and countries. A workfare program generally finances the labor cost of a project at the national or federal level, and asks that local governments or agencies provide for the material costs. Thus, there is a clear incentive in workfare programs for the local agency to find labor intensive methods of construction, and choose labor intensive projects. Since SIF projects are bid out to the private sector, often the most modern and capital intensive construction methods are used, although in some cases social funds specify minimum employment levels to be attained in their operations.

Most social funds are agencies independent of line Ministries, often attached to the office of the country's President, which reviews and funds projects submitted by NGOs, local governments and other sponsoring agents. Their strong points include local community involvement and the ability to respond to local perceptions of needs, especially in rural areas where normal government expenditures often do not reach the poor. Social funds also have a better ability to avoid corruption and "make work" projects. But they are not very good at providing safety nets, and they do not normally expand during a crisis to provide more employment. In fact, the amount of employment and income generation provided by social funds has historically been low. For instance, a review of social funds found that for 10 major social funds provided employment on average equal to only 4 percent of the labor force (Goodman et al., 1997.) Likewise, the monetary contribution of wages was judged to be small, as well as the poverty reduction impact coming from the projects themselves. Social funds are better at improving the supply of health, education, and basic infrastructure services, with in some cases impacts on outcomes such as school enrollment rates, age-for-grade, or the incidence of illnesses (recent evaluations using household level data include Pradhan et. al, 1998, for Bolivia, and ESA Consultores, 1999, for Honduras).

Still, one of the clear advantages of social funds is that they have strong organizations that exist with relatively good systems for project management and monitoring. These organizations can be used in times of crisis for the delivery of social safety nets. The existing social fund in Honduras, for instance, has proven highly valuable in directing emergency assistance to local villages after Hurricane Mitch. One possibility therefore is to work with social investment funds to modify their operations during a crisis, such as by putting more emphasis on labor intensive projects, and by having the fund involved in new, hard hit areas. It is thus a good idea to identify labor intensive projects in advance of a potential crisis, so that these are ready for funding should a crisis come about. As was the case with Mexico's Probecat job training program, social funds can be a valuable channel for special assistance during economic shocks or after natural disasters.

C. Nutrition and food programs

Nutrition and food programs take a variety of forms. Subbarao et al. (1997) have identified about thirty countries using food policies with redistributive aims. Among these countries, price subsidies are used as often as feeding programs and food for work requirements, and much more often than food quantity rationing and food stamps. In fact, many workfare programs now providing wages in cash initially started as "food-for-work" programs. As for direct feeding programs, they provide food to needy recipients, through direct delivery of unprepared foods from a program warehouse, delivery of prepared food from a community kitchen, or the provision of a lunch or breakfast to children in school[11]. Evaluations of nutrition programs generally indicate that there is only a small, marginal improvement in nutrition compared to the case where the family receives an equivalent cash grant. This is because families may substitute free food for their own purchases, and largely use the savings for other purposes. However, even if a food program is roughly equivalent in effect to a cash grant, there are fewer possibilities of diversion of funds, since food is less likely to be misappropriated than cash. In addition, food is more likely to go to women, and be used to improve the welfare of the family, while cash is more likely to be used by men for lower priority activities. An intermediate alternative between cash and food are food stamps. Food stamps have the added benefit of not requiring a complicated system of storage and transport of food, while making use of the already existing private food distribution network. In Honduras, the food stamp program used to also cover medicines and school books. In Jamaica, the food stamp program was introduced in place of general food subsidies, and has proven effective in raising the incomes of the poor (Grosh, 1992.)

A common way of targeting food programs is by linking distribution to a health program, particularly maternal and child health care. In this way, the food serves as an incentive to attend the program, and nutrition education can help improve the use of the food given out. As already mentioned, giving food to women also lessens the possibilities of it being diverted for sale in the market. Food programs also can be designed to be self targeted, if the food products given out are those consumed by the poor and not by the middle class. Alternatively, food distribution can take place at centers located in poor neighborhoods. Such approaches can reduce the administrative burden of targeting programs, but they increase the possibility of leakage to the non-poor. School lunch and breakfast programs are also difficult to target at the individual level if one is to avoid stigmatizing some students within the school as being "poor." In many countries, schools from poor areas are targeted, but completely untargeted national programs are also common. One benefit of these programs is the incentive given to keep the children in school in order to have them fed, and to improve their learning abilities while in school (see Wodon and

[11] School feeding programs are especially popular in Latin America (see, e.g., Phillips et al., 1995 on Honduras, Dall'Acqua, 1991, on Brazil, and Jacoby, Cueto and Politt, 1996, on Peru).

Siaens, 1999a, for an evaluation of the Mexican school breakfast program.) From a nutrition point of view, the prime beneficiaries of the programs can however be other members of the family, if the children are not fed at home because the parents know that they will receive a school lunch.

Food subsidies are another way to help the poor by reducing the cost of their consumption bundle (Besley and Kanbur, 1988.) Means-tested food subsidies tend to be more effective than other subsidies in reducing inequality and improving welfare. For Mexico for example, Wodon and Siaens (1999b) suggest that universal subsidies do not perform well for the reduction of inequality and the improvement of welfare. They compare three programs: the now defunct universal subsidy on Tortilla, a program providing one kilo of free tortilla for households with income below two minimum wages, and a program of subsidized milk, also means-tested. Their main results were as follows:

- Food subsidies are better than non-food subsidies. Subsidies for basic consumption goods such as tortilla reduced inequality, especially in urban areas, and more so than subsidies for utilities such as water and electricity. However, food subsidies generate price distortions and they are costly. Furthermore, a universal subsidy on tortilla is less effective than would be a similar generalized subsidy for the ingredients needed for making tortilla, such as corn flour.
- Within food subsidies, means-tested subsidies are better than universal subsidies. The marginal impact on inequality and welfare achieved with the universal tortilla subsidies does not come close to the welfare gains achieved with the means-tested subsidies.

Still, food subsidies may not represent a sound and cost-effective investment for poverty reduction. Food subsidies and distribution systems can have negative incentive effects on the supply of labor (Sahn and Alderman, 1995.) They can be badly targeted, with high leakage among the non-poor (Grosh, 1994; Cornia and Stewart, 1995.) And, while self-targeting can be achieved to some extent by subsidizing goods consumed in larger quantities by the poor than by the non-poor, this is no panacea (Tuck and Lindert, 1996.) There has been therefore a tendency to reduce funding for food subsidies in order to fund other programs, for example in Mexico (Levy and Davila, 1998.)

D. Conditional cash transfers

Since food is fungible with money, one could argue that cash grants are the simplest and most direct way of providing safety net assistance. The use of cash grant also avoids the utility losses associated with in-kind support. In developed countries, and some advanced Latin American countries, cash payments to selected households are slowly becoming more common. Unconditional cash payments and similar forms of social assistance are usually targeted to women with dependant children, the disabled, the aged, and those unable to work. However, the problems of targeting and controlling cash payments makes this approach problematic in the poorer countries that lack good administrative arrangement. For instance, in Bolivia, the Bonosol program provided once a year cash grant equal to four weeks pay at the minimum wage to adult citizens. The attractiveness of the grant and the lack of screening or identification mechanisms resulted in widespread abuses, including double payments and payments to non-Bolivians.

An attractive alternative is to link cash grants with school attendance or other desirable behavior. This has been introduced in various degrees in such countries as Brazil (Bolsa Escola), Argentina (Beca Secundaria), Mexico (Progressa), and Honduras (PRAF), among others[12]. These programs are not safety nets properly speaking, or at least, they were not originally designed to function as compensatory safety

[12] A rigorous evaluation of Mexico's Progresa is being prepared by the Progresa staff with support from the International Food Policy Research Institute. Preliminary results are available in Progresa (1999.) The International Food Policy Research Institute is also going to help for the evaluation of Honduras's PRAF, with a design combining demand and supply-side interventions.

nets during crises. Yet the programs do provide valuable benefits which households can rely upon during crises, and these benefits can be increased during a recession if need be. In other words, as was the case for job training programs and social investment funds, existing programs providing conditional cash transfers can be expanded and modified to serve as safety nets during a crisis. In general however, school related grants will offer only a partial response to crisis situations, if only because the programs are targeted to families with children already in school, so that some of the poorest who cannot afford to send their children to school are excluded from the programs' coverage.

School-based conditional cash transfers programs reduce the opportunity costs for poor parents of keeping their children in school. This opportunity cost is essentially the loss in child wages or in the value for the parents of the domestic work done by the children which cannot be enjoyed when the children go to school. In many cases, this opportunity cost of schooling is difficult to estimate, and it is not obvious that the grants must be equal to the opportunity cost for the parents to send their children to school (Ravallion and Wodon, 2000a.) Indeed, it is reasonable to think that the parents have an intrinsic interest in having their children go to school, either for altruistic motives, or for the future benefits that intergenerational transfers provide once the children reach adulthood. In some countries however, the level of the conditional grants appears to be high. For Progresa in Mexico for example, to justify the relatively high level of the Progresa grants, it has been argued that apart from providing incentives to accumulate human capital, they also improve the families' overall quality of life. Yet there may be more cost effective ways to improve the quality of life of the program's beneficiaries. But more work would be needed to measure the trade-offs.

At what level of schooling should the grants be provided? This will depend on the characteristics of the country. In Brazil and Argentina, the programs focus on secondary school, since these are the children that are more likely to be pulled out of school during a crisis. In Honduras, the program focuses on the last few years of primary school. In Mexico, the program covers the end of primary schooling, and the lower secondary school cycle. In Venezuela, the program covers primary school children. In some cases, these programs are tied not only to attendance, but also to school performance, including passing on to the next grade. While this may provide valuable incentives, one has to make sure that such conditions do not exclude the poorest which may have more difficulties in succeeding at school.

How should the grants be targeted? The experience Progresa is interesting (Skoufias et al., 1999.) The program uses a three stage targeting mechanism. First, poor rural localities are selected for participation. Next, poor families are selected within participating communities using a multivariate discriminant analysis. Third, local communities may review the Progresa's selection staff and reclassify poor families as non-poor and vice versa. This targeting mechanism is basically sound, and the results appear to be good. One concern is that the level of community involvement remains marginal. The targeting process is centralized in part due to the desire to avoid political interference in the choice of beneficiaries. Nevertheless, more efforts could be put to promote the role of communities in targeting. Another related question relates to the need for targeting within poor communities. The higher the proportion of the poor in a community, the less the need to target within that community, especially if targeting is costly not so much administratively, but rather in terms of social cohesion (those who do not get the program may envy those who benefit from it.) In Honduras, where the PRAF program is being modified in part on the basis of Progresa's experience, it has been decided to provide support to all the families residing in the poor communities that participate[13].

Conditional cash transfer programs can also be used to promote good health practices, including the consultation of local health providers. This is again the case with Mexico's Progresa where eligible families receive a transfer (both in cash and in kind through a nutritional supplement) for health purposes apart from the transfers related to schooling. That is, Progresa aims at providing a coordinated

[13] It is important when feasible to use distributional weights in the evaluation of the targeting of social programs and other interventions. For such an analysis, see for example Ravallion and Wodon (2000b.)

intervention for education, health, and nutrition, with the hope that the impact of the whole program will be larger than that of its individual parts. Of course, with Progresa as with the other programs, in maximizing the impact of the school- and/or health-based interventions, it is important to take care of supply side issues. For example, Progresa has been successful in raising school enrollment and attendance at health care centers, but this has led to tensions on the supply side. Steps have been taken to coordinate Progresa's action with that of other Ministries, such as the Ministries of Education and Health, but more may be needed to optimize demand and supply side interventions.

E. Other programs

There are several other types of social protection programs that exist, including pensions for the elderly. Because many of the poor belong to the informal sector, they do not have access to the pensions provided by social security systems (similarly, those in the informal sector often lack access to other state organized benefits such as low income housing.) A discussion of pension issues for the poor is provided in Holzmann et al. (1999.)

Unemployment insurance is common to Europe and North America, but relatively rare in Latin America, in part because of its high cost. On the other hand, the current labor legislation in many LAC countries mandates a severance payment on termination that is a function of the number of years worked. Normally, this is about one month's salary for every year of service, up to some maximum. This may be supplemented by an unemployment insurance scheme (as in Argentina, Brazil for formal sector workers) in which monthly contributions from payrolls and/or the employer entitles the worker to a monthly payment over a limited time horizon, with the payment set low enough to reduce disincentive effects. But since the formal sector in many countries is less than half of the total work force, the coverage of unemployment insurance/severance payments is far from complete, and the exclusion of the informal and rural sectors means that these mechanisms miss those areas containing many of the poor. Moving from a severance pay system to an unemployment insurance system could be beneficial if it reduces labor costs. However, unemployment insurance can also create moral hazard problems by subsidizing unemployment (as compared to workfare programs, which subsidize employment.) One important element here is to ensure that unemployment benefits are not so generous as to discourage job search. For this, both the level of the payments and the length of time workers can receive benefits must be monitored. There is a large literature on these issues, but it cannot be reviewed here.

IV. The constraints: Fiscal space and administrative capacity

A. Are social protection programs counter-cyclical?

Good social protection programs should expand during an economic crisis as unemployment grows and income levels decline. In other words, the programs should be counter-cyclical in nature, i.e. rising when the economy falls. In some countries, the system of safety nets is supported by automatic entitlements that force the public sector to spend more on those who need it. For instance, unemployment causes an increase in the numbers eligible for unemployment benefits, and declining incomes can increase the number of households eligible to receive cash or food assistance. But in most Latin American countries, there are no such automatic triggers. This is in part because the need to have counter-cyclical social protection programs can conflict with the need to impose fiscal austerity during a recession. An economic crisis, whether domestically or externally induced, leads to a drop in output, and consequently in a fall in government revenues. But during a crisis, governments are reluctant to raise taxes. Thus maintaining high expenditure levels can then lead to large budget deficits.

The extent to which LAC countries have provided counter-cyclical social protection is an empirical question which has received surprisingly little attention. One problem is that the data on budget expenditures normally do not typically identify social protection or safety nets as a separate activity. Social protection programs are scattered in various sectors such as health, education, social security, and welfare. However, in some countries there is data available. This is the case for Argentina and Mexico on which this sub-section is based.

Consider the data presented in Table 4. Both Argentina and Mexico suffered an adverse shock in 1995 (Mexico was first, Argentina followed). Per capita GDP in Argentina decreased by 5.32 percent between 1994 and 1995, while it decreased by 4.93 percent in Mexico between 1994 and 1996. The share of GDP devoted to targeted social spending decreased a bit in the two countries. The poverty rate increased in the two countries, leading to an increase in the total number of poor people. The targeted spending per poor person decreased much more than per capita GDP, yielding an elasticity to growth (in this case to a recession) of targeted spending per poor person of about five in the two countries. During this recession, spending for the poor was thus highly pro-cyclical, while ideally it should have been counter-cyclical in order to protect the poor from the adverse macroeconomic shock.

Table 4

Targeted public spending per poor person, 1994-1996, Argentina and Mexico

	Real per capita GDP (1994 = 100)	*Share of targeted social spending in GDP (%)*	*Poverty rate (%)*	*Number of poor people (million)*	*Targeted spending per poor person (1994 = 100)*
Argentina					
1994	100	1.24	21.6	7.5	100
1995	94.68	1.21	27.2	9.6	63.12
% change	-5.32%				-27.88%
Mexico					
1994	100	1.36	46.95	42.04	100
1996	95.07	1.23	60.93	56.51	67.30
% change	-4.93%				-23.70%

Source: Wodon and Hicks (1999.)

A number of factors compound to work against the ideal of counter-cyclical safety nets funding during a recession. First, as noted by critics of structural adjustment mechanisms, the share of GDP devoted to public spending tends to decrease in order for fiscal restraint to restore macroeconomic fundamentals. Second, GDP itself is by definition reduced during a crisis, so that even if the share of GDP devoted to public spending remains constant, there will still be less resources available for the poor. These two factors tend to make aggregate targeted public spending for the poor pro-cyclical rather than counter-cyclical. Third, poverty increases during a crisis, so that the available aggregate resources targeted to the poor have to be distributed among a larger pool of applicants, yielding lower spending per poor person.

The pro-cyclicality of safety nets in Argentina and Mexico is also observed over longer periods of time (Wodon and Hicks, 1999; see also Ravallion, 2000, for Argentina.) Table 5 provides estimates of the elasticities of various categories of spending to GDP growth. Social spending is not only pro-cyclical, i.e. falling when the economy contracts, but the elasticities are often higher for social protection programs than for the social sector as a whole or total government spending. Hence, the evidence suggests that social protection programs, instead of expanding quickly in a crisis, actually are contracting more rapidly than other types of spending. For instance, in Argentina, the elasticity of total spending with respect to GDP growth has been 0.94 over the period 1980-1997 (see Table 5), while the corresponding elasticities for social spending and social protection (i.e. programs targeted to the poor) were 1.55 and 1.63.

Table 5

Estimated Elasticities of Expenditures with Respect to Changes in GDP

	Argentina (1980-97)	*Mexico (1987-1997)*
Total government spending	0.94	1.88
Social sectors spending	1.55	1.90
Social protection spending	1.63	2.73

Source: Authors' estimation. All estimates are statistically significant at the five percent level. However, since the data for the two countries are not strictly comparable, it should not be inferred that social protection spending is more pro-cyclical in Mexico than in Argentina. Note that the Government of Mexico has made a substantial effort for increasing targeted funding for the poor in recent year, for example by providing funding for Progresa. This is not yet reflected in the elasticity computed here.

The elasticities in Table 5 can also be presented in terms of the responsiveness of the amount of targeted public spending per poor person to GDP growth (Wodon and Hicks, 1999.) When doing so, it can be shown that in both countries, a one percentage point decrease in per capita GDP leads to an estimated three percentage point decrease in targeted public spending per poor person. One third of this impact is due to the reduction in targeted public spending as a share of GDP that follows from fiscal discipline. Another third is due to the reduction in per capita GDP itself, which reduces spending even when the share of targeted spending in GDP remains constant. The last third comes from the increase in poverty due to the crisis, i.e. public spending must be shared among a larger number of poor people.

The fact that targeted programs for the poor are not well protected may be surprising given that these programs represent a small proportion of GDP (typically 2 percent or less), and a small proportion of total spending as well. One reason for the lack of protection for targeted spending may be related to the lack of bargaining power of the poor. Yet expenditure protection may also be difficult during an economic and fiscal crisis when the country must honor its debt service and a number of entitlement programs, with consequently low levels of discretionary resources. Said differently, if 30 percent of the budget is protected because of its safety net and poverty aspects, and 50 percent is for debt service and other programs that cannot be cut, a 10 percent reduction in overall spending would produce a 50 percent cut in the remaining sectors. Given that the remaining sectors might include such sensitive areas as defense, justice and administration, this may not be a feasible solution, thereby forcing the Government to abandon the idea of protecting funding for key social protection programs.

B. How can one select the programs to be protected or expanded during a crisis?

The objective during a crisis should be first to agree that key programs that benefit the poor will not be cut back even though total government expenditures may be reduced. Next comes the difficult question of which specific programs should be protected or even expanded. It is tempting to put on the list almost all programs in basic health, education and nutrition. But not all programs in the social sectors are equally effective in reducing poverty, and some programs producing long-term benefits for the poor may be deferrable. In deciding which programs to keep and expand during a crisis, an important criteria should be the cost-effectiveness of the program in quickly channeling income or its equivalent in kind to the poor. As suggested in the case of workfare programs, the cost-effectiveness of programs depends on a number of parameters. Knowing these parameters before hand helps in making a selection. The comparison of the cost-effectiveness of alternative safety nets in smoothing consumption patterns for the poor via income generation, in kind commodity distributions or commodity subsidies is one area where additional analytical work should clearly be done.

One element of a viable strategy – actually, one of the key parameters of the cost effectiveness of safety nets --, is to protect programs that have good targeting mechanisms for reaching the poor. Untargeted or universal welfare programs are often fiscally impossible to sustain, particularly during a crisis. It is true that targeting beneficiaries by complicated means testing, i.e. intensive questioning over income and wealth, can be costly and not very reliable. This is why many World Bank funded programs have relied on geographic targeting even though this can lead to substantial leakage. But an alternative approach is the *proxy means test*, whereby likely recipients are interviewed and respond to questions concerning their living conditions, such as the type of housing in which they live, the availability of water, the types of appliances possessed by the household, etc. Wodon (1997) has shown that these indicators are powerful for avoiding the two types of errors that can be committed in targeting, namely identifying as poor a non poor household, and as non poor a poor household. For any given budget, good targeting also helps for improving coverage among the poor (i.e., what percentage of the poor actually receive program benefits), which is an important advantage in Latin America where coverage has often been low.

Variants of means-testing systems have been used, among others, for the Fischa CAS in Chile, SISBEN in Colombia, SISFAM in Argentina, and Progresa in Mexico. In practice, people who apply for assistance are interviewed, and the score on the questionnaire determines eligibility. The weights for the various indicators included in the questionaire are based on estimated econometric relationships between the poverty status of a representative sample of households and their indicators. Grosh (1994) has estimated that the cost of targeting trough proxy-means testing or geographic targeting (poor areas) need not be much higher than the cost of universal distribution (a reasonable mark-up would be 3 to 8 percent), while producing substantial benefits. In a sample of untargeted programs, only 33 percent of the benefits accrued to the lowest 40 percent of the population, whereas targeted programs had 72 percent of their benefits reaching that population.

Beyond the need to protect the consumption of the poor during a crisis, it is also clear that some existing health and education programs not necessarily targeted to the poor should be preserved. It is possible that the demand for these programs might go up, if for example the losses in income due to unemployment or underemployment cause people to shift from private providers and private health insurance to public programs. Still in health, some programs not targeted to the poor should be maintained because there are large externalities involved. This would be relevant for disease surveillance, immunization campaigns, malaria control, AIDS prevention, etc. Preserving access to basic (primary and lower secondary) education is not a short-term safety net issue. But as discussed earlier, it does reduce the costs of a crisis over the longer term by avoiding that cuts in education spending for the poor eventually lead to a reduction in human capital, and thereby lead to lower productivity.

To protect all the above programs, it will be necessary to identify some programs that can be reduced, put on hold, or eliminated. For example, some of the worse cases of misspent social spending in Latin America have come from large subsidized housing programs for the middle class, which are often mandated through earmarked taxes. While it may be impossible for a government to change these programs quickly without major legislative or even constitutional authority, in some cases the need to reallocate spending due to an emergency or a crisis may facilitate fundamental changes. Other candidates for expenditure reduction may include subsidies such as lifeline rates for utilities with consumption ceiling set too high, or price reductions for urban transport in relatively well off areas. Better cost recovery for higher education (e.g., at the university level) and for some health care services may also help. Table 6 gives a generic ranking based on common practice and observation. While the priorities may change depending on the country, Table 6 gives an idea of the programs to protect.

Table 6

Priorities in protecting programs during crises: A possible hierarchy

	Health	*Education*	*Social Protection/Others*
High Priority	- Immunizations - Disease control - AIDS prevention - Pregnancy care and early child development	- Means-tested stipends - School breakfasts in poor areas - Special programs for indigenous populations	- Workfare programs - Means-tested pensions for the elderly - Means-tested nutrition supplements
Moderate Priority	- Primary health care posts and centers - Basic care in hospitals	- Basic education (primary and lower secondary) - Scholarships for poor students at universities	- Unemployment insurance - Social security - Social funds - Job training - Food subsidies
Low Priority	- Advanced curative care in hospitals	- Free/low cost university education for non-poor - research budgets	- Subsidized housing - Subsidies for infrastructure services

Source: adapted from World Bank (1999b)

C. Additional implementation issues

There are several additional issues which must be considered when implementing safety nets. First, establishing new institutions that work effectively at the national level is difficult. Most social funds, for instance, take 2 to 3 years to get up and running at a level that reaches a substantial number of poor people. Under time pressure, it is much more easy to work with existing institutions by providing them with support that enables them to expand their operations during a crisis. It is also often interesting to expand new safety nets programs that have already started on a pilot basis, and that have been evaluated and proven effective. As a corollary, it is useful to start new pilot programs every now and then on a pilot basis, in order to anticipating their strengths and weaknesses and their ability to be expanded in case of need. Also, as indicated earlier, it may be practical to use existing institutions running programs for job training, social funds, or transfers to distribute emergency assistance when needed.

Second, not all governments possess the same capacity to administer programs. In some countries, a simple program that is not well targeted might be a better choice than a more complicated program. Safety net programs need to strike a balance between administrative capacity, fiscal sustainability, political acceptability, the scope of the intervention, and targeting efficiency. An additional problem is the relationship between the federal and provincial level governments. The staff of multilateral development banks have traditionally established a dialogue with federal authorities, but a large part of social spending takes place at the provincial level. It may be necessary to agree to additional support from the federal budget to state, provincial, or municipal budgets during a crisis if safety net programs are operated locally. However, while decentralization has a number of advantages, it is not necessarily pro-poor, so that serious monitoring of sub-national authorities is needed.

Third, one problem encountered in many countries is the proliferation of small programs throughout various parts of the government. Nutrition programs, for instance, are found in the Ministries of health, education, social development and agriculture, as well as in autonomous agencies in the office of the President. Training programs are run by the Ministries of education, Labor, and Economic development. It is important to attempt some sort of inter-ministerial coordination in order to avoid overlaps and duplication. In the longer term, it may be possible to combine or consolidate programs, and to eliminate the programs that are least effective. As mentioned earlier, a crisis can help in reorienting social budgets.

Fourth, in monitoring expenditure levels, it is in principle preferable to use actual expenditures, rather than the amounts budgeted. However, actual expenditure levels are difficult to monitor in many countries because of the long lag involved in receiving the information. By the time it is known that actual expenditures have fallen, or that the available credits have not been used, it may be too late. To avoid non-intentional budget cuts due to lags in spending, it is important after budget allocations have been made to make some efforts in order to ensure that the budgets are set operationally and maintained at adequate levels, with continuous monitoring of the outlays so that the plans are effectively being carried out.

V. Conclusion

Economic shocks may lead to a decline in real income caused by a loss of employment, a situation of underemployment, or a shift to a less lucrative employment. Real wages may be reduced as well by high levels of inflation. Changes in relative prices may have negative effects. The poor may also lose their access to essential public services for health, nutrition and education as a result of reduced government real spending. They may lose the value of their financial assets (however meager) if these are not protected from bankruptcy by the financial system or by the public social security system. Or they may simply have to sell these assets. In all these potential effects and in many others, the poor are more vulnerable than the non-poor because their income may fall far more quickly below bare subsistence levels.

It is common practice to recommend that governments protect key social protection programs during a crisis and expand the social safety net. However, with fiscal resources shrinking at a time when the number of poor are increasing, it may be extremely difficult to do this. Still, one would hope at least that high priority programs will be less subject to cuts than other programs. This is feasible because social safety nets represent a small part of existing budgets. Yet this does not appear to be the case at present. Rather than being counter-cyclical, safety nets are actually more pro-cyclical than other sources of public expenditures.

Assuming that there is an agreement to protect the poor from budget cuts during a crisis, the question becomes: which programs should be protect? There are no easy answers to this question, and the answer is bound to be country specific. Still, one important criteria for the selection of the programs to protect or expand is the ability to quickly provide income support or its equivalent in kind for the poor. Workfare may help, but policy makers should be aware that it typically costs more than three dollars to generate one additional dollar in net earnings for the poor through these programs. Some nutrition and food programs may work as well provided that they are well targeted, which is not always the case. Good targeting is one of the key parameters of the cost effectiveness of safety nets. Also, existing social programs which are not safety nets per se (e.g., job training programs, social funds, and conditional stipends for school attendance in poor areas) can prove to be valuable delivery mechanisms for emergency assistance when there is limited administrative capacity in the country. Apart from compensating the poor from the likely loss in market-based income taking place during a crisis, it is also necessary for the government to protect some universal programs. This would include primary health care and education, as well as health programs with large externalities. But the most difficult task of all is to identify those programs that can be reduced, put on hold, or eliminated. Candidates may include subsidized housing, other subsidies for commodities not consumed mainly by the poor, some social security programs, and spending for higher education and advanced curative care. While it is often difficult politically to reform these programs, the need to act during a crisis may facilitate the necessary fundamental changes.

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Appendix: Key Risks by Age Group, and Role of Social Protection in Addressing these Risks

Age Group	*Main Risks*	*Role for Other Sectors*	*Role for Social Protection: Insurance*	*Role for Social Protection: Assistance*
0-4	- Stunted child development	- PHC Services - Pre-schools	--	- Early Child Development
5-14	- Low education quality - Late entry to school - Late age by grade	- Quality education - Earlier entry - Reduced repetition	--	- Scholarship and schooling incentives
15-24	- Low secondary school completion rates - Teen pregnancy - STDs	- Access/quality of secondary education - Remedial education - Reproductive health	--	- Scholarship and schooling incentives
25-64	- Low income (unemployment/ underemployment)	- Labor-intensive growth (SMEs emphasis) - Labor market reforms	- Unemployment insurance	- Workfare - Cash transfers - Job training - Job search assistance
65+	- Low income (no pension, no assets)		- Social security (contributory pensions)	- Income transfer (non-contributory pensions)
All	- Low access to and quality of health care - Low housing quality - Low access to basic infrastructure - Insecure tenancy - Risk of flood	- Better provision of health services - Affordable housing - Investments in basic infrastructure - Titling programs	- Health insurance	- Housing subsidies - Relocation to safe areas

Source: Adapted from Arriagada (1999.)

LABOR MARKETS AND INCOME SUPPORT: WHAT DID WE LEARN FROM THE CRISES?

by

Gustavo Márquez

Office of the Chief Economist – Inter-American Development Bank

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Abstract

The adoption of emergency employment and short term training programs to provide income support to the population affected by the episodes of economic volatility since 1995 reveals the failure of the traditional, Labor Law-based income support mechanisms in the region. These emergency programs are not additional and transitory, but rather have become a permanent component of social policies. As such, they present policy makers with the opportunity to build a more encompassing and better designed mechanism to protect workers against the effects of macroeconomic volatility. The paper argues for an income support system centered on unemployment insurance and complemented with additional mechanisms to provide effective income support to workers during normal times, and discusses what changes are necessary in the emergency programs to make them work as part of that system.

I. Introduction

The high level of macroeconomic volatility that has historically affected Latin American economies has not diminished with the adoption of growth-oriented sustainable economic policies. Economy wide shocks like the Tequila effect in 1995 and the renewed instability since 1997 have induced governments to revisit the ideas around the building up of mechanisms that could protect the population from income losses.

Structural reform and macroeconomic stabilization have increased the risks that workers face given the vulnerability of domestic production to changes in the international capital and goods markets. At the same time, the traditional legally mandated severance payment mechanisms established in the Labor laws have become irrelevant in this new environment, given the narrow scope of its coverage.

Therefore, countries in the region did not have the option of expanding "normal" income support programs when hit by economy-wide shocks, but had to adopt emergency responses. The programs that resulted from that constitute more a mosaic of often unrelated initiatives than a coherent and well thought system of income support. However, the fact that these emergency programs are in place creates an opportunity to build a more permanent system of income support that solves the failure of the traditional mechanisms.

The question this paper purports to address is how a more comprehensive income support system can be built starting with those emergency programs. In other words, what is required to transform this mosaic of programs in a coherent set of mechanisms that can provide income support to workers both in an economy-wide shock, and in the normal process of job churning that flexible and dynamic labor markets experience. Efforts to cope with economy-wide shocks are doomed to failure if we do not count with mechanisms that can provide income support in the normal course of business, and that can expand to help workers cope with economic downturns.

The paper does not attempt to extrapolate from this small and haphazard set of programs a complete social risk management framework. Not only extrapolation would be unwarranted given the limited size and scope of the programs in place, but also social risk management must by necessity include programs that do not operate through the labor market (as subsidies for school attendance of school-age children, social investment funds, and demand side subsidies to health service consumption, to mention just a few).

What the paper does attempt is to draw some conceptual generality from the practical (and very real) particularities of the implementation of labor market based income support devices in the region. By doing so, it can help policy makers to put emergency measures in the broader and more structured framework of the long term objective of helping workers cope with both economy wide and idiosyncratic shocks that result in income losses and unemployment.

In the first section, we will discuss how the traditional legally mandated severance payment system fails to work both because it covers a dwindling fraction of the population, and because it creates rigidities that hinder the ability of firms to operate in more open and contested markets. The second section will be dedicated to a characterization of the labor market-related income transfer programs that 7 countries in the region had in place around 1995, and that were used to attempt to mitigate the impact of the Tequila crisis on their labor markets. There we will argue that these emergency programs were not designed in such a way as to act as counter-cyclical devices, and in some cases created important labor market distortions. The third section will present a discussion of the changes needed in each of these programs to mitigate the negative externalities they generate, and to enhance the positive ones. Finally, in the fourth section we will present some ideas on how to develop from these emergency programs an income protection system centered on a well-designed unemployment insurance system, and complemented by employment generation and short-term training programs to address the needs of workers who do not have access to unemployment insurance.

II. The failure of traditional income support mechanisms in Latin America

The high level of macro-economic volatility of Latin American economies has generated a strong social demand for mechanisms to protect the working population from the resulting risk of income losses. Traditionally this demand has been met by the enactment of employment security regulations that penalize terminations either through high severance payments when terminations are allowed, or through direct prohibition of terminations. The region has had until the mid-nineties high levels of employment protection, even relative to those enjoyed by workers in more developed OECD countries (Márquez 1997 and IPES 1997). For workers in regulated contracts severance payments are quite high, and employment protection regulations are strictly enforced both in practice and in legal courts.

The "social justice" rationale behind these employment security regulations is quite well known. Firms enjoy rents that arise from high tariffs and other forms of privileged access to financial and non-financial resources in the context of so called "crony capitalism", and employment security is just one form of sharing those rents with their employees. In a sense, the system works as privately implemented unemployment insurance with coverage limited to those workers in a regulated employment contract. These workers are protected both because the firm has a positive cost associated with termination (that ensures that lay-offs and firings will be used sparsely as adjustment mechanisms), and because workers who end unemployed receive an income transfer through the payment of severance.

This pattern of employment security that protects the job but not the worker after losing his or her job is associated with the "polarized" model of wage setting (Banuri and Amadeo, 1992). For the purpose of protecting against income volatility, this model of regulation provides effective protection against income losses to a minority of highly organized and vocal workers, while leaving a large fraction of the working population uncovered either in non regulated employment contracts or in self-employment.

In the cozy environment of a semi-closed economy this was possible because demand-boosting government policies, however unsustainable, protected the domestic market against external shocks. Workers who lost their jobs received severance payments and could find or invent an alternative job in the unregulated sector of the economy. In an inflationary environment real wages could be adjusted by raising nominal wages slower than the general price level. Therefore, employment in the regulated sector was quite stable, unemployment was low, and the adjustment variable in the labor market was the real wage.

To the extent that demand-boosting government policies deepened the misallocation of resources resulting from protectionism and cronyism, the growth performance of the region deteriorated during the eighties. As a consequence, employment in the regulated sector remained stagnant and employment in non-regulated jobs without any form of protection against income loss grew to cover almost half of the working population (see Marquez [1997]). Therefore, the protection against income volatility ended up covering just the fraction of the labor force employed in the bigger and more closely regulated firms.

In the more dynamic environment that resulted from economic opening and stabilization at the beginning of the nineties, the relevance of this model of protection is questioned by the increase in the pro-cyclicality and level of unemployment. What caused these changes in unemployment? First and foremost, structural reforms and macro stabilization changed the relative prices of capital and labor in favor of the former (Lora and Olivera [1998]). This in and by itself increased the use of physical capital and slowed employment generation. But macro stabilization also implied important changes in the employment behavior of the public and private sectors.

Public sector retrenchment resulted in the displacement of workers that increased the stock of unemployed. More importantly and of larger consequences, the maintenance of low or zero fiscal deficits required by fiscal discipline makes it impossible for governments to act as employers of last resort, as they had done directly or indirectly in the crisis of the eighties (Lora and Márquez [1998]).

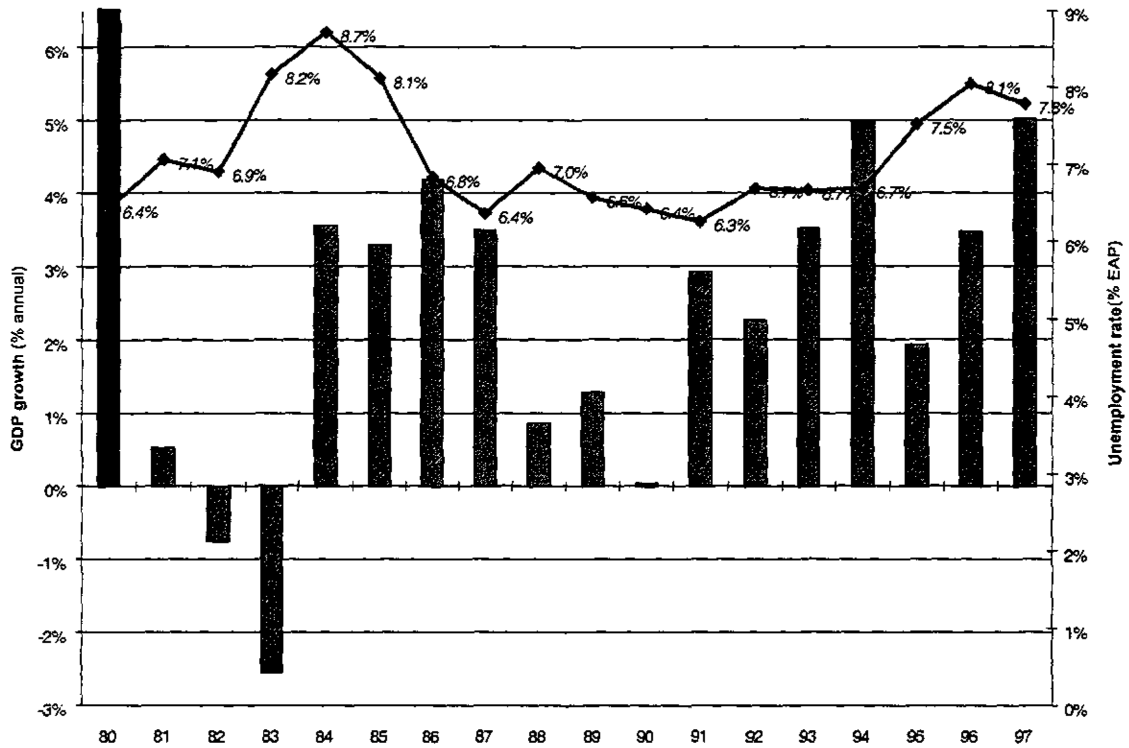
The reduction of inflation reduced the latitude that private (and public) employers had enjoyed to reduce real wages through nominal wages lagging behind inflation. The increased nominal rigidity makes employment —and not real wages— the adjusting variable in the labor market during economic downturns. Therefore, shocks translate themselves into more unemployment, rather than into a collapse of real wages (Márquez and Pages [1998]). Once this higher level of unemployment is reached, slower employment generation makes its reduction a more protracted and prolonged process over time (Márquez [1998]).

From a world where unemployment was almost absent, and where low quality jobs in the non-regulated sector were the crux of the problem, we jumped into a brave new world of growing unemployment. By the end of 1998 a record number of countries in the region were experiencing double digit unemployment rates (Argentina, Colombia, and Venezuela the most notorious cases) and, more concerning, unemployment remains high when the economy recuperates after each shock (see Graph 1). Although macro and financial policies are used to limit the domestic vulnerability to external shocks, the fact remains that the recessionary environment of 1999 is translating itself in most countries in more unemployment and falling wages, particularly for the less skilled workers.

But perhaps the most damaging blow to the relevance of severance payments-based income protection has been the recognition that privately insuring workers against income losses may hurt the ability of firms and workers to profit from the enhanced opportunities associated with a more open and competitive economic environment. Colombia in 1990, Peru in 1991, Nicaragua and Argentina[1/] in 1995, and Venezuela in 1997 have enacted reforms of labor regulations aimed at creating more flexible forms of employment contracts, both through the reduction of firing costs and through the introduction of promotional contracts with lower payroll taxes.

[1/] Some of the Argentina reform measures of 1995, however, were partially reversed in 1998.

Graph 1
Unemployment and growth in Latin America, 1980-1996
(Population-weighted averages for 17 countries in the region)



Source: Growth of GDP at constant 1990 US$ from IADB Statistical data base; unemployment data from ILO *Panorama Laboral.*

One of the impacts of these reforms has been a further reduction in the share of full-benefit contracts in total employment, and a corresponding expansion of more precarious forms of employment. The introduction of more flexible forms of employment contracts has not in fact weakened the employment protection enjoyed by workers in the old full-benefit, full-protection employment contracts. With relatively few exceptions, the labor reforms enacted during the nineties have aimed at flexibilizing hiring and firing conditions at the margin, without diminishing the legal protections enjoyed by workers already employed. Making the changes binding only on new labor contracts has in fact grandfathered employees already in the job. However, as the new contractual forms have cost advantages for firms, employers have substituted workers in full-benefit contracts by workers under the more flexible contracts. In Argentina, for instance, promotional employment contracts generate lower payroll taxes and do not generate rights to severance payment upon termination. According to official information[2] the number of new jobs created under promotional contracts more than doubles the number of new full-benefit contracts, while the opposite is true regarding the number of workers terminated under each type of contract.

In summary, at the mid-nineties we find ourselves in a situation where unemployment is higher and more sensitive to economic downturns, and where more than half of the employed do not have any protection against the risk of income loss associated with unemployment. Economic downturns may result in very large income losses for both the unemployed and workers in more precarious employment contracts, and society does not offer them any formal mechanism to insure against that risk.

[2] *Encuesta de Indicadores Laborales,* Min. de Trabajo y Seguridad Social, October 1998.

III. The "emergency" income support mechanisms in 1995

In order to at least partially compensate for the adverse labor market effects of the Tequila effect in 1995, governments in the region adopted and/or expanded labor market policies and programs aimed at supporting incomes and/or expanding employment opportunities for particularly vulnerable groups. The renewed volatility in international capital markets since the end of 1997 has maintained the interest of policy makers in the adoption of income support programs and suggests that these programs are more permanent than what the "emergency" label indicates.

The enactment of these programs has created an opportunity to test some new ideas and to disseminate innovative approaches to old problems. Labor intensive public work programs, youth-aimed training programs, and semi-universalized unemployment insurance systems all became acceptable ideas to help sustain the fragile political coalitions behind the economic modernization process.

These programs were designed in a crisis context, when incomes were falling, unemployment was increasing, and the risk of loosing political support for the reform efforts was high. Therefore, the ability of these mechanisms to expand and reach the groups at risk as fast as possible took priority over optimal design considerations. As a consequence, we ended up with a mosaic of programs and mechanisms that lack the coherence and size necessary to fulfill the role of income support to wider groups of the population, that often introduce labor market distortions, and that have difficulties adjusting counter-cyclically.

On the positive side, these programs are generally well suited to the institutional layout of the countries and have demonstrated capability to deliver resources fast. The experience of the region with income support programs shows than they can, at least to some extent, help to compensate for the effects of economy-wide shocks on workers. A varied array of programs has been used to help workers cope with one or another of the damaging effects of economy-wide shocks. This battery of programs will be the backbone of any income support system, given organizational, political, and resource constraints that limit the ability of the government to create new programs.

Given the urgency of coping with the effects of the crisis, the quest for mechanisms that could be set up quickly to transfer income to the poor in the most targeted way possible dominated any optimal design consideration. In a perfect world, countries would have automatic mechanisms as unemployment insurance to protect vulnerable groups during economic shocks. In reality, however, few countries in the region have a system of unemployment insurance and, even in those countries, the protection of unemployment insurance is limited to a relatively small fraction of the total workforce.

What the countries did was to put in place or expand a wide array of actions, programs, and policies that were considered suitable as income transfer devices and that could be expanded on short notice. Labor intensive public works programs executed in a decentralized fashion by sub-national governments or NGOs were widely used. Short-term training program with scholarships and some form of job search assistance were also used to provide an immediate source of income for the beneficiaries.

Public investment programs were not used as employment programs, in spite of their important direct and indirect employment effects. Part of the reason for this was the lack of fiscal resources to finance their execution; it was often the case that investment programs were used as adjustment variable in equilibrating the fiscal budget. Besides, there is no technical reason why (and often many why not) a large-scale investment in sanitation, for instance, should be executed with labor intensive technology.[3/]

[3/] Another factor that probably explains this is that the redesign of investment programs to incorporate labor-intensive technology takes a long time and requires a complete re-engineering of the investment project, not to speak of the needed institutional redeployment.

The particular responses of different countries varied widely both in function of tradition and history of labor market programs implementation, and in terms of the political equation that made diverse groups more or less visible as objects of income protection. Generally speaking, governments reacted along two main lines. Where organizational and political constraints so permitted, labor intensive public work programs were implemented. Where the perception was that youth unemployment was a particularly important problem, training programs that targeted unemployed youth as clientele were implemented. Some governments in the region opted for developing both lines of action simultaneously, and yet some others opted for an ever-wider variety of programs that also covered subsidization of private sector employment generation.

A. Unemployment insurance

In Table 1 we present a summary description of unemployment insurance systems in the region. As can be seen, very few countries in the region have legally and/or administratively enacted unemployment insurance systems, and even fewer have working unemployment insurance schemes. This is a consequence of the very weak incentives that exist for the development of unemployment insurance and other more socialized forms of income protection, given the fact that severance payments work as privately provided income insurance for workers in full-benefit employment contracts that are laid-off.

In those countries that do have unemployment insurance systems, coverage is limited to workers that have contributed while employed to the financing of the system. In other words, only workers in full-benefit employment contracts and working in payroll tax-paying firms enjoy the benefits of the unemployment insurance system. The level of benefits provided and its duration is low relative to more developed countries unemployment insurance systems. Replacement rates are normally in the order of 50-60% of last wage, with tops linked to the minimum wage for higher salaries. Benefits are granted for periods typically not longer than four months.

The unemployment insurance system in Argentina is quite limited in number of beneficiaries, and has remained so in spite of strong increases in the number of unemployed workers. Mazza 1999 reports that the number of beneficiaries has remained stable around 100-125 thousand workers, more than 70% of whom are prime age males, and more than 50% are not household heads. She also reports that an analysis of beneficiaries in their personal and previous job characteristics shows that there is a definite trend towards serving younger and middle class displaced workers. This suggests that unemployment insurance is not fulfilling a safety net role for the poor in the case of Argentina.

Brazil has the biggest unemployment insurance system in the region, with around 300-400 thousand beneficiaries. Mazza 1999 reports that unemployment insurance in Brazil is also serving younger (more than 50% of beneficiaries are younger than 30) and more educated (45% of beneficiaries have completed eight grade or better) workers. As IPEA 1998 assesses, the unemployment insurance system reflects wage inequality, in the sense that benefits accrue to the middle deciles in the distribution of income.

In Venezuela, the unemployment insurance system is enacted in the law since 1989, but was never implemented. The system has been reformed last year. The new system will protect beneficiaries through a mix of individual and collective insurance operated by competitive insurance providers, but implementation has not yet begun as of this date. Given that only workers with regulated, tax-paying contracts are entitled to benefits, it is likely that the pattern of distribution of beneficiaries will be very similar to that of Argentina and Brazil discussed above.

Mexico and Uruguay have unemployment insurance programs operated by the social security system. In both cases coverage is quite limited, and in the former it is just an advance payment of old age pensions for a maximum period of five years. In the Barbados case, the unemployment insurance system is very small in coverage, though quite well adapted to the needs of an island economy with frequent but short episodes of unemployment concentrated in workers in the tourism industry (Mazza 1999).

Table 1

UNEMPLOYMENT INSURANCE IN THE REGION

	Law	IV. FUN DING	Replacement rates [a]	Benefit duration	Benefits Min/Max	Coverage	Requirements
Argentina	1991 reform. 95	Worker: 1 % wage Empr.: 1.5 % payroll	60 %	4-12 meses	Min: 1 m.w. Max:4 m.w.	Employees	1 (12), 2,3
Barbados	1982	Worker: 1.5 % wage Empr.: 1.5 % payroll	60 % 10 weeks 40% 16 weeks	26 weeks in a 52 week period		Employees 16-64 yo	1(6)
Brazil	1986 1990	FAT (.65% tax on total sales)	1-3 minimum wages	4 months	Min: 1 m.w.	Employees	4(36, 4), 5,6
Chile	1981	Government	37$ monthly for the first 6 months, 18$ last 6 months	Max. 1 year [b]		Employees	2, 4(12,2), 5,
Ecuador	1958, 1988	Worker: 2% sal. Empr.: 1 % payroll	One time subsidy, amounts decided each year.			Employees	1(24), 7(30)
Mexico		Social Security	95 % pension	5 years max		Employees 60-65 yo	Between 60-65 yo
Uruguay	1981	Contributions to Social Security	Up to 50%	6 months	Min:0.5m.w . Max: 4 m.w.	Employees in commerce and industry	1(6), 5, 3, 8.
Venezuela	1989 reform. 1998	Worker: .7 % wages Empr.: 1.5 % payroll	Up to 60%	13-26 weeks	Max. $44	Employees	1(12), 2

Taken from Lora E. and C. Pages, 1997

Source: S.S. Programs throughout the World – 1995, US Dept. of Health and Human Services

Notes: [a] % last wage.

[b] Beneficiaries receive also family support, medical and maternity benefits.

Requirements: 1 (s) – *Be employed s months before receiving subsidy;* 2 – Availability to work; 3 – Does not receive; other social security benefits; 4 (s, j) – Not having received more than s months of benefits in the last j years;

5 – Unemployed for reasons outside the conduct and willingness of worker; 6 – Subject to economic need; 7(x) – Waiting period of x days; 8 – At least 12 months between periods of receiving subsidy.

B. Employment generation programs

In Table 2 we present a summary description of the employment generation that 7 countries in the region had in operation at the end of 1995. The list was extracted from a joint ILO-IADB volume on active labor market policies in Argentina, Brazil, Chile, Costa Rica, Jamaica, Mexico, and Peru. These countries represent a wide spectrum of variation in terms of policy development, operational capabilities, and exposure to international capital markets volatility. Program description and characteristics were summarized in Verdera (1998) and a more thorough discussion of programs is presented in the national reports contained in that volume. An itemized description of the programs is presented in Table A-1 in the Appendix.

Table 2
EMPLOYMENT GENERATION PROGRAMS IN 7 COUNTRIES IN THE REGION

	Beneficiaries		Expenditure	
	1.000s	*% of total labor force*	*million US$*	*% GDP*
Argentina	892.2	**9.31%**	249.2	**0.09%**
Brazil	221.8	**0.49%**	1,188.8	**0.21%**
Chile	4.3	**0.10%**	1.4	**0.00%**
Costa Rica	8.1	**0.71%**	3.3	**0.04%**
Jamaica	6.0	**0.61%**	21.2	**0.50%**
Mexico	1,024.0	**4.42%**	1,802.0	**0.51%**
Peru	27.8	**0.93%**	100.0	**0.19%**

Source: data from Verdera 1998, modified by the author. For a complete listing, see Table in Appendix.

Argentina is the country with the most varied set of employment generation programs, comprising a combination of public works and subsidies to private employment. Public subsidies to private sector employment, in the form of subsidies to firms that increase the number of employees, were widely used under a variety of mechanisms. Workers displaced from the public sector and unemployed workers receiving unemployment insurance were given vouchers that employers could use to pay tax liabilities. Firms could opt for tax rebates if hiring particular groups of workers (young, women, ex-combatants, etc.) under promotional contractual forms. Also, firms in particular activities (like reforestation) were subsidized if they hire new workers. But the most visible mechanism of subsidization was the use of "promotional employment contracts" established in a series of decrees in 1995. These promoted contracts were more precarious than regular full-benefit contracts, did not originate rights to severance payments, and payroll tax liabilities were lower.

Argentina federal government also financed labor intensive public works as an employment generation device. The *Trabajar* and similar programs were financed and supervised by the Federal government using the *Fondo Nacional de Empleo* (a fund financed through pay-roll taxes). The resources were used to build small scale and labor-intensive public works (in many cases social infrastructure, but also roads and small sanitation works), with the works being executed by a wide variety of agencies, including from local and state governments to NGOs.

The *PROGER* program in Brazil is a contrasting mechanism for employment generation. The program operates through the establishment of credit lines offered through the national development banking system to small enterprises, cooperatives, NGOs, and other civil society associations. This mechanism serves to circumvent the sub-national governments for works execution, in order to avoid the creation of budgetary entitlements. Partial and incomplete evaluations of *PROGER*, however, are not too optimistic about the results in terms of employment generation.[4/]

Chile does not have any employment generation program as such, though it has a number of very small and narrowly targeted programs to address living conditions that may hinder the labor market insertion of particular groups.

Costa Rica uses public works, wage subsidies, and credit to small enterprises as mechanisms to promote employment generation. Credit to promote employment generation in small firms is also widely used in Jamaica in a battery of programs, some of which also include a form of short-term training. Jamaica has a training and temporary employment program for unemployed youth, aimed at easing their labor market insertion.

Mexico uses public works (rural roads and other social infrastructure) as employment generation devices. The programs are financed by allocations from general revenues (not from payroll taxes) in the Federal Government budget, and states and local governments execute the works.

Finally, Peru uses legal incentives, a social investment fund, and a micro and small enterprise credit program as tools for employment promotion. The Labor law reform of 1991 introduced a number of more precarious forms of employment contracts, allowing firms to hire workers without generating rights to severance payments under fixed term contracts. FONCODES, a social investment fund, is also used as a employment generation device which can be quickly adjusted to the situation of local labor markets. However, it is not clear how much capacity or interest FONCODES management has in employment generation as opposed to the physical execution of civil works (Verdera 1995).

C. Training as income transfer programs

In Table 3 we present a summary description of the training programs that were being used as income transfer devices in 7 countries in the region by the end of 1995 (Verdera (1998)). An itemized description of these programs is presented in Table A-2 in the Appendix. Training programs were widely used as a mechanism to transfer income, particularly to unemployed youth, through scholarships during the classroom-training period (normally 3 to 6 months) and in some cases through job search assistance and/or apprenticeship stages in private firms. In most cases these training programs were financed by the government and delivered by private and NGO training providers, with little or no intervention of the traditional National Training Institutions

The basic operational technology of these training programs was based on *Chile Joven*, a pioneering youth training program that combined an scholarship for classroom-training with a three month paid apprenticeship in a private firm. Instead of direct purchasing of training services, resources are used to create a fund that is managed by a central government agency. The managing agency requests proposals for training projects, and funds are granted through open biding. The proposals must describe the content of the courses to be taught, and must include a commitment from private sector firms to accept the trainees as apprentices for a period of time (normally three months). The provision of scholarships served as an income transfer to beneficiaries, took them out of the unemployment queue, and gave them some labor market experience during the apprenticeship. These three beneficial effects of the *Joven* program were

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[4/] *Relatorio da forca-tarefa sobre politicas de emprego – Diagnóstico e recomendaciones*, Min. do Trabalho, Brasilia, Agosto 1998.

quite adequately suited to situations characterized by high youth unemployment rates[5/]. However, other countries in the region emulated the contracting methodology of the *Joven* program to cater to the needs of other population groups.

Table 3

TRAINING PROGRAMS IN 7 COUNTRIES IN THE REGION

	Beneficiaries		**V. EXPENDITURE**	
	1.000s	% of total labor force	million US$	% GDP
Argentina	133.0	**1.4%**	95.6	**0.04%**
Brazil	740.5	**1.6%**	310.2	**0.06%**
Chile	36.6	**0.8%**	18.3	**0.03%**
Costa Rica	13.1	**1.2%**	60.6	**0.73%**
Jamaica	43.5	**4.4%**	18.6	**0.44%**
Mexico	410.3	**1.8%**	135	**0.04%**
Peru	1.5	**0.1%**	5.0	**.01%**

Source: data from Verdera 1998, modified by the author. For a complete listing, see Table in Appendix.

Among the countries in the study reported here, Argentina, Chile and Peru have programs inspired in the *Chile Joven* design, targeting low income unemployed youth. Argentina has also used the contracting mechanisms of the *Joven* program to develop training programs for other groups of the population, and granted subsidies to private employers who hire apprentices under promotional employment contracts.

Brazil also uses competitive biding for training provision, but the program operates in a highly decentralized way. The *PLANFOR* program is financed through the FAT, a payroll tax financed fund, and funds are allocated to states and local governments, who in turn hire different providers (both private and public) through competitive bidding. States must present annual training plans to the *PLANFOR* administration, and funds are allocated in proportion to the state's share of the total workforce. This method of allocation is presently being changed to reflect the state level of poverty and education, and past experience with the execution of annual training programs. It is interesting to note that the national training institutions (in the case of Brazil the SENAI-SENAC system) participate in the bidding process as another provider of training services, thus creating an interesting financial and institutional dynamic in the overall training system.

Costa Rica used instead the national training institution (INA) as a channel for delivery of training services to semi- and skilled unemployed workers. Thus, INA schedules and delivers training programs for low income workers in marginal urban areas, for displaced public sector workers and for handicapped workers using its own facilities and instructors. A special line of action was established to enable INA to contract out other training institutions, but no special targeting mechanism has been used.

Jamaica uses a number of programs to provide training for unskilled and young unemployed workers, but the mechanism for income transfer is temporary jobs rather than scholarships during training.

[5/] The contracting mechanism of *Chile Joven* was in fact a way to create incentives for training providers to deliver good quality and labor market-relevant content of their courses. This created pressures for an institutional and content revamping of the training system, as firms accepting apprentices acted as controllers and gatekeepers of the relevance and adequacy of the training provided. The program was therefore rightly perceived as a tool to modernize and connect the training system with real productive activities.

Mexico has the biggest training with income transfer program in the region, and it has been effectively used as a protective device for unemployed and displaced workers, and expanded and contracted according to the economic cycle. The PROBECAT program provides a scholarship for the beneficiaries, and the state offices of the Labor Ministry organize a variety of training programs that are delivered locally. Different program evaluations have found that the program has been somewhat successful as a training program, increasing incomes and likelihood of employment for beneficiaries, even though positive effects tend to increase with higher levels of education of the beneficiary.[6/]

D. Expenditure in income support devices

In general terms, the 7 countries in our sample invest a smaller fraction of GDP in unemployment insurance, employment generation, and training-cum-income-transfer programs that a wide sample of more developed OECD countries (Table 4). On average, the countries in our sample spend less than half a point of GDP in these programs, while the average for the OECD countries is 2.4% of GDP. Only the US, Japan, and Greece spend a smaller fraction of GDP in these programs than the LAC average.

Mexico is the country that spends the most resources in employment generation (one half of a percentage point of GDP) to benefit around 4% of the total workforce, while Argentina reports expenditure below one tenth of 1% of GDP to benefit around 9% of the total workforce. Resources invested in training programs[7/] are of the same order of magnitude than those dedicated to employment generation programs, though the number of beneficiaries seem to be somewhat bigger.

It is also interesting to note that countries in the region that do have unemployment insurance systems (Brazil and Argentina) spend less in unemployment compensation than even the less spendthrift countries in the OECD.

These comparative figures suggest that there is room for expansion of the expenditure in income support programs. Even doubling the expenditure in these programs (an increase well beyond any reasonable expectation) would not make countries in the region big spenders in international terms.

6/ *Capacitación y Empleo: Evaluación del programa de becas de capacitación para desempleados*, Sec. De Trabajo y Previsión Social, Mexico DF, Agosto 1995

7/ These figures exclude the expenditure of the traditional National Training institutions.

Table 4
EXPENDITURE ON LABOR MARKET PROGRAMS
OECD AND LATIN AMERICAN COUNTRIES
(% of GDP)

	Training for unemployed	Employment generation	Unemployment compensation	Total
		OECD countries		
Australia (1994-95)	0.23	0.21	1.62	2.06
Austria (1995)	0.13	0.05	1.30	1.48
Belgium (1995)	0.24	0.68	2.11	3.03
Canada(1994-95)	0.29	0.07	1.50	1.86
Denmark (1995)	0.86	0.36	3.06	4.28
Finland (1995)	0.60	0.68	3.57	4.85
France (1995)	0.67	0.40	1.43	2.50
Germany (1995)	0.44	0.44	2.08	2.96
Greece (1995)	0.04	0.09	0.44	0.57
Italy (195)	0.39	0.69	0.68	1.76
Japan (1994-95)	0.03	0.06	0.39	0.48
New Zealand (1994-95)	0.44	0.15	1.26	1.85
Spain (1995)	0.33	0.31	2.46	3.10
Sweden (1994-95)	0.98	0.90	2.51	4.39
US (1994-95)	0.07	0.01	0.35	0.43
		LAC countries		
Argentina (1995)	0.04	0.09	0.14	0.27
Brazil (1995)	0.06	0.21	0.19	0.46
Chile (1995)	0.03	-	-	0.03
Costa Rica (1995)	0.73	0.04	-	0.77
Jamaica (1995)	0.44	0.50	-	0.94
Mexico (1995)	0.04	0.51	n.a.	0.55
Peru (1995)	0.01	0.19	-	0.20

Notes: Training for unemployed includes training for the unemployed adults and those at risk, plus measures for unemployed and disadvantages youth and support of apprenticeship programs.
Employment generation includes all forms of subsidized employment, plus direct job creation by public and non-profit sector.
Unemployment insurance includes all expenditure on benefits, independently of source of financing.

Source: For OECD countries, Table J, ps. 211-218, *Employment Outlook*, June 1998, OECD.
For LAC countries, Verdera(1998).

IV. The pieces of an income support system

The repeated bursts of economic instability during the nineties induced governments to revisit the ideas around the building up of mechanisms that could protect the population from income losses. These efforts, described in the previous section, were conceived as emergency measures aimed at transferring resources as fast as possible to vulnerable groups of the population affected by an economy-wide shock. Much more attention was brought to the capacity of these programs to expand rapidly than to their ability to expand or shrink in response to demand. This trait made these programs a semi-permanent component of social sector expenditures, therefore raising all types of questions regarding their role in a comprehensive social policy.

One question that has been overlooked in the discussion about income support programs is what they tell us about the failure of the established mechanisms in our societies to protect workers (including the poor) from the effects of both economy-wide and idiosyncratic shocks. Because of the failure of the traditional income support mechanisms (i.e., the severance payment system) there is an absence of mechanisms to deal with the income losses associated with the idiosyncratic shocks normal in the process of job churning. Therefore, when hit by the crisis countries in the region did not have the option of expanding "normal" income support programs, but had to adopt emergency responses. On the positive side, however, these emergency programs create the opportunity to build a more permanent system of income support that solves the failure of the traditional mechanisms.

This system of income support should operate through the labor market, because labor is the only asset for an overwhelming majority of the population and because most of the transmission mechanisms of shocks operate through labor demand (Lustig and Walton, 1998). Programs and policies that facilitate the use of labor in income earning activities will be the most effective to mitigate the impact of cyclical or shock-originated downturns on workers. However, when workers fall into unemployment their consumption capacity needs to be protected (be it by generating employment, or by providing other forms of income support) without generating a dependency trap.

From a design point of view, these mechanisms should provide a minimum income guarantee to all workers. To be feasible in financial and economic terms, they need to fulfill at least three requirements:

- Their design should not introduce labor market distortions and, in particular, should not induce workers to reduce their search effort or increase their reservation wages.
- Their coverage should be as wide as possible, given that the risk of unemployment affects all workers, including those in non-regulated and precarious forms of employment contracts.
- Their budget allocation should be adjusted counter-cyclically, expanding in economic downturns when unemployment increases, and contracting in expansions when it decreases.

How well do the programs and mechanisms already in place in the region comply with this requisites? Table 5 presents an attempt to summarize some characteristics of these programs relative to those criteria. In the most general possible terms we find that an effective and relevant income protection system should be a composite of programs offering different mechanisms targeted to different groups in function of their human capital levels and labor market insertion.

Table 5

SOME CRITERIA FOR EVALUATION OF INCOME PROTECTION PROGRAMS IN THE REGION

Program	Labor market distortions	Coverage	Counter-cyclically
Cash transfers	Very important Reduce incentives for labor market participation	Requires very thorough and expensive targeting system to target on the poorest.	Low Create entitlements, contraction is politically very expensive.
Unemployment insurance	Low if well designed (individual contributions, low replacement rates, short period of benefits)	High productivity workers in regulated employment contracts Requires keeping of administrative records	High, automatic
V. EMPLOYMENT GENERATION PROGRAMS		VI.	VII.
• Labor intensive public works	Low if well designed (wages below average wages of poor deciles)	Local labor markets Self-selection into the program	Politically expensive if the program generates budgetary entitlements of sub-national governments
• Wage subsidies	High Induce substitution of non-subsidized by subsidized groups	Narrowly defined groups Requires supervision capacity and keeping of administrative records	Potentially very high, though program may create entitlements
Scholarships for short-term classroom training, apprenticeships, and job search assistance	Low May increase participation rates of target group Increase the efficiency of market exchange mechanisms	Targeting is easy on observable characteristics, self-selection More adequate for unemployed youth and new-entrants, not very useful for displaced workers	High. Requires maintenance of the network of non-government providers.

A. Cash transfers

The most immediate and direct way to protect unemployed workers' income is through cash transfers to families that fall below a predetermined income level. Even though the criteria for receiving benefits from the program is formulated in terms per capita family income, low family income levels are associated with either very low wages (Hausmann and Szekely (1998)) or unemployment.

Cash transfer programs are usually targeted to the poorest segments of the population, which cannot obtain a minimum survival income level in the labor market. In many cases, a cash transfer is part of a more comprehensive program aiming at protecting and furthering the ability of low income families to maintain and accumulate human capital and, therefore, to "graduate" from the program.[8/] Because these families are poor to begin with, economy wide or even idiosyncratic shocks can put into question their ability to sustain minimum consumption levels. Therefore, a cash transfer can help them smooth their consumption levels.

However, cash transfers induce very important labor market distortions, by increasing reservation wages and creating incentives against work. Because they do not require any counterpart work effort (making participation in the program effectively a free good), these programs also require a very sophisticated targeting system and a complex system of verification and enforcement, to avoid fraud by inclusion of non-needy families and to avoid exclusion of needy ones. Cash transfers also tend to create strong entitlements among the beneficiaries, making it extremely hard to adjust either the number of beneficiaries or the amount of benefits in a counter-cyclical fashion.

B. Unemployment insurance

Though differences in design, coverage, and benefits makes it quite difficult to present an overall assessment of the importance of unemployment insurance systems as part of a comprehensive income support mechanism, there are some common traits that deserve comment. In the first place, unemployment insurance is normally a benefit additional to severance payments. Once the worker is fired, he or she receives severance payments. In addition to that, the worker has the right to unemployment insurance as a supplementary source of income during his or her search for a new job. Therefore, income protection by the unemployment insurance system is targeted to workers that have had full-benefit employment contracts. As we mentioned above, this excludes from the protection a sizable fraction of the work force that work in the unregulated segment of the labor market, presumably those who because of their human and social capital deficits are the neediest in terms of income protection.

In the second place, unemployment insurance systems generally lack connection with other labor market intermediation and placement services. Even in the cases where the UI system is operated through the Labor Ministry (as in Brazil) workers are not required to register in the intermediation service, and payment of the benefit is not contingent on verification of search effort. On the one hand, this lack of connection generates opportunity for fraud. Even if it is illegal to have a job and receive UI payments simultaneously, most operators complain of their lack of capacity to control what is perceived to be

[8/] The rationale for programs as *Bolsa Escola* in Brazil, *Programa de Asignaciones Familiares* (PRAF) in Honduras, and *Beca Alimentaria* en Venezuela is to avoid perpetuating a vicious circle of poverty. Thus, these programs require keeping children in school or attending primary health care facilities during pregnancy, as mechanisms to prevent the transmission of poverty to the next generation.

widespread fraud and collusion between firms and workers.[9] On the other hand, this lack of connection with labor market intermediation services makes the system a pure income transfer that does not ease the transition of the unemployed into a new job.

In the third place, most unemployment insurance systems are financed through payroll taxes, which are already quite high in the region. This partly explains why coverage is limited, replacement rates are low, and periods of coverage quite short. Any expansion of the system to cover hitherto unprotected segments of the population is likely to face substantial opposition by its own present beneficiaries and by firms operating in the regulated sector of the economy. Only in the case of Brazil some expansion to new groups have been made (to traditional fishermen and to workers affected by the drought in the Northeast), but the expansion has been temporary and financed through the use of excess funds. If unemployment insurance is to work as part of the safety net in a crisis, the expansion of coverage would have to be produced just when the flow of benefits to already protected workers is highest, creating financial strains on the system and the need for additional funding. The question is whether this effort is worth doing through the unemployment insurance system, or by creating alternative mechanism for income transfer better suited to the needs of workers with different labor market insertions.

In the fourth place, it has been argued that the implementation of unemployment insurance requires considerable institutional resources in terms of accounting and record keeping. However, it should be noted that mandatory savings-based schemes in place in countries as Brazil, Colombia, Ecuador, and Peru also require considerable institutional resources of the same type. Furthermore, pension system reforms in a number of countries in the region[10] have created a network of institutions that hold individual worker's accounts that can be used for record keeping in the unemployment insurance system with little additional costs.

In conclusion, the design and target population of unemployment insurance makes it suitable to protect workers who have full-benefit employment contracts and that acquire rights to it through their contributions while employed. In terms of labor market distortions, the low level of benefits and their short duration apparently do not create incentive against search. In fact, the reports on fraud in Argentina and Brazil rather suggest that workers use unemployment insurance as a means to obtain additional income while in a new job. As Hopenhayn and Nicolini (1999) show it is possible to design optimal unemployment insurance schedules that do not induce reduction in search efforts. Furthermore, schemes of unemployment insurance based on nominative contributions to individual accounts that can be rolled-over into retirement funds can minimize negative impacts on search effort.[11]

In terms of ability to expand and contract counter-cyclically, unemployment insurance expenditure is an ideal mechanism. By definition outlays increase when unemployment is raising, and contract with the recuperation of employment.

The most problematic aspect of unemployment insurance, however, is related to its coverage. Workers must bear at least part of the cost of insurance to prevent moral hazard problems. For high productivity workers wages are high enough to make the benefits of paying for unemployment insurance (the expected value of benefits when unemployed) higher than the current income foregone by paying the contribution. However, for low productivity workers the utility gain from an increase in current income will be big enough as to generate incentives to negotiate with employers a contract without benefits in exchange for a higher current income.

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[9] Mazza 1999 reports that some efforts have been made in Argentina to detect if workers receiving unemployment insurance were working by using a common taxpayer identification number. It was found that a sizable number of workers were not only working, but also contributing to the social security in a new job while continuing to receive the UI payment.

[10] Most notably Chile, but also Argentina, Uruguay, Peru, and Venezuela.

[11] For a proposal of an unemployment insurance system along these lines see Cortazar et al. (1995) and the Venezuelan Social Security law of 1997.

C. Employment generation programs

Employment generation programs are a natural reaction of governments to increasing unemployment. Politically they show the concern of the government with the workers' plight and, by providing jobs, they directly attack unemployment. For analytical purposes it is convenient to separate labor intensive public works from wage subsidies to the private sector.

1) Labor intensive public works

Labor intensive public works have been the tools of choice to deal with economy wide shocks. The number and variety of programs in place in the region shows that governments choose to spend more additional resources in employment generation than in other mechanisms to provide income support to unemployed workers. One of the main advantages of these programs is that they are self-targeted (Grosh 1994, Ravallion 1998) and, therefore, can be implemented without the delays necessary to implement a targeting mechanism.

Three characteristics of labor intensive public works are crucial in their success as income support mechanisms. In the first place, these programs are financed by the central government and executed by local organizations (be it local governments or NGOs), who normally are in charge of selecting the works to be performed and the selection of beneficiaries. Thus, labor intensive public works require an extensive and solid network of institutions at the local level, with the technical and operational capacity to choose the works to be done, to organize the production process, and to channel resources to the needy poor. A large part of the success of these programs hinges on how well structured is the relationship between the central government and the executing agencies. There is not a unique way of designing this relationship. To mention just two examples, Argentina choose to finance works that are approved by a central government agency and executed mostly by local governments, while Brazil choose to allocate resources semi-automatically on a regional needs base and have works selected by the sub-national governments. In any case, what is important is that the design of the relationship between financing and work execution be adequate to the institutional and political structure of the country. More federalist countries should respect local autonomy in work selection and allocate budgets on objective criteria, while more centralized countries will be more able to select works and distribute resources at the central level while keeping responsibility for execution at the local level.

In the second place, the wage level and the criteria for selection of beneficiaries are set at the central level, while local organizations are in charge of the selection of beneficiaries. Thus, there is a certain degree of tension between the criteria set at the central level and the local political and social reality within which the selection of beneficiaries take place. There are multiple ways to solve, or at least mitigate the consequences, of this tension. Community participation is useful to oversee that resources are not diverted through political favoritism or other forms of corruption, but there is no guarantee that the needed level of community participation will exist. A useful complement to community participation is a system of random sampling of projects and beneficiaries by the central government agency in charge of overseeing the program to check whether or not resources are being diverted. This implies a non-trivial investment of resources in sampling and supervision, but these resources will pay for themselves in more transparency and better targeting of beneficiaries.

In the third place, the virtue of self-targeting has the vice of low wages. In order to target resources on needy groups and to avoid inducing distortions in local labor markets, wages in labor intensive public works are frequently set below the market wage of the relevant labor market. The literature on work-fare in the developed world suggests that this targeting mechanism is not without costs in terms of stigmatizing workers who participate in the program (Lightman 1995), and in terms of political and social discrimination among workers by program administrators (Rose 1994). There is no solution to this problem, short of raising wages to market levels, which in most cases will be impossible given resource constraints.

In summary, labor intensive public works do not generate important labor market distortions to the extent that they offer wages below the relevant market, and can provide a source of income to workers temporarily unemployed. Their coverage depends on the amount of resources allocated to the program, but there is no intrinsic reason why coverage of low skill workers could not be as ample as needed to reduce unemployment to the target level. This same property, however, brings us to the problem of their counter-cyclicallity. Because the amount of resources dedicated to the program is a political decision there is no way of guaranteeing that the program will move in sync with the economic cycle, expanding in downturns and shrinking in upturns. In fact, the experience in the region shows that once the programs are in place it is very difficult to reduce their size. In the well known cases of programs that were phased out during the eighties (PEM and POJ in Chile and PAIT in Peru), the closing seems to have been mostly a reaction to widespread problems of design and political manipulation (Graham (1995)).

2) Wage subsidies

The experience of subsidizing private sector jobs is much less widespread than labor intensive public works programs. Argentina is the only case where wage subsidies were widely used, and even there the scope of these programs has shrunk recently due to criticisms from the union movement.

Wage subsidies work through reducing the payroll tax and/or severance payments in employment contracts for particular groups of workers (youth, women, ex-combatants, etc.). This characteristic makes them suitable for the introduction of more flexible (or precarious) employment contracts in a process of labor market regulation reform. In fact, this was the role these programs fulfilled in Argentina in 1995. But at the same time, this makes them the center of a political debate on labor market flexibilization, which in large measure explains why these programs were faced out in front of union opposition in 1998.

On the other hand, because they are targeted on particular groups, they change the relative prices of different types of workers in favor of the target group and induce large labor market distortions, not the least of which is the substitution of subsidized by non-subsidized workers[12/]. In order to mitigate this problem, there is normally an "additionality" requirement, by which subsidies are granted only for new net hires that expand the payroll. In turn, this requires the determination of a baseline number of employees and a control on new hires. Theoretically this is a task that Ministries of Labor fulfill in the normal course of their business. In practice, the Ministries are extremely weak and have a very low enforcement capability. This weakness makes impossible the task of determining base lines and controlling hires of subsidized workers, therefore making worker substitution a widespread problem. As a consequence, is not clear whether or not these programs really create more jobs than those that would have been created without the subsidy.

In summary, these programs tend to generate large and important labor market distortions by attempting to change the relative salaries of different types of workers. Because they have to be explicitly targeted by design, they require a comprehensive and often non-existent enforcement apparatus, making the problem of targeting the program an intractable one. In terms of their counter-cyclicallity, expanding and shrinking the program requires an administrative decision. To the extent that these programs are often perceived as a mechanism to introduce more flexible (or more precarious) employment contracts, they can

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[12/] More formally, deadweight effects appear when the subsidized jobs would have been created anyway without the subsidy, while substitution effects appear when subsidized workers replace non-subsidized (Calmfors (1994)). The additionality requirement address the deadweight effect, while substitution effects are only prevented at the margin.

become the center of an often ardent political debate and make decisions about program implementation politically very costly. This has been the experience of Argentina, where these programs were faced out jointly with the rejection of more far reaching labor regulation reforms during 1997.

D. Short term training programs

Short term training programs work as an income support device through the provision of scholarships to trainees during the classroom training and apprenticeship periods, normally between 4 and 6 months. The scholarships are below the relevant market wage, and the apprenticeships are developed in private firms with which the training providers sign an agreement. The short duration of the classroom training makes these programs more adequate to provide young new entrants to the labor market with job search skills, than to the needs of skill updating or upgrading of workers displaced from declining sectors.

The main challenge in the design of these training programs arises from the existence of a national training institution, normally a monopolistic public provider of training financed through a payroll tax with no incentive whatsoever to adapt the nature of its activities and clientele to the challenges of high unemployment. In order to circumvent this obstacle the programs are organized through the setting up of a separate pool of resources managed by a specialized agent at the central government level. This agent in turn bids out resources to private providers that execute the training programs in a decentralized fashion. As we mentioned, these decentralized providers must enter into agreements with private sector firms to ensure that trainees will have an apprenticeship stage, making private firms the effective gate-keepers of the quality and relevance of the training programs. Another interesting by product of this process is the development of stronger connections between firms and training providers, which make the latter effectively providers of job search assistance services.

Training programs tend to be more expensive on a per beneficiary basis than labor intensive public works, given that a larger part of the resources goes to pay the training provider. However, calculations of benefits should include the long term change in the structure of the training system and the development of job search assistance services, which are very large positive externalities of these programs.[13/]

The organization of the programs makes it easy for the program organizer to administratively target groups of the population, and the programs have been quite successful in attracting unemployed youth. However, it should be noted that the programs can be too effective in attracting the target group: in Mexico in 1996 youth participation rates increased so much that even if the employment rate of the group rose, so did its unemployment rate. Although there is no formal proof that this was the result of the expansion of training programs (particularly PROBECAT) in that year, there is a suggestive association between expansion of these programs, decline in school enrollment rates, and increase in labor force participation and employment of the target groups.

In summary, these programs tend to generate positive labor market externalities beyond the training process itself, by easing the insertion of young workers and creating experience in the operation of labor market intermediation mechanisms (job search assistance). In terms of coverage, the nature of the training provided makes them suitable for unemployed youth and, as with any training program, one should not expect them to create new jobs but rather to provide new entrants with some labor market experience. Because youth unemployment is a permanent problem in the labor market, one should not think about these programs as counter-cyclical devices, but rather as permanent features of a well-functioning labor

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[13/] These emergency training programs have created the opportunity to introduce institutional innovation into a training system characterized by the monopolistic power of payroll tax financed institutions. Disseminating these innovations to the mainstream vocational training system will make it much more successful in addressing the needs of skill upgrading of workers caught in the normal process of job churning.

market intermediation system, that could be expanded and contracted following demand in a counter-cyclical way.

V. Putting the pieces together

Macroeconomic volatility seems to be a permanent feature of the Latin American economies, and the adoption of growth-oriented sustainable economic policies has not reduced it. In the brave new world of higher and more pro-cyclical unemployment the traditional legally mandated severance payment mechanisms have failed to provide the income support needed by unemployed and displaced workers. These traditional mechanisms have become irrelevant in the new environment of more open and competitive economies, given the narrow scope of its coverage. This same failure has led governments, faced with sharp economic instability since 1995, to develop a series of attempts at the setting up of mechanisms to support the incomes of groups of the population hurt by unemployment and declining incomes.

The pieces of the new income support system are there in most countries. However, because they were developed as emergency programs, they are more a mosaic of often unrelated initiatives than a coherent and well thought system. As such, their ability to expand rapidly was a dominant concern. Little attention was paid to the potential labor market distortions they introduced, and even less to their ability to expand and contract in a counter-cyclical fashion. Moreover, the scarcity of resources available at the moment of their implementation called for narrow targeting on the poor, as the programs were thought as emergency devices to protect the population that did not have the resources to protect themselves. The underlying thought was that the traditional income support mechanism based on severance payments served to protect the non-poor.

The starting point for a new income support system is the recognition that workers in general, and not only the poor, need to count with mechanisms to help them cope with both economy wide and idiosyncratic shocks that result in income losses and unemployment. The protection of the severance payment system covers today not more than half the labor force, and has a high cost in term of labor market distortions. As has been argued extensively elsewhere (IPES 1997, for instance) more socialized forms of income protection, as unemployment insurance, can provide effective protection and cost less in terms of labor market distortions. In this sense, some of the recent labor market reforms (exemplified by the Venezuelan reform of 1997), that reduce legally mandated severance payments and create a system of unemployment insurance, represent a step in the right direction.

However, coverage of unemployment insurance will not be wide enough to protect all workers, and particularly the poorer ones. Part of what differentiates the poor from the non-poor is the nature of their labor market insertion and, therefore, the mechanisms that need to be devised to insure them against the risk of income loss. Poorer, low productivity workers must relay on alternative mechanisms to protect themselves as they cannot afford the cost of unemployment insurance, or are in employment situations (self-employment or causal work in unregulated contracts) that make it unsuitable as insurance mechanism. For those workers, a menu of alternatives needs to be provided based on the existing mechanisms on income support.

A very general vision of the components of an income support system is presented in Table 6. At the center of the scheme, a well-designed unemployment insurance system covers the group of workers that, given their employment contracts and their productivity, can "buy" the insurance. Both individual accounts and collective insurance are needed in order to prevent moral hazard and to extend as much as possible the coverage of the system. The rationale for the implementation of the collective insurance component is that workers that suffer more frequent or more prolonged unemployment episodes can "borrow" against future deposits. The Chilean Ministry of Labor proposed a good example of this type of unemployment insurance in 1993 (see Cortazar et al. (1995)), and the recent reform of the social security system in Venezuela contemplates an unemployment insurance system along the same lines.

Table 6

THE DESIGN OF AN INCOME SUPPORT SYSTEM

Program	Targeting	Financing	Institutional requirements
Unemployment insurance	Non-targeted, covering all workers in regulated contracts (in lieu of severance payments).	Financed from workers' and firms' contributions.	Independent financial institution(s). System connected to pension system.
Scholarships for short-term classroom training, apprenticeships, and job search assistance	Unemployed youth	Financed from training system payroll tax.	Opening of the market for training services. Network of non-government providers.
VIII. Employment generation programs			
• Labor intensive public works	Self-targeting.	Financed from general revenues, strongly counter-cyclical.	A solid network of local institutions able to apply selection criteria and to implement works' execution.
• Wage subsidies	Administrative.	Exemption of payroll taxes, financed by general revenues.	Sophisticated enforcement and verification system from labor authority.
Cash transfers	Very narrow, based on family income below the poverty line.	Financed from general revenues.	Sophisticated targeting system.

Mandatory-savings based schemes (the so called "separation funds" in Brazil, Colombia, Peru, and Venezuela) mimic a number of the desirable characteristics of unemployment insurance, and can serve as an alternative basis to protect the income of workers in regulated employment relations.

For workers that do not have access to unemployment insurance a variety of mechanisms need to be put in place, depending on the reasons for their lack of access. In the first place, short term training courses could provide low skill new entrants with the necessary training, labor market experience, and job search assistance necessary to access a regular job. Scholarships should be set at a level low enough as to not discourage search in the local labor market [14/], and targeting should concentrate resources on out of school unemployed youth. Careful attention should be given to attract exclusively individuals out of the school system, and therefore to deter school desertion pulled by the program. Financing of this program should be obtained from the existing payroll tax earmarked for training, maintaining the system of decentralized provision with apprenticeships. Funding should be provided in sync with demand for these services, higher during economic downturns, lower during expansions. However, to the extent that the training system unifies around the decentralized model of provision, a continuous level of funding should be provided to help all workers deal with normal job churning, while the youth component adjusts to the economic cycle in function of the evolution of the youth unemployment rate.

For displaced low skill workers, labor intensive public works are the tools of choice in order to provide them with jobs at the local level. As we mentioned above, in the design of these programs it will be necessary to take into account the level of development of local governments, and the nature of its financial and political relationship with the central government. Many of initiatives to set up employment

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[14/] The main criteria here is that the scholarship should be below the market wage that equivalent workers obtain in the labor market, and not in function of the overall average wage.

generation programs have failed for not taking into account the organizational and political dimension of the separation between financing and execution. Again, wage levels in the programs should be low enough as not to crowd out alternative employment opportunities. Funding should be provided from general revenues and not, as is normally done, from payroll tax revenue[15/]. Again, funding should be provided in sync with demand, with expenditure adjusting according to the evolution of the general or, if available, local unemployment rates.

The other member of the family of employment generation programs, wage subsidies, should be used sparingly if at all, in spite of the conceptual attractive of the idea of generating private sector "real" jobs (as opposed to the "make work" jobs of labor intensive public works). The distortions caused by meddling with the relative wages of different types of workers are important enough as to counsel caution in this area. Besides, the sophisticated enforcement and supervision system needed to mitigate the deadweight and substitution effects of these subsidies is not present in most of the countries.

Finally, cash transfers to poor families are the last resort mechanism to support those families that "fall through" the other support mechanisms. As a mechanism of last resort a signal of good implementation is low coverage. If coverage grows up to a well-defined poverty head count there is a clear signal that other components of the income support system are failing, and too many workers are "falling through". The complication of their design and implementation are well known[16/], and extreme caution is recommended given that the program can create dependency traps for beneficiaries.

This set of programs and mechanisms centered on unemployment insurance, and encompassing other complementary mechanisms to protect more vulnerable workers is a quite comprehensive system of income support. As such, the system as described is more a statement of purpose than a guide for action. Political realities and implementation abilities will determine what part of a labor market based income protection system can be implemented in a given country at a given time. As a vision of purpose it could be useful to put emergency measures into a more structured framework of long term objectives. Most of the components of this comprehensive system exist in one form or another in most countries in the region. Setting some of them (as replacing legally mandated severance payments by unemployment insurance or saving-based separation funds) will require far-reaching political agreements, but these agreements can only be facilitated by sharing a vision of the end product as a system to protect all workers against income volatility. In other cases (as in designing emergency employment programs) the pitfalls of designing in the context of an emergency can be to some extent mitigated by a vision of how the emergency program will fit in the context of a new and more effective income protection system.

15/ The use of payroll tax resources (which increase the cost of labor and therefore reduce employment generation) to generate jobs is somewhat contradictory in terms.

16/ For a summary of state-of-the-art arguments around cash transfers see Family allowances program, Fase II, Loan Proposal (HO-0132), IADB, Project Report nr. 2354.

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Annex

Table A-1
Employment generation programs in 7 countries in the region

	Beneficiaries		Expenditure	
	1.000s	% of total labor force	10^6 US$	% GDP
Argentina		9.31%		0.09%
Public works financed with public resources				
1. **Programa de Asistencia Solidaria** (PROAS) Unemployed household heads in public works executed jointly by Sec. Desarrollo Social and state Governments	260.0	2.7%	54.5	0.020%
2. **Programa de Entrenamiento Ocupacional** (PRENO)	94.0	1.0%	20.0	0.007%
3. **Programa de Servicio Comunitario** (ASISTIR) Female household heads in community development activities	25.0	0.3%	2.6	0.001%
4. **Programa Trabajar** Unemployed household heads in public works executed by local governments and NGOs.	233.0	2.4%	44.9	0.017%
Private sector employment promotion				
5. **Programa de Empleo Privado para Pequeñas y Medianas Empresas** Subsidy for new jobs for unemployed workers in firms with less than 100 employees	254.0	2.7%	42.4	0.016%
6. **Programa Nacional de Forestación Intensiva** (FORESTAR) Subsidy for new jobs for unemployed workers in new agricultural/forestry firms.	21.0	0.2%	4.4	0.002%
7. **Programa de Reinserción Laboral** Subsidy to workers that find a job while receiving unemployment insurance.	n.a.		n.a.	
8. **Programa de Movilidad Geográfica** Subsidy to workers that have to move from place of residence to keep the job.	n.a.		n.a.	
9. **Bono para la creación de empleo privado** (BOCEP) Fiscal credit for workers displaced from states' payroll. New employer can use as collateral for credit from public banks.	5.2	0.1%	73.4	0.027%
IX. BRASIL *(1)*	221.8	**0.49%**	1,188.8	**0.21%**
1. **Programa de Generación de Empleo e Ingresos** (PROGER) Special credit lines to MSMEs, cooperatives and informal sector.	221.8	0.5%	1,188.8	0.21%
X. CHILE	4.3	**XI. 0. 10%**	XII. 1. 4	**XIII. 0.0 0%**
1. **Trabajadoras temporeras** Child-care and educational services for children of ag. Temporary workers	4.3	0.1%	1.2	0.002%
2. **Programa de desarrollo del microempresario indígena** Strengthening of economic networks of indigenous groups through ME creation and support	n.a.		0.2	
XIV. COSTA RICA	XV. 8. 1	**XVI. 0. 71%**	XVII. 3. 3	**XVIII. 0.0 4%**
1. **Programa nacional de generación de empleo** Transfer of a min. wage to unemployed workers who participate in construction of social services infrastructure and service delivery.	2.1	0.2%	0.1	0.001%
2. **Pro Trabajo**				
- *Incentivos para la reinserción laboral y el empleo temporal* Subsidy of 50% of min. wage for on-the-job-training for unemployed/vulnerable workers.	3.4	0.3%	2.1	0.026%
- *Ideas productivas* Support to ME creation.	2.6	0.2%	1.1	0.013%

	Beneficiaries		Expenditure	
	1.000s	% of total labor force	10^6 US$	% GDP
XIX. JAMAICA	XX. 6. 0	**XXI. 0. 61%**	XXII. 21 .2	**XXIII. 0.5 0%**
1. **Micro Investment Development Agency** (MIDA) Credit for ME development	6.0	0.6%	7.6	0.181%
2. **The Government of Jamaica/Government of the Netherlands Micro Enterprise Project** (GoJ/GoN MEP) Credit for ME development	n.a.			0.000%
3. **The Government of Jamaica/European Union Programme** Credit for ME development	n.a.		1.4	0.034%
4. **Mel Nathan Institute for Development and Social Research** (MMI) Community development services	n.a.		1.6	0.038%
5. **Enterprise Development Trust** (EDT) Credit for ME development	0.0	0.0%	0.2	0.004%
6. **The Women's Construction Collective** (WCC) Training and credit for female construction workers	n.a.		n.a.	
7. **ASSIST Ltd.** Credit for ME development	n.a.		0.1	0.002%
8. **Bee Keeping and Honey Bee Project** Training and employment for youth in bee-keeping activities.	n.a.		0.3	0.007%
9. **SESP** Training and temporary employment for unemployed workers	n.a.		10.0	0.237%
XXIV.MEXICO	XXV. 1, 024.0	**XXVI. 4. 42%**	XXVII.1, 802.0	**XXVIII. 0. 51%**
2. **Programa de Conservación de Caminos Rurales** Rural public works for unemployed youth, Federal Govt. financed, works organized by State and local govts.	712.0	3.1%	350.0	0.099%
3. **Progr. de Construcción de Infraestructura Física y Obras de Empleo Productivo** Social infrastructure public works for unemployed youth, Federal Govt. financed, works organized by State and local govts.	312.0	1.3%	1,452.0	0.410%
4. **Programas Sociales Privados Club de Leones y Rotarios**	n.a.	n.a.	n.a.	n.a.
XXIX.PERU (2)	XXX. 27 .8	**XXXI. 0. 93%**	XXXII.0. 1	**XXXIII. 0. 19%**
1. **Progr. de autoempleo y microempresa** (PRODAME) Training and credit for ME creation and support	4.2	0.1%	0.1	0.000%
1. FONCODES Social investment fund builds small public works using local work-force.	23.6	0.8%	100.0	0.002%

(1) PROEMPREGO is excluded from the Brazilian list of employment generation programs, as it is an investment program, with obvious employment consequences, but with the primary objective of improvements in sanitation, environmental infrastructure, urban transport, etc. through BNDES lines of credit.
(2) Peru has also implemented a number of its employment generation programs as labor intensive investments sub-projects, complementary to the normal investment activities of institutions such as Instituto Nacional de Desarrollo (INADE), Programa Nacional de Asistencia Alimentaria (PRONAA), Empresa Nacional de Edificaciones (ENACE), Fondo Nacional de la Vivienda (FONAVI), Instituto Nacional de Infraestructura Educativa y de Salud (INFES), SEDAPAL, CORDECALLAO, CORDELIMA, INABIF, Fondo de Compensación Municipal, PROMANACHCS (Min. Agricultura), Ministerio de Transporte.

Table A-2
Training programs in 7 countries in the region

	Beneficiaries		XXXIV. EXPENDITURE	
	1.000s	% total labor force	10^6 US$	% GDP
Argentina	133.0	**1.4%**	95.6	**0.04%**
1. **Proyecto Joven** Scholarships and stage in temporary job for low-income, non-skilled, unemployed youth.	53.0	0.6%	71.7	0.027%
2. **Proyecto de Microemprendimiento** Entrepreneurship training for experienced, unskilled workers	5.4	0.1%	6.5	0.002%
3. **Programa Imagen** (Orientación para el empleo) Job-search assistance	27.0	0.3%	1.2	0.000%
4. **Programa de Talleres Ocupacionales** (PTO) Support to NGOs on setting up training institutions	18.0	0.2%	4.2	0.002%
5. **Programa de Capacitación Ocupacional** Training of unemployed and SMEs personnel	24.0	0.3%	7.3	0.003%
6. **Programa de Capacitación para el Empleo** Scholarships and stage in temporary job for low-income, non-skilled, unemployed and displaced workers	1.7	0.0%	2.3	0.001%
7. **Programa Aprender** Financing of health and accident insurance for young workers hired under *Contratos de Aprendizaje*	1.9	0.0%	-	
8. **Programa Emprender** Financing of training cost for workers in new firms.	2.0	0.0%	2.4	0.001%
9. **Programa de Crédito Fiscal** Tax exception for training firms.	n.a.		n.a.	
Brazil	740.5	**1.6%**	310.2	**0.06%**
XXXV. PLANFOR FAT-financed training program executed at the federal and state level by independent training institutions.				
1. *Programas Federales y Estatales* Federal and state programs for vulnerable groups.	340.8	0.7%	149.8	0.03%
2. *Programas de Emergencia* Emergencies from drought and declining/restructuring sectors	399.7	0.9%	159.4	0.03%
Chile	36.6	**0.8%**	18.3	**0.03%**
1. **Programa Chile joven** Stipend and stage in temporary job for low-income, non-skilled, unemployed youth.	17.9	0.4%	10.4	0.019%
2. **Programa de apoyo a mujeres jefas de hogar de escasos recursos** Training, day-care, health and other services to improve labor market insertion of poor women	15.0	0.3%	4.9	0.009%
3. **Mujer y microempresa** (Capacitación en gestión empresarial con perspectiva de género) Entrepreneurship training for female household heads with some education	0.1	0.0%	0.3	0.001%
4. **Programa de reinserción laboral** Job search and relocation assistance to displaced workers from carbon and textile workers.	0.2	0.0%	0.8	0.002%
5. **Programas regulares de becas.** Scholarships for training at official institutions for vulnerable groups (temporary workers in ag., ports and fishing)	1.3	0.0%	0.3	0.001%

	Beneficiaries		XXXIV. EXPENDITURE	
	1.000s	% total labor force	10^6 US$	% GDP
6. **Proyecto apoyo a los progr. de inserción laboral para personas con discapacidad** Policy formulation and pilot program for labor market insertion of handicapped workers	0.1	0.0%	0.1	0.000%
7. **Programa de capacitación e inserción laboral para personas con discapacidad.**	0.6	0.0%	0.9	0.002%
8. **Programa de rehabilitación, capacitación e inserción laboral para personas discapacitadas.**	0.2	0.0%	0.1	0.000%
9. **Programa de formación y capacitación para el trabajo.** Adult training program privately operated.	1.2	0.0%	0.4	0.001%
Costa Rica	13.1	**1.2%**	60.6	**0.73%**
3. **Llave en mano.** Contracting out of training activities by the public training institution (INA)	n.a.		n.a.	
5. **Formación y reconversión para los movilizados** Training for displaced public sector workers	1.5	0.1%	n.a.	
6. **Talleres públicos** Training of low-income workers in marginal urban areas	6.2	0.6%	n.a.	
7. ***Formación profesional para el desarrollo socio* laboral de personas con discapacidad** Training of handicapped workers	1.0	0.1%	n.a.	
8. **Prog. de becas de capacitación para el empleo del Ministerio de Trabajo y Seguridad Social** Scholarships for training of workers with secondary education.	4.4	0.4%	0.1	
Jamaica	43.5	**4.4%**	18.6	**0.44%**
1. **Skills 2000** Training for out-of-school and unskilled unemployed workers	40.0	4.1%	11.4	0.3%
2. **Special Training Empowerment Programme** (STEP) Youth training	0.6	0.1%	4.6	0.1%
3. **Strategies to Rehabilitate Inner Cities through Viable Enterprises** (VIABLE) Urban youth training	n.a.		n.a.	
4. **National Youth Service** (NYS) Training temporary employment for unemployed youth	2.9	0.3%	2.6	0.06%
Mexico	410.3	**1.8%**	135	**0.04%**
1. **Programa de Becas de Capacitación para Desempleados** (PROBECAT) Training and scholarships for unemployed workers	410.3	1.8%	135	0.038%
Peru	1.5	**0.1%**	5.0	**0.01%**
1. **Programa de Capacitación Laboral Juvenil** (PROJOVEN) Scholarships and training for unemployed youth	1.5	0.1%	5.0	0.01%