



Argentina: Preconditions for the Establishment of a Fiscal Rule including a Structural Fiscal Balance Component

Carlos Gabriel Rivas

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Abstract^{*}

This paper discusses Argentina's preparedness to implement a structural fiscal balance (SFB) rule. The authors conclude that the country does not yet have the conditions required to consider establishing a SFB rule. From the 11 preconditions outlined, Argentina only meets two of them—debt sustainability and soundness of the financial system—and with important caveats. On one hand, in order to preserve the sustainability of indebtedness, it becomes necessary to maintain a deficient tax structure; on the other, the banking system's soundness could be impacted by the lack of independence of the Central Bank of Argentina from the executive branch.

JEL Codes: E62, H60

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^{*} The author for the collaboration provided by Mr. Murat Nakas and Mr. Abel Viglione.

1. Introduction

During the last decade Argentina's macroeconomic performance has been extremely volatile. In 2002, Convertibility and the fixed exchange rate regime were set aside, and at the same time a selective public debt default was declared. That debt was later partially restructured in 2005. The 2002 crisis led to a GDP reduction of over 10 percent per year, which as could be expected had a significant impact on the fiscal accounts and on employment. Starting in that year, the country began experiencing a process of significant recovery of economic activity, sustained by a very favorable evolution in exports prices. Fiscal accounts improved, although they were sustained on a tax structure that was very deficient. That is, it was strongly dependent on specific taxes (bank transaction fees¹ and export tariffs²) that were against the principles of fiscal federalism and long-term sustainability, since they can have very negative effects on private activity. In particular, export tariffs are only sustainable if international prices remain strong and internal cost structures do not increase.

In 2008 and 2009 the economy was impacted by the world financial crisis, which substantially reduced its growth and its fiscal results. This was worsened by the permanent increase in expenditures, which occurred as a result of decisions taken in the context of the June 2009 parliamentary elections.

The decision to embark on what has been called the pensions counter-reform allows the treasury to collect temporary net revenues, since in the future the outflows associated with accounts payable to future pensioners will tend to increase. The reforms that were implemented were as follows:

1. 2006 moratorium: instrumentation of access to benefits without having made prior contributions, through the assignment of a debt that is deducted from the beneficiary's assets in sixty installments.

¹ Tax on funds movements in and out of bank checking accounts, with a total rate of 1.2 percent.

² With a maximum tax rate of 35 percent in the case of soybeans.

2. 2007 reform: primarily, increase of the PAP³ (from 0.85 percent to 1.5 percent of the salary of the previous 10 years) and transfer of undecided pensioners to the distribution system (instead of the AFJPs).
3. 2008 counter-reform: appropriation of AFJP's financial asset stock and collection of all affiliate contributions through the distribution system.

As we shall see in the present analysis, of the 11 preconditions required to establish a Structural Fiscal Balance (SFB) type rule, Argentina only complies with two, and in both cases important caveats exist:

- In order to preserve the sustainability of indebtedness it becomes necessary to maintain a deficient tax structure.
- The banking system's soundness could be impacted by the lack of independence of the Central Bank of Argentina (BCRA) from the executive branch.

The other required preconditions are not currently met. During the last two decades the country has failed almost completely to maintain fiscal rules. We wonder: can any valuable lessons be learned from these failures?

Paradoxically, at this time the country has four laws in force that address issues of fiscal solvency, but none of these is being observed. With the probable exception of Law 24156/1992, the Financial Management Law, the other three pieces of legislation were drafted more as a response to specific short-term situations than as instruments designed to achieve long-term fiscal solvency. Their short-term targets included a reaffirmation of expectations that appropriate fiscal behaviors would be followed (always in the future), and that financing agreements would be signed with multilateral organizations. Long-term targets were never respected; the Table presented below clearly shows the number of times that these laws were modified.

³ PAP: "Prestación Adicional por Permanencia," pension increases associated with continuing contributions.

Law	Publication date	Known as	Number of norms that modify it	Number of norms it modifies	Status
24156	10/29/1992	FINANCIAL MANAGEMENT AND CONTROL SYSTEMS	354	3	In effect
25152	09/21/1999	FISCAL CONVERTIBILITY REGIME	38	3	In effect
25453	07/30/2001	ZERO DEFICIT	14	14	In effect
25917	08/25/2004	FEDERAL FISCAL RESPONSIBILITY REGIME	34	3	In effect

In general, the common denominator that is present in this behavior is the fiscal rules' lack of consistency and coherence with the rest of the macroeconomic policies adopted during these years, as well as the institutional weaknesses that prevented the compliance with or observance of rules. Institutional weaknesses have worsened, and Argentina has become an example of why in the absence of certain preconditions the rules will not only fail, but also damage the credibility of fiscal institutions and of economic policy in general.

This pattern of non-compliance with norms is a clear indication that laws cannot, by themselves, replace a weak institutional framework. Furthermore, the lack of compliance contributes to exacerbate the precariousness of existing institutions.

In this regard, Argentina is a good example of what should not be done with the fiscal rules, since when applied in environments beset with high volatilities and low credibility in the sustainability of fiscal policy, the rules not only fail to fulfill their function: they also wind up losing their credibility as useful institutional mechanisms to achieve fiscal discipline, strengthen long term fiscal solvency, and improve fiscal policy's anti-cyclical capabilities, objectives that become possible when this policy is based on a structural fiscal balance (SFB).

Clearly, before adopting new fiscal rules the country would need to comply with its current legislation. This would require an adjustment both of the public sector's expenditures and of its revenues, a prospect which does not seem to be on the current administration's agenda. The federal tax system must also be discussed and redesigned; again, this is not a topic on the government

party's political agenda. This would seem to indicate that the times are not auspicious for the introduction of fiscal rules at a time in which the country continues to show a significant degree of institutional fragility. This does not mean, however – from a less ambitious perspective – that the calculation of the SFB cannot be used as a guide for fiscal policy. Eventually, as the perception of the importance of this exercise becomes more widespread, this could provide the foundations for a sustainable medium-term and long-term program of fiscal discipline.

In the following sections, we shall analyze the evolution of the Argentinean economy's main fiscal and debt indicators. In Section 2, we will examine the evolution of the fiscal situation, evaluating the behavior of the main revenue and expenditure items during the period, analyzing these items' recent structure, the evolution of primary and overall balance, the evolution of the Debt/GDP ratio, the composition of debt in 2009, the evolution of actual GDP during the period, the main factors that explain the GDP's volatility, and the main factors that explain revenue and expenditure volatility. In Section 3 we present the accounting and methodological adjustments required to measure the Structural Fiscal Balance (SFB) and estimate the cyclical and permanent components of GDP. In Section 4, we present the dynamics of indebtedness and the calculation of the projected sustainable primary balance. We then enumerate the fiscal agreements between the various national and subnational governmental levels, as well as the legal or economic restrictions on public expenditures that can have an impact on the SFB rule. Finally, we present a summary of the current situation of the Argentinean financial system, analyzing some of its most relevant indicators to determine whether risk factors exist that may have an incidence on the SFB. In Section 5 we discuss if the present situation would allow the establishment of fiscal rules in the country, arriving at a negative conclusion. In closing, Section 6 presents an outlook on the country's future financial stability.

2. Evolution of the Fiscal Situation

2.1. Analysis of the Evolution of the Main Revenue and Expenditure Items during 1998–2009

This section discusses the evolution of the revenues and expenditures of the non-financial national public sector⁴ (NFSP) as a percentage of GDP. It is useful to keep in mind that both revenues and expenditures (its main components) have procyclical behaviors. In Table 1 we show the elasticities relative to GDP calculated for the 1998–2008 period, as well as the quality of the fitness. Coefficients were calculated on the basis of the nominal value of the variables.

Table 1			
	Coefficient	t-Test	R2
Total revenue	1.35	9.66	80%
Tax revenue	1.38	7.58	70%
Soc. Sec. Contrib.	1.45	5.24	60%
Profits	1.35	3.98	28%
VAT	1.33	6.49	70%
Primary Expenditure	1.28	11.41	85%
Consumption Expenditure	1.04	9.00	80%
Soc. Sec. Contrib.	1.12	5.27	57%
Private Sector Transfers	1.66	6.14	58%
Public Sector Transfers	1.27	6.80	66%
Co-participation Revenues	1.33	4.83	52%
Capital Expenditures	2.00	4.27	48%

Source: Author's calculations.

During the last 10 years, total revenues increased by 10 percentage points in relation to GDP. After experiencing an erratic trend and reaching a trough in 2002, the indicator gradually increases and reaches 29 percent in 2009. These increases, which will be analyzed later in greater detail, are due mostly to the introduction of new taxes, the pensions counter-reform, or the inclusion of one-off extraordinary transfers.

⁴ Includes all transfers to the provinces and the City of Buenos Aires. The original series was reconstructed to take this aspect into account, since as of 2008 official publications ceased to reflect the automatic transfers or collected revenue sent to those destinations.

Social Security Contributions declined from 4 percent of GDP in 1998 to 3.1 percent in 2002/2003. After the sudden reversal of the business cycle, this component began to gradually increase up to over 5 percent, and eventually reached a level slightly below 7 percent after the reversal of the pension reform reversal.

Other Current Revenues did not show significant changes until 2008. The sharp increase observed in 2009 (almost doubling the value from the previous year) was due to an increase in SDR reserves close to US\$ 10 billion⁵ (0.9 percent of GDP). In the meantime, in 1999 capital revenues increased significantly as a result of the privatization of the government's remaining participation in YPF. Table 2 shows the detail of the evolution of revenues, while Table 3 shows its distribution in percentage terms.

Table 2
COMPOSITION OF REVENUE NON-FINANCIAL NATIONAL PUBLIC
SECTOR (% OF GDP)

	Total Revenue	Tax Revenue	Contrib. to Social Sec.	Other Current Revenue	Capital Revenues
1998	18.9%	13.5%	4.0%	1.2%	0.2%
1999	20.3%	13.6%	3.8%	1.8%	1.0%
2000	19.6%	14.3%	3.8%	1.4%	0.1%
2001	18.8%	13.8%	3.6%	1.3%	0.1%
2002	17.6%	12.8%	3.1%	1.7%	0.0%
2003	20.5%	16.2%	3.1%	1.2%	0.0%
2004	23.5%	18.7%	3.3%	1.5%	0.0%
2005	23.8%	19.2%	3.5%	1.1%	0.0%
2006	24.2%	19.0%	3.9%	1.3%	0.0%
2007	27.0%	20.3%	5.5%	1.2%	0.0%
2008	27.9%	21.1%	5.3%	1.5%	0.1%
2009	29.2%	19.6%	6.7%	2.9%	0.0%

⁵ The IMF capitalization provided US\$ 2,565 million; the amount was recorded by the National Government as current revenue (for an amount equivalent to A\$ 9,598 million).

Table 3
COMPOSITION OF REVENUE NON-FINANCIAL NATIONAL PUBLIC
SECTOR

	Total Revenue	Tax Revenue	Contrib. to Social Sec.	Other Current Revenue	Capital Revenues
1998	100.0%	71.4%	21.2%	6.5%	0.9%
1999	100.0%	67.3%	19.0%	8.9%	4.8%
2000	100.0%	73.1%	19.2%	6.9%	0.7%
2001	100.0%	73.7%	19.1%	6.9%	0.4%
2002	100.0%	72.7%	17.6%	9.5%	0.2%
2003	100.0%	78.7%	15.1%	6.1%	0.1%
2004	100.0%	79.5%	13.9%	6.4%	0.1%
2005	100.0%	80.7%	14.7%	4.4%	0.2%
2006	100.0%	78.4%	16.2%	5.3%	0.2%
2007	100.0%	75.1%	20.4%	4.4%	0.1%
2008	100.0%	75.5%	19.0%	5.3%	0.2%
2009	100.0%	67.2%	23.0%	9.8%	0.1%

When analyzing the composition of tax revenues⁶ (including Social Security), it can be seen that although the collection of traditional taxes (taxes on profits⁷ and VAT) does increase, revenues would have been much more modest should two new taxes not have started to generate revenues in 2002 (year in which they fully entered into effect): taxes on financial deposits and withdrawals, and taxes on merchandise exports (called “retentions”).

By 2009 these new taxes had grown to 4.6 percent of GDP. As will be discussed below, if these taxes had not been collected the financial results for every year in the examined period would have been negative. This indicates that the flexibility the authorities had to diminish the rate levels of these taxes (mainly of the “retentions”) was limited or non-existent, even in situations in which business profitability had been seriously compromised due to sharp declines in the international prices of the taxed products. These taxes now represent close to 18 percent of

⁶ This information is obtained from the monthly Revenue Collection Report prepared by the Treasury Department. The information included in the previous figure was obtained from the Savings-Investment Mechanism, prepared by the same Secretariat. The consolidation of the data obtained from these two sources is not necessarily exact.

⁷ In the case of the tax on profits, it must be observed that starting in 2002 the adjustment of company assets to account for inflation was no longer allowed, and therefore the rate applied to companies (35 percent) became effectively higher, particularly for those enterprises that had greater stocks of fixed assets and inventories.

all revenue collection. Table 4 shows the composition of tax revenues during the examined period in terms of GDP, while Table 5 shows their structure in terms of percentages.

Table 4
COMPOSITION OF TAX REVENUES, INCLUDING SOCIAL SECURITY (% OF GDP)

	On Profits	VAT	Bank Debit and Credit	Social Security	Export Tariffs	Other	TOTAL	NET TOTAL (1)
1998	3.2%	7.0%	0.0%	3.4%	0.0%	3.1%	16.7%	16.7%
1999	3.3%	6.6%	0.0%	3.2%	0.0%	3.7%	16.8%	16.8%
2000	3.7%	6.7%	0.0%	3.2%	0.0%	3.7%	17.3%	17.3%
2001	3.8%	5.7%	1.1%	3.0%	0.0%	3.3%	16.9%	15.8%
2002	2.9%	4.9%	1.6%	2.6%	1.6%	2.6%	16.1%	13.0%
2003	3.9%	5.6%	1.6%	2.6%	2.5%	3.1%	19.2%	15.2%
2004	5.0%	6.9%	1.7%	2.8%	2.3%	3.2%	22.0%	17.9%
2005	5.3%	6.9%	1.8%	3.1%	2.3%	3.1%	22.4%	18.3%
2006	5.1%	7.2%	1.8%	3.6%	2.2%	2.9%	22.9%	18.9%
2007	5.3%	7.7%	1.9%	4.3%	2.5%	2.9%	24.6%	20.2%
2008	5.2%	7.8%	1.9%	5.0%	3.5%	2.8%	26.1%	20.7%
2009	4.8%	7.6%	1.8%	6.6%	2.8%	2.9%	26.6%	22.0%

(1) Tax revenues net of Financial Transactions Tax and Exports Tax.

Table 5
COMPOSITION OF TAX REVENUES (INCLUDING SOCIAL SECURITY)

	On Profits	VAT	Bank Debit and Credit	Social Security	Export Tariffs	Other	TOTAL
1998	19.0%	41.7%	0.0%	20.5%	0.1%	18.8%	100.0%
1999	19.4%	39.4%	0.0%	19.2%	0.1%	22.0%	100.0%
2000	21.3%	38.7%	0.0%	18.3%	0.1%	21.6%	100.0%
2001	22.2%	33.8%	6.5%	17.7%	0.1%	19.7%	100.0%
2002	17.7%	30.2%	9.6%	16.2%	9.9%	16.3%	100.0%
2003	20.4%	29.0%	8.2%	13.4%	12.7%	16.3%	100.0%
2004	22.7%	31.5%	7.8%	12.9%	10.4%	14.7%	100.0%
2005	23.5%	30.9%	7.9%	13.7%	10.3%	13.6%	100.0%
2006	22.4%	31.4%	7.8%	15.7%	9.8%	12.9%	100.0%
2007	21.5%	31.4%	7.5%	17.7%	10.2%	11.7%	100.0%
2008	19.9%	29.8%	7.2%	19.0%	13.4%	10.7%	100.0%
2009	18.2%	28.7%	6.7%	24.8%	10.5%	11.0%	100.0%

Another way in which tax collections can be classified is by budget category. Although during the last 10 years every component grew in relation to GDP, non-budgetary components increased, after being virtually nonexistent, to a level close to 1 percent of GDP, as can be seen in Tables 6 and 7.

Table 6
REVENUE COMPOSITION BY BUDGET CATEGORY (% OF GDP)

	National Administ.	Social Security	Provinces	Non Budgetary	TOTAL
1998	8.8%	3.4%	4.5%	0.1%	16.7%
1999	9.0%	3.2%	4.6%	0.1%	16.8%
2000	9.5%	3.1%	4.6%	0.1%	17.3%
2001	8.9%	2.9%	5.0%	0.2%	16.9%
2002	9.3%	2.5%	3.8%	0.5%	16.1%
2003	11.4%	2.5%	4.3%	1.0%	19.2%
2004	13.0%	2.7%	5.2%	1.1%	22.0%
2005	13.3%	3.0%	5.3%	0.9%	22.4%
2006	13.3%	3.5%	5.3%	0.9%	22.9%
2007	12.8%	4.2%	6.7%	0.9%	24.6%
2008	13.7%	4.7%	6.7%	1.0%	26.1%
2009	12.7%	6.4%	6.6%	0.9%	26.6%

Table 7
REVENUE COMPOSITION BY BUDGET CATEGORY

	National Administ.	Social Security	Provinces	Non Budgetary	TOTAL
1998	52.7%	20.1%	26.7%	0.4%	100.0%
1999	53.5%	18.8%	27.4%	0.4%	100.0%
2000	54.9%	17.8%	26.8%	0.5%	100.0%
2001	52.4%	17.2%	29.3%	1.0%	100.0%
2002	57.7%	15.7%	23.4%	3.2%	100.0%
2003	59.3%	13.1%	22.4%	5.2%	100.0%
2004	59.2%	12.4%	23.5%	4.8%	100.0%
2005	59.1%	13.2%	23.6%	4.1%	100.0%
2006	57.8%	15.1%	23.1%	3.9%	100.0%
2007	52.0%	17.0%	27.4%	3.6%	100.0%
2008	52.6%	18.2%	25.5%	3.7%	100.0%
2009	47.7%	24.2%	24.6%	3.5%	100.0%

The composition of public expenditures, shown in Tables 8 and 9, had an evolution similar to that of revenue, increasing during the last decade by 10 percentage points (in relation to GDP). This entire increase is attributable to primary expenditure, since interest payments are equal to those registered a decade ago. This component (debt interest) reached its greatest relative share in 2001, year in which it represented 3.8% of GDP; it then fell after the 2002 default to about 2% of GDP. On the other hand, relevant changes did occur in the composition of primary expenditures, since capital expenditures almost tripled their share of GDP⁸.

Table 8
COMPOSITION OF EXPENDITURE (% OF GDP)

	Total Expenditure	Total Primary Expenditure	Current Prim. Expenditure	Capital Expenditure	Interest
1998	20.3%	18.0%	16.8%	1.3%	2.2%
1999	21.9%	19.0%	17.9%	1.1%	2.9%
2000	22.0%	18.6%	17.5%	1.0%	3.4%
2001	22.0%	18.2%	17.3%	1.0%	3.8%
2002	19.1%	16.9%	16.2%	0.7%	2.2%
2003	20.1%	18.2%	17.4%	0.8%	1.8%
2004	20.9%	19.6%	18.3%	1.3%	1.3%
2005	22.0%	20.1%	18.2%	1.9%	1.9%
2006	22.4%	20.7%	18.2%	2.5%	1.8%
2007	25.8%	23.8%	21.1%	2.7%	2.0%
2008	26.5%	24.8%	22.1%	2.6%	1.7%
2009	29.9%	27.7%	24.3%	3.4%	2.1%

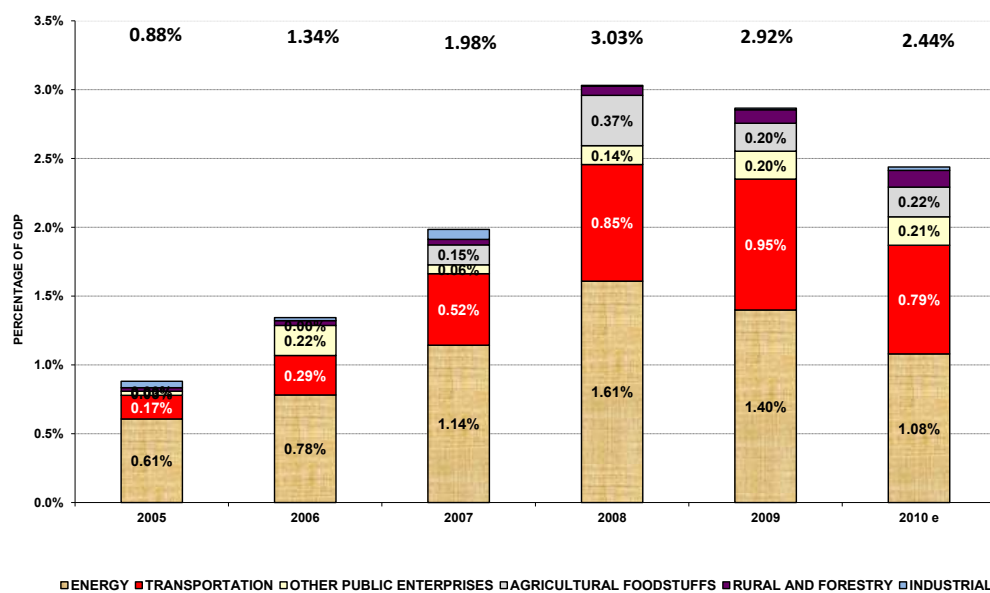
⁸ After 2004 the increase in public investment (IBIF) was significant, and was directed particularly towards public utility companies (or similar entities) that had participated in concession or privatization processes during the nineties.

Table 9
COMPOSITION OF EXPENDITURE

	Expenditure Total	Total Primary Expenditure	Current Prim. Expenditure	Capital Expenditure	Interest
1998	100.0%	89.0%	82.8%	6.2%	11.0%
1999	100.0%	86.8%	81.7%	5.1%	13.2%
2000	100.0%	84.5%	79.9%	4.7%	15.5%
2001	100.0%	82.8%	78.3%	4.5%	17.2%
2002	100.0%	88.6%	84.9%	3.7%	11.4%
2003	100.0%	90.9%	86.6%	4.2%	9.1%
2004	100.0%	93.9%	87.7%	6.2%	6.1%
2005	100.0%	91.2%	82.7%	8.5%	8.8%
2006	100.0%	92.1%	80.9%	11.2%	7.9%
2007	100.0%	92.2%	81.7%	10.4%	7.8%
2008	100.0%	93.5%	83.6%	9.9%	6.5%
2009	100.0%	92.8%	81.5%	11.3%	7.2%

The components of current primary expenditure that had the largest increases in relation to GDP were transfers to the public sector (both automatic and discretionary), and transfers to the private sector. These increases were associated with subsidies for passenger transportation in the metropolitan area, as well as for companies that produce and distribute basic services (electricity, gas and water) and were compensated for the fact that service rate adjustments were insufficient for these companies to operate normally. Also, since 2007 there was an incipient growth in expenditures to finance public company deficits after a bout of nationalizations (mainly in water distribution and passenger aviation).

Figure 1
SUBSIDIES AND LOANS (% OF GDP)



Note: data for 2010 are taken from the Official Budget.

Figure 2
ENERGY SUBSIDIES AND LOANS (% OF GDP)

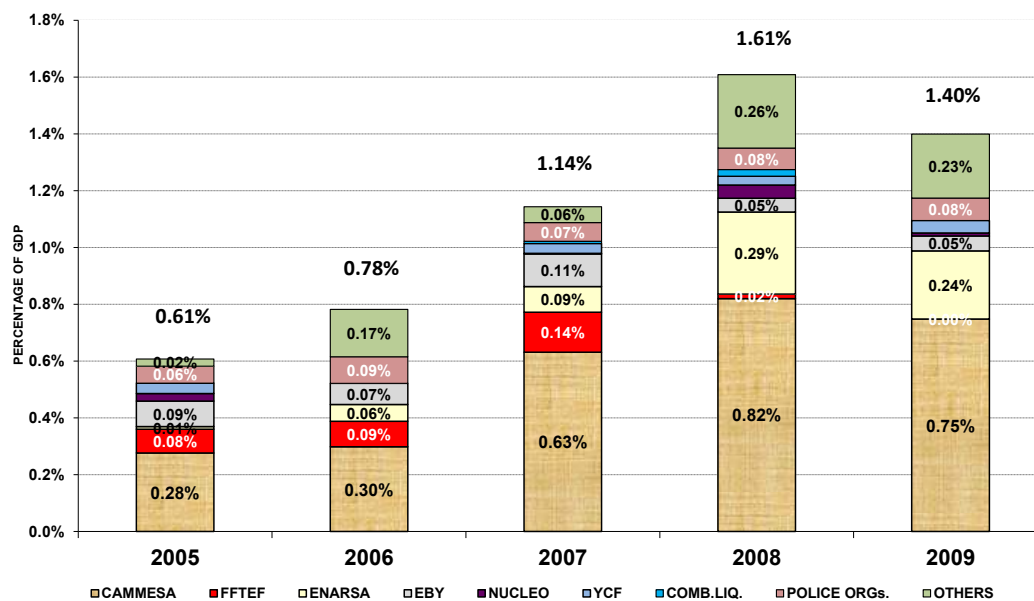
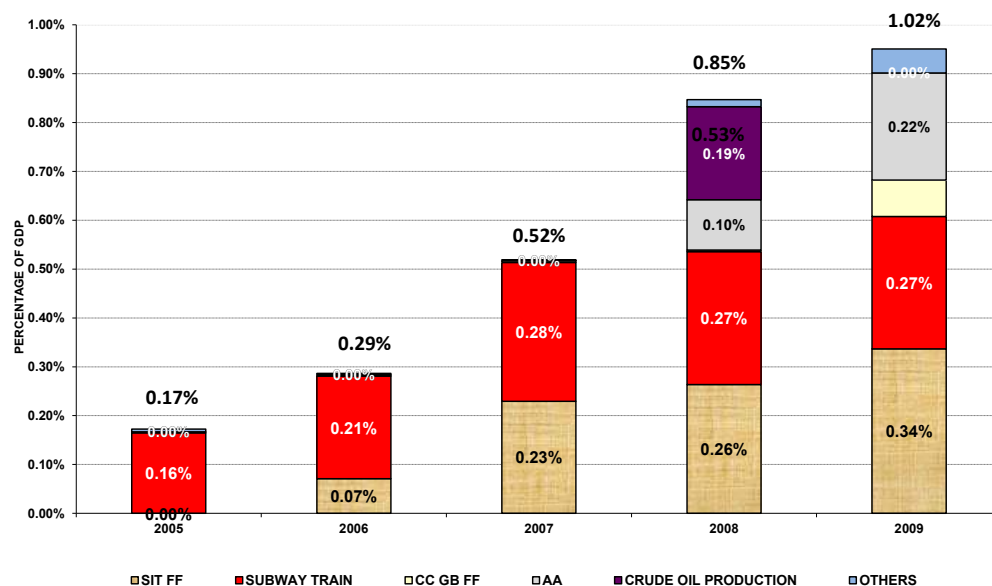


Figure 3

SUBSIDIES FOR TRANSPORTATION SECTOR (% OF GDP)



Tables 10 and 11 show the evolution in the composition of Current Primary Expenditure.

Table 10

COMPOSITION OF CURRENT PRIMARY EXPENDITURE (% OF GDP)

	Current Primary Expenditure	Consumption Expenditures	Social Security Services	Transf. Private Sector	Transf. Public Sector	Public Enterp. Deficit	Other
1998	16.8%	3.1%	5.8%	2.0%	5.9%	0.0%	0.0%
1999	17.9%	3.3%	6.1%	2.3%	6.2%	0.0%	0.0%
2000	17.5%	3.0%	6.1%	2.2%	6.2%	0.0%	0.0%
2001	17.3%	3.1%	6.2%	2.2%	5.8%	0.0%	0.0%
2002	16.2%	2.9%	5.3%	2.8%	5.2%	0.0%	0.0%
2003	17.4%	3.1%	5.2%	3.0%	6.0%	0.0%	0.1%
2004	18.3%	2.9%	5.1%	2.8%	7.4%	0.0%	0.1%
2005	18.2%	3.0%	4.7%	2.8%	7.6%	0.0%	0.1%
2006	18.2%	2.9%	4.9%	2.7%	7.5%	0.0%	0.1%
2007	21.1%	3.1%	6.2%	3.5%	8.1%	0.1%	0.2%
2008	22.1%	3.2%	6.3%	4.4%	7.9%	0.2%	0.3%
2009	24.3%	4.0%	7.3%	4.6%	8.1%	0.2%	0.3%

Table 11
COMPOSITION OF CURRENT PRIMARY EXPENDITURE

	Current Primary Expenditure	Consumption Expenditures	Social Security Services	Transf. Private Sector	Transf. Public Sector	Public Enterp. Deficit	Other
1998	100.0%	18.2%	34.9%	11.8%	35.0%	0.0%	0.2%
1999	100.0%	18.5%	34.3%	12.6%	34.3%	0.0%	0.2%
2000	100.0%	17.3%	35.0%	12.3%	35.2%	0.0%	0.2%
2001	100.0%	17.8%	35.8%	12.6%	33.6%	0.0%	0.2%
2002	100.0%	17.7%	32.7%	17.2%	32.3%	0.0%	0.2%
2003	100.0%	17.7%	29.8%	17.1%	34.6%	0.1%	0.7%
2004	100.0%	15.8%	27.9%	15.1%	40.4%	0.2%	0.6%
2005	100.0%	16.6%	25.7%	15.2%	42.0%	0.1%	0.4%
2006	100.0%	16.1%	27.1%	14.8%	41.2%	0.2%	0.5%
2007	100.0%	14.6%	29.4%	16.5%	38.4%	0.3%	0.8%
2008	100.0%	14.3%	28.2%	19.8%	35.6%	0.7%	1.2%
2009	100.0%	16.3%	29.9%	18.8%	33.4%	0.6%	1.1%

Half of the two-percentage-point increase (in relation to GDP) observed in transfers to the public sector is associated with automatic transfers for co-participations. The other half is related to transfers of a more discretionary nature, as can be seen in Tables 12 and 13.

Table 12
COMPOSITION OF TRANSFERS TO THE PUBLIC SECTOR (% OF GDP)

	Public Sector Transfers	Co-participation Revenues	Universities	Other
1998	5.9%	4.5%	0.6%	0.9%
1999	6.2%	4.5%	0.6%	1.0%
2000	6.2%	4.6%	0.6%	1.0%
2001	5.8%	4.1%	0.6%	1.1%
2002	5.2%	3.2%	0.5%	1.5%
2003	6.0%	4.2%	0.5%	1.3%
2004	7.4%	5.1%	0.5%	1.8%
2005	7.6%	5.3%	0.5%	1.8%
2006	7.5%	5.3%	0.6%	1.6%
2007	8.1%	5.6%	0.6%	1.9%
2008	7.9%	5.5%	0.7%	1.7%
2009	8.1%	5.4%	0.8%	1.9%

Table 13
COMPOSITION OF TRANSFERS TO THE PUBLIC SECTOR

	Public Sector Transfers	Co-participation Revenues	Universities	Other
1998	100.0%	76.1%	9.4%	14.5%
1999	100.0%	73.9%	10.2%	15.9%
2000	100.0%	73.8%	9.8%	16.4%
2001	100.0%	71.3%	10.5%	18.2%
2002	100.0%	61.7%	9.5%	28.9%
2003	100.0%	70.3%	8.8%	20.9%
2004	100.0%	69.3%	7.0%	23.7%
2005	100.0%	69.0%	6.9%	24.1%
2006	100.0%	70.2%	7.9%	21.9%
2007	100.0%	68.7%	7.9%	23.4%
2008	100.0%	70.0%	9.0%	21.0%
2009	100.0%	66.1%	10.5%	23.4%

2.2. Evolution of the Primary and Total Results during 1998–2008: Structure of Revenues and Expenditures in 2009

Table 14 shows that since 2003 both the primary and the financial results have experienced changes in their trends, registering satisfactory numbers up to 2008 and then declining steeply in 2009. Primary results were negative in 2009. Financial results, however, did not experience such a dramatic deterioration, since interest rates (in relation to GDP) were close to half those recorded in 2000/2001.⁹

⁹ This was due to the 2002 default, from which an agreement was reached in 2005 with some of the creditors through which the amount of capital owed was substantially reduced. However, close to 25 percent of the total

Table 14
RESULTS OF NON FINANCIAL
PUBLIC SECTOR
(% OF GDP)

	Primary Result	Financial Result
1998	0.9%	-1.4%
1999	1.2%	-1.7%
2000	1.0%	-2.4%
2001	0.5%	-3.2%
2002	0.7%	-1.5%
2003	2.3%	0.5%
2004	3.9%	2.6%
2005	3.7%	1.8%
2006	3.5%	1.8%
2007	3.2%	1.1%
2008	3,1%	1,4%
2009	1,5%	-0,6%

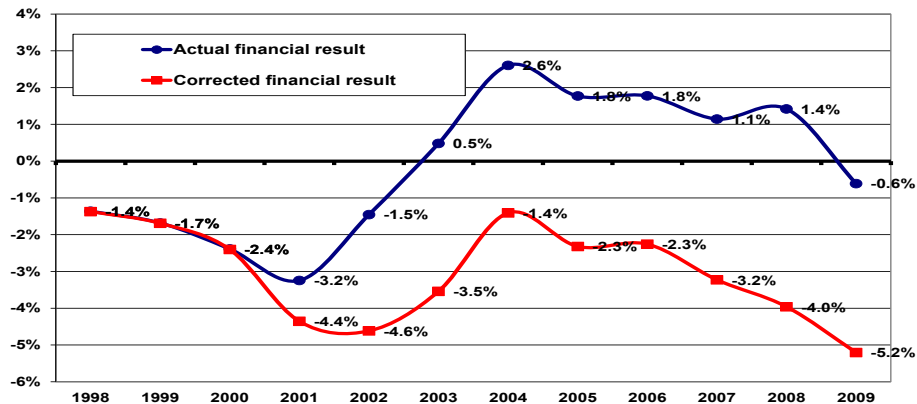
However, if the financial results were to be adjusted, subtracting the revenue obtained from the two new taxes mentioned in the last section, the fiscal situation would be alarming, presenting values for 2009 that are even lower than those recorded in 2001 and 2002. This scenario is shown in Table 15 and Figure 4.

debt did not participate in the agreement, a situation that was presumably in the process of being regularized towards the middle of 2010.

Table 15**ADJUSTED RESULTS OF NON FINANCIAL PUBLIC SECTOR
(% OF GDP)**

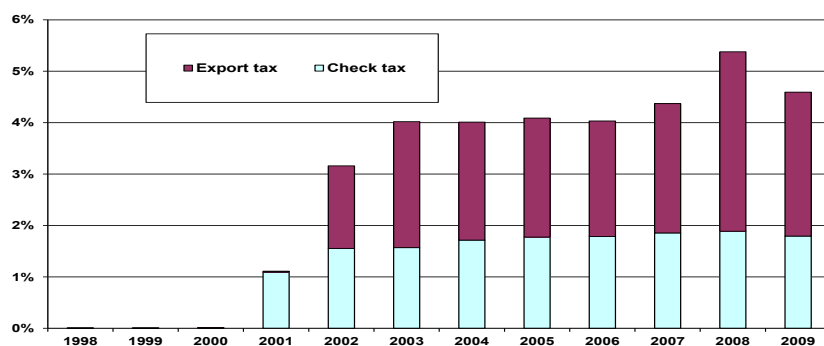
	Actual Financial Result	Bank Debit and Credit	Export Tariffs	Adjusted Financial Result
1998	-1.4%	0.0%	0.0%	-1.4%
1999	-1.7%	0.0%	0.0%	-1.7%
2000	-2.4%	0.0%	0.0%	-2.4%
2001	-3.2%	1.1%	0.0%	-4.4%
2002	-1.5%	1.6%	1.6%	-4.6%
2003	0.5%	1.6%	2.5%	-3.5%
2004	2.6%	1.7%	2.3%	-1.4%
2005	1.8%	1.8%	2.3%	-2.3%
2006	1.8%	1.8%	2.2%	-2.3%
2007	1.1%	1.9%	2.5%	-3.2%
2008	1.4%	1.9%	3.5%	-4.0%
2009	-0.6%	1.8%	2.8%	-5.2%

Figure 4
FINANCIAL RESULT (% OF GDP)



The so-called “Check Tax” was introduced during the second quarter of 2001; that year it collected an amount equivalent to slightly over 1 percent of GDP. In 2002, “retentions” were established (collected mostly through taxes on agricultural products) and the rate of the Check Tax was increased to the maximum allowed by law (1.2 percent of transactions). The decrease in the combined contribution of both taxes to 2009’s revenue is almost fully explained by the decline in “retentions” collection associated with a fall in foreign sales (both in volume and prices).

Figure 5
CONTRIBUTION OF “CHECK” TAX AND EXPORT TAX (% OF GDP)



2.3. Evolution of Debt/GDP Ratio During the 1998-2008 Period: Debt Composition, Maturities, Currency Denomination, and Interest Rates

National Public Sector debt, described in Tables 16 and 17, (in current foreign currency) shows marginal changes in size compared to 2001. However, a change is seen in its composition. The 2009 structure is closer to the one that existed in 1998, when there was a greater share of Public Bonds and Treasury Bills, and a smaller share of Loans. This is due to the fact that once default risk perception starts to increase, the stock of public bonds issued in capital markets becomes difficult to maintain, which has the effect of increasing the issuance of loans from international organizations and the local private banking sector (many of which were issued quasi-compulsorily). A peculiarity observed in 2009 is the debt incurred with BCRA and the arrears for which restructuring is still pending (primarily with the “Club of Paris”). The debt that remained outside the swap (after the 2002 default) is not included in the public debt total.

Table 16
NATIONAL PUBLIC SECTOR DEBT BY YEAR AND BY INSTRUMENT
(MILLIONS OF US\$)

	1998	2001	2009
<i>I – TOTAL PUBLIC DEBT</i>	<i>114,134</i>	<i>144,222</i>	<i>147,118</i>
<u>II – DEBT DUE</u>	114,134	144,194	140,873
<u>PUBLIC BONDS AND TREASURY BILLS</u>	82,363	83,051	93,090
<u>LOANS</u>	31,771	61,143	38,157
GUARANTEED LOANS	-	21,284	4,541
INTERNATIONAL ORGANIZATIONS	19,167	32,357	16,209
GOVERNMENT AGENCIES	7,634	5,876	1,749
GUARANTEED DEBT – (BOGAR)	0	0	10,088
COMMERCIAL BANKS	3,585	715	5,102

OTHER CREDITORS	1,385	911	468
<u>TEMPORARY BCRA ADVANCES</u>	-	-	9,626
<u>III – ARREARS PENDING TO BE RESTRUCTURED</u>	-	28	6,245
<u>TOTAL REMAINING DEBT AFTER THE SWAP</u>	-	-	29,808

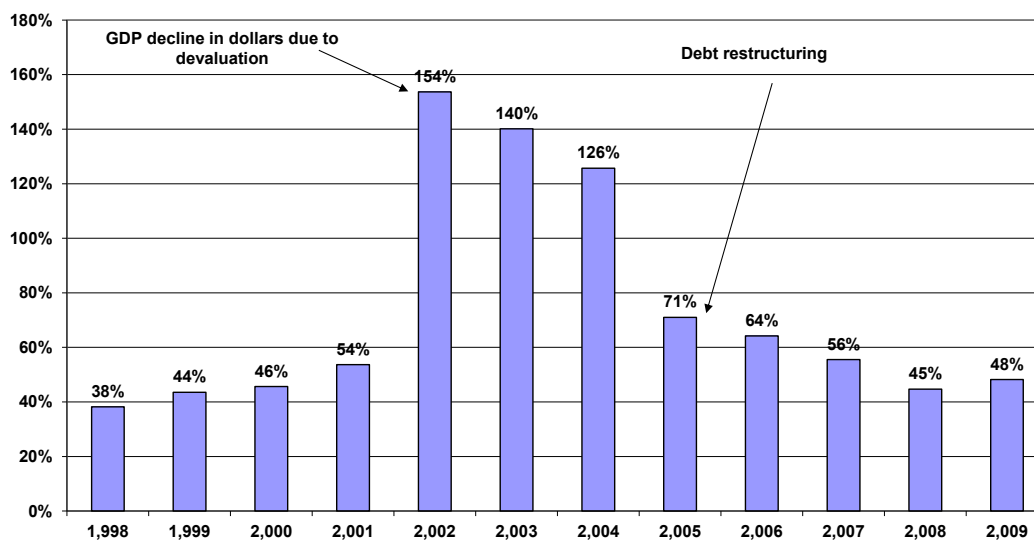
Table 17
NATIONAL PUBLIC SECTOR DEBT BY YEAR AND BY INSTRUMENT
COMPOSITION

	1998	2001	2009
<i>I – TOTAL PUBLIC DEBT</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>
<u>II – DEBT DUE</u>	100%	100%	100%
<u>LOANS</u>	28%	42%	26%
GUARANTEED LOANS	0%	15%	3%
INTERNATIONAL ORGANIZATIONS	17%	22%	11%
GOVERNMENT AGENCIES	7%	4%	1%
GUARANTEED DEBT – (BOGAR)	0%	0%	7%
COMMERCIAL BANKS	3%	0%	3%
OTHER CREDITORS	1%	1%	0%
<u>TEMPORARY BCRA ADVANCES</u>	0%	0%	7%
<u>III – ARREARS PENDING TO BE RESTRUCTURED</u>	0%	0%	4%

The debt to GDP ratio registered a very significant increase in 2002, as a result of a calculation of GDP value in foreign currency at an exchange rate much greater than the one used the year before, and in which the real exchange rate was still beginning to adjust after attaining very high levels (initial overshooting). As the real exchange rate adjusted, the ratio fell consistently up to 2005 (after a substantial portion of the defaulted debt was restructured), year in which it reached a level slightly over 70 percent (see Figure 6).

The stability of the foreign currency debt stock and the consequent nominal increase in national currency GDP, which when valued at a stable exchange rate registered GDP values in dollars that increased over 20 percent, made the debt/GDP ratio reach levels similar to those observed during the two years that preceded the default declaration. However, and although the Debt/GDP ratio for these two different periods is very similar, there are three elements make the previous situation incomparable to the current one. Although these differential elements have gradually lost their significance with the passage of time, they continue to be present.

Figure 6
PUBLIC DEBT (% OF GDP)



One of the significant differences is the debt maturity profile. In 2001 debt maturities were more concentrated in the short term, a situation corrected after the 2005 renegotiation. In 2001 over half the debt matured in 5 years; in 2009 this feature accounts for slightly over a third of the entire debt, as can be seen in Figures 7 and 8.

Figure 7
PROFILE OF DEBT MATURITIES (YEARS)

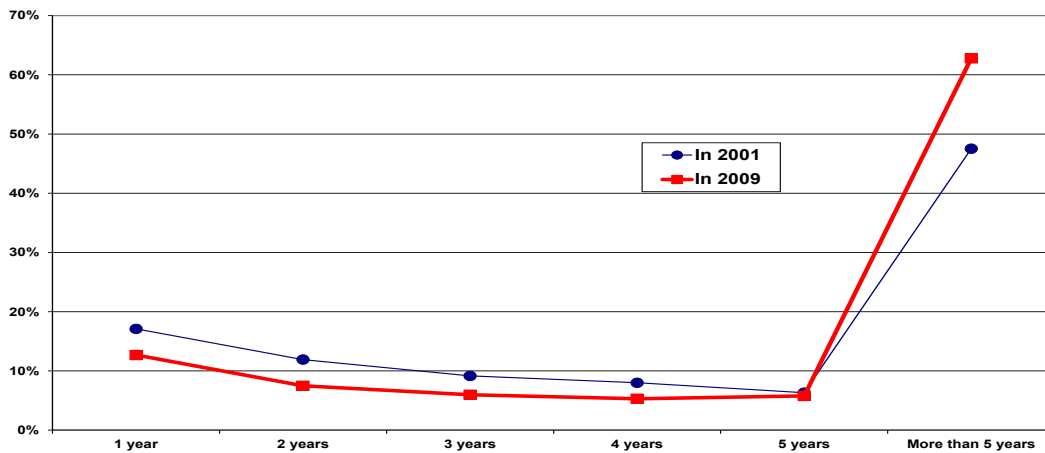
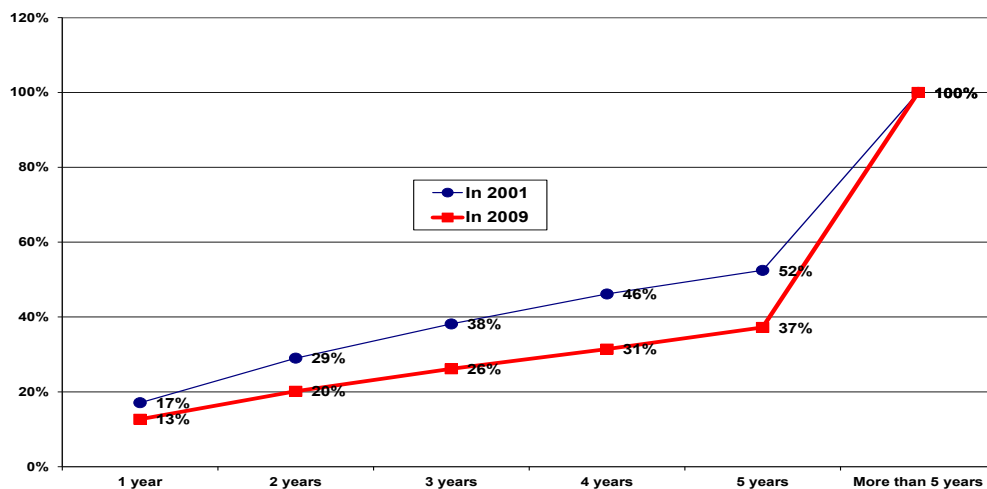


Figure 8
PROFILE OF ACCUMULATED DEBT MATURITIES (YEARS)



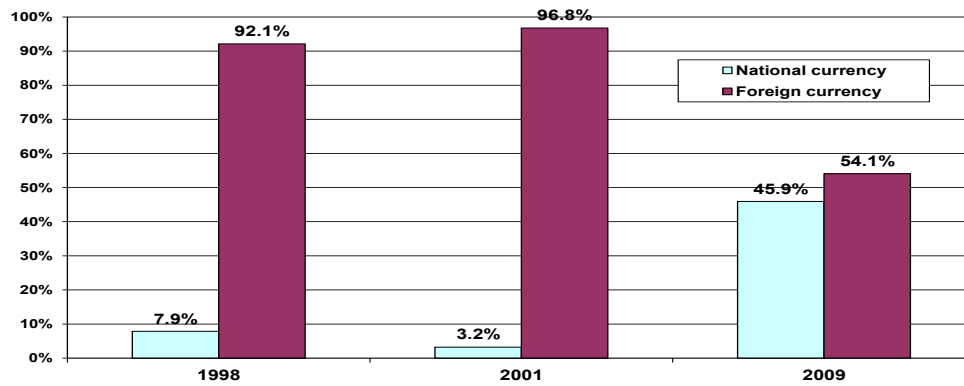
The 2005 renegotiation significantly increased the debt's average life, taking it from 8.3 years in 2001 to 11.1 in 2009, after attaining an average of 13 years in 2006. This indicator doubled in the case of public bonds and treasury bills. Regarding loans, that category shows a stable or slightly higher average life in all its modalities, except for the guaranteed loans, which were exchanged for the public bonds that local financial institutions had kept in their portfolios. An additional voluntary swap implemented in 2009 also increased the average life of these instruments. Meanwhile, the average life of loans to commercial banks declined to below half the 2008 average. Table 18 shows this evolution for selected years.

Table 18
AVERAGE LIFE OF NATIONAL PUBLIC DEBT (YEARS)

	2001	2006	2007	2008	2009
TOTAL AVERAGE LIFE	8.3	12.9	12.6	11.7	11.1
Public Bonds and Treasury Bills	7.3	17.3	16.6	15.4	14.3
Total Loans	14.8	5.8	5.5	5.2	5.3
- International organizations	3.7	5.5	6.0	6.4	7.2
- Government Agencies	4.5	4.2	3.5	3.7	4.2
- Guaranteed loans (November 2001 Swap)	13.9	6.5	6.2	5.5	10.1
- Guaranteed Provincial Bonds		7.3	6.6	5.9	5.2
- Commercial Banks	3.9	26.7	18.1	13.6	5.9
- Other Creditors	4.5	1.4	1.2	1.1	3.7
- Temporary advances		1.0	1.0	1.0	1.0

Another differentiating aspect is the debt's currency composition. Before the default declaration, debt denominated in foreign currency constituted about 97 percent of the total. In contrast, by 2009 foreign currency debt represented only 54 percent of total debt; the rest was denominated in local currency (see Figure 9).

Figure 9
PUBLIC DEBT: COMPOSITION BY CURRENCY



The implicit interest rate (calculated by dividing the interest payments by the average debt stock in the current and previous year) fell by 5 percentage points as soon as the payments default was declared. The marginal decline in 2001 compared to the previous year was due to the assistance provided by international organizations at rates lower than those prevailing in the market. After the debt renegotiation, the implicit rate increased gradually, reaching 5 percent in 2009 (although its levels continued to remain below those of 1998–2001). This evolution can be seen in Figure 10. Table 19 shows the debt composition by currency and interest rate.

Figure 10
IMPLICIT INTEREST RATE (INTEREST PAID / DEBT STOCK)

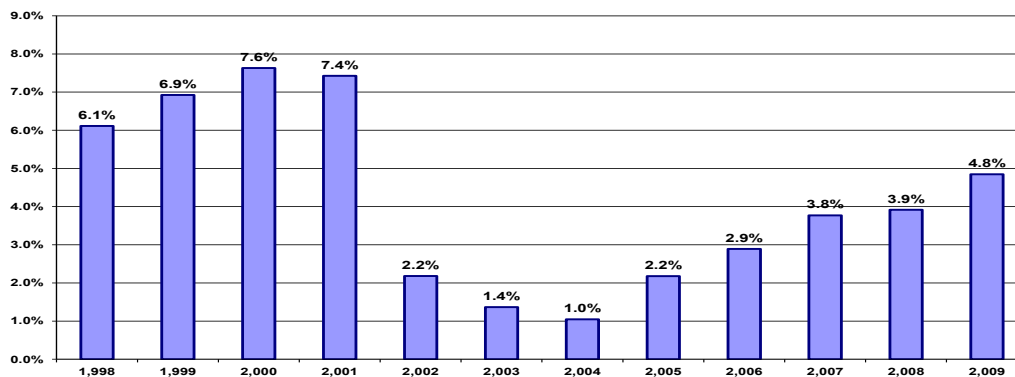


Table 19
NATIONAL PUBLIC SECTOR DEBT
COMPOSITION BY CURRENCY AND RATE

	Millions of US\$	%
Local Currency	67,583	45.9%
Debt not adjustable by RSC¹⁰	30,164	
<i>Fixed rate</i>	1,900	
<i>Zero rate</i>	12,346	
<i>Variable rate</i>	15,918	
Debt adjustable by RSC	37,430	
<i>Fixed rate</i>	37,430	
Foreign currency	79,526	54.1%
<i>Fixed rate</i>	52,191	
<i>Zero rate</i>	228	
<i>Variable rates</i>	27,107	
<i>Libor rate</i>	16,064	
<i>Other variable rates</i>	11,043	
TOTAL GROSS DEBT (*)	147,119	100%

Note: Excludes debt not presented to the swap.

The last differentiating factor is fiscal performance. Until the 2002 default, fiscal accounts had persistent financial deficits. Conversely, after the 2005 renegotiation financial results have experienced ups and downs, but have always remained positive. This situation was reversed in 2009.

¹⁰ RSC is the Reference Stabilization Coefficient, built on the basis of CPI (Consumer Price Index) data.

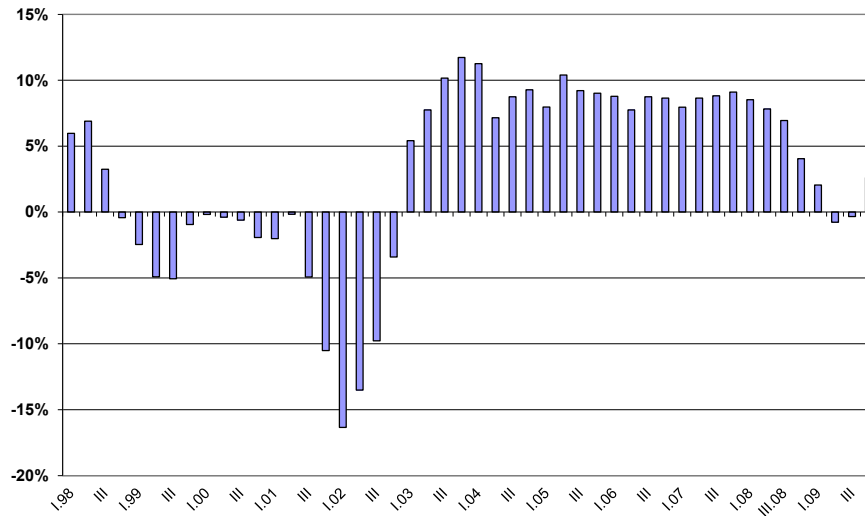
2.4. Evolution of Actual GDP during 1998–2008: Main Factors that Explain its Volatility

The evolution of GDP during the last decade, shown in Figure 4, can be disaggregated into four stages:

- Stage I: up to the third quarter of 1998. This was the last period of the decade during which growth rates were observed.
- Stage II: A period of declines in GDP begins, and later turns into stagnation, due to the impact of the Brazilian devaluation (January, 1999) and an unstable international context (with problems in Russia that began in 1998 and corrections in international stock markets).
- Stage III: the period immediately preceding the payments default and the collapse of the Convertibility Plan. Declines of over 10 percent are recorded.
- Stage IV: reversal of the international scenario; an increase in export prices; strong improvement of fiscal accounts as a consequence of the dilution of expenditure and the collection of new taxes. This stage may have reached its end in 2007, since deterioration is observed both in international conditions and in the health of fiscal accounts. Private measurements indicate that declines in GDP began in the fourth quarter of 2008.¹¹

¹¹ Private measurements calculate that in 2009 GDP declined between 2.5 percent and 4 percent. Official data for that year report a 0.9 percent increase.

Figure 11
REAL GDP (% CHANGE)



When constructing a model to explain the evolution of GDP, three explanatory variables were used.

1. TI: terms of trade levels.
2. VARCC: variation in the Current Account of the Balance of Payments as a percentage of GDP, reversing its sign.
3. RF: NFSP financial result as a share of GDP.

These three variables all have a positive relationship with GDP growth, with coefficients that are statistically significant¹².

¹² 2009 has not been included, since significant differences exist between official statistical data on economic activity and the private measurements of same.

Dependent Variable: GDP
Method: Least Squares
Sample: 1994-2008

Variable	Coefficient	t-Statistic
TI	0.00040	6,072
VARCC	1.30129	5,072
RF	1.34745	2,983
R-squared	0.831	
Adjusted R-squared	0.802	

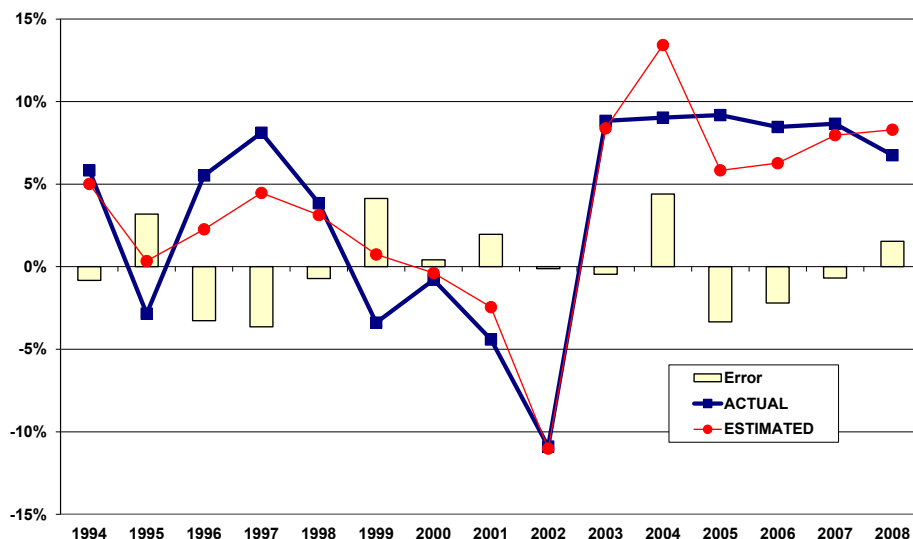
The model postulates that GDP grows when:

1. The terms of trade improve.
2. The relationship between changes in the current account of the Balance of Payments and GDP declines, indicating an increase in capital inflows or a decrease in outflows.
3. Fiscal performance improves as a percentage of GDP. This is an indicator that gauges perceptions on the public sector's solvency.

Figure 12 presents a comparison of estimated results with the actual evolution of GDP.

Figure 12

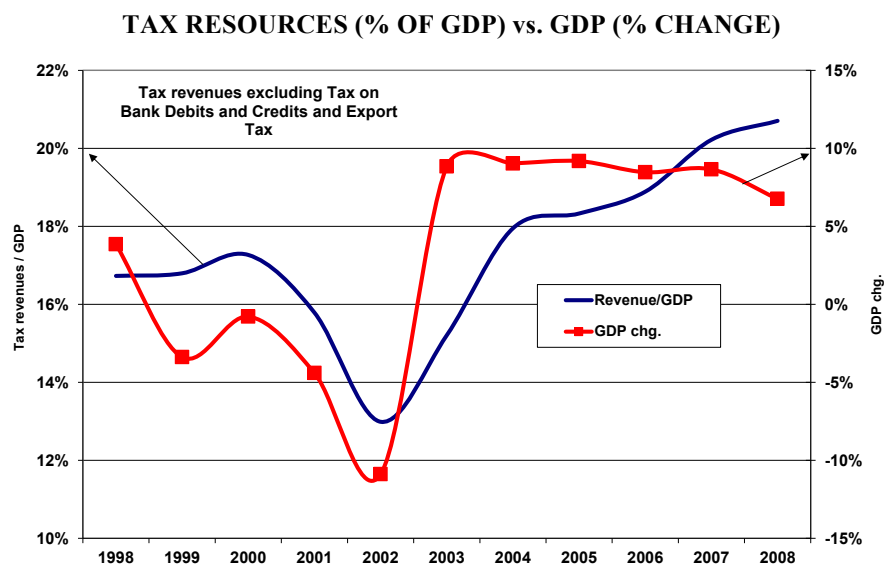
ACTUAL GDP vs. GDP ESTIMATED BY MODEL (% CHANGE)



2.5. Main Factors that Explain Revenue and Expenditure Volatility during 1998-2008

In order to make comparisons that are valid over time, the contribution of the two new taxes was subtracted from the total tax revenue. Figure 13 shows the clearly procyclical nature of revenue collections. Revenue volatility in relation to GDP can be explained to a great extent by the growth rate of GDP. This may be a consequence of the fact that the limited development of local capital markets and the virtually nonexistent access to foreign financing¹³ make the treasury operate as one of the main “financial agent” of companies and natural persons that need to overcome financial difficulties when confronting adverse economic scenarios. Although a deceleration of activity was experienced in 2009 (a phenomenon that private measurements deemed deeper than what was recorded in official statistics), fiscal revenues increased in relation to GDP due to the collection of two months of income derived from the enactment of the pensions counter-reform.

Figure 13



The behavior on the expenditure side (net expenditures, after discounting automatic transfers to the provinces) is much more erratic, as can be seen in Figure 14. It has no clear relationship with the evolution of economic activity. The causes of expenditure decisions may be more closely associated with political and financial factors. Therefore, in electoral years expenditure behavior is much more dynamic, and later weakens. Political motivations can be diverse, since occasionally priority may be given to publicizing the existence of a wide fiscal surplus. On the other hand, in other political circumstances (and if surplus resources exist) priority may be given to distributing the excess income through various kinds of transfers or be directed towards capital expenditures, giving lower priority to fiscal solvency.

¹³ Since 2002, Argentina has not participated in the voluntary foreign debt markets. From that date to 2008, Venezuela has been the only buyer of bonds issued by Argentina.

Figure 14

PRIMARY EXPENDITURE (*) (% OF GDP) vs. GDP (% CHANGE)

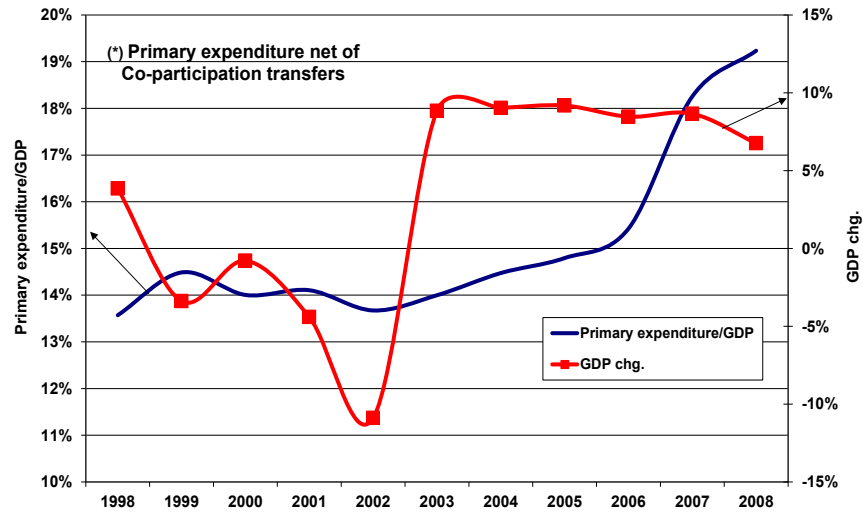


Figure 15 shows that two of the three most notorious increases in the primary expenditure/GDP ratio took place during presidential election years: 1999 and 2007. The third occurred during a year with parliamentary elections that were crucial for the government party: 2009. Meanwhile, the only two decreases of the indicator occurred during the first year of the alliance government (to counteract the growing perception that the “model” was not sustainable) and after the deep devaluation of 2002 (which generated an obvious dilution in the real value of primary expenditures).

Figure 15

PRIMARY EXPENDITURE (% CHANGE)

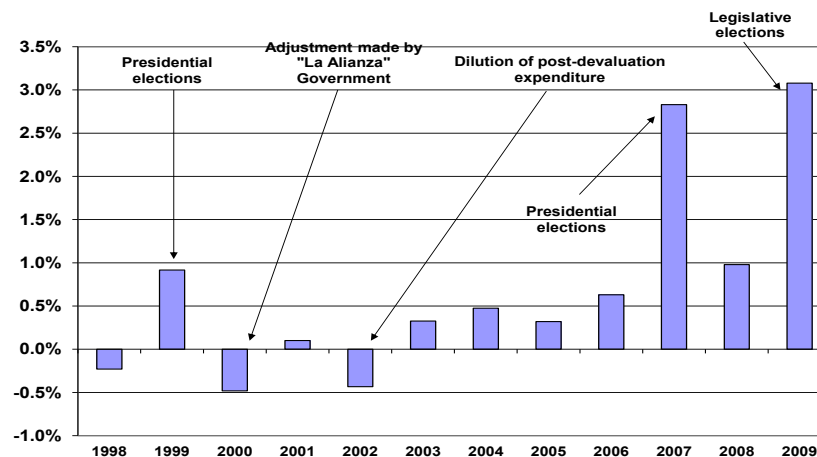
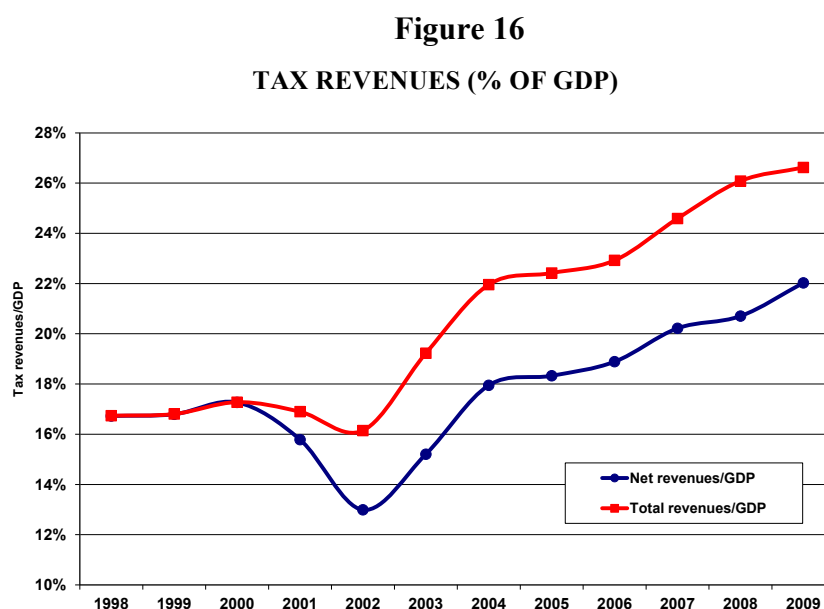


Figure 16 presents adjusted series of tax revenues in relation to GDP (excluding debit and retention taxes). We see here that the indicator's performance becomes poorer, although it continues to grow, showing a 4 percent increase (in relation to GDP).



3. Methodological Considerations

3.1. Accounting and Methodological Adjustments to the Fiscal Accounts Needed to Measure Structural Fiscal Balance (SFB)

From the point of view of revenues, the following adjustments need to be made:

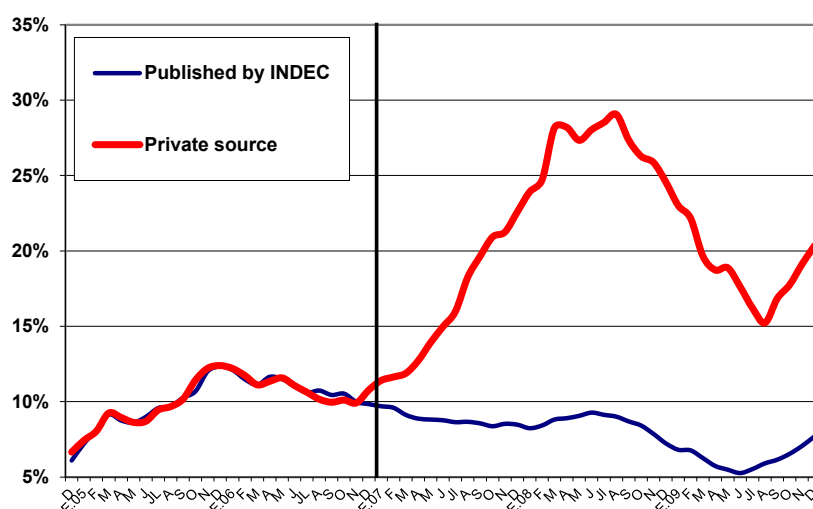
1. The creation of new taxes (debit and credit tax, and exports tax) has generated an additional collection of over 5 percent of GDP. Although their elimination, or a decrease in their rates, seems difficult in the short term (due to the clear deterioration of fiscal results observed in 2009), preserving them can generate solvency problems in the private sector (due to the collection of export taxes combined with declines in the terms of exchange) or low level of bancarization (due to the collection of the bank deposit and withdrawal tax).

2. A sharp increase in Other Current Revenue in 2009 (reaching a value that almost doubled the one recorded in the previous year) was due to an increase in DEG reserves, which was close to US\$ 10 billion. This revenue is a one-off income that should not be taken into account when constructing the Structural Fiscal Balance.
3. The substantial inter-annual increase in Social Security Contributions recorded in 2009 was due to the effects of the pensions counter-reform. Although this income will continue to flow into the Treasury, the steep increase in inter-annual change that occurred in 2009 will not happen again.

From the point of view of expenditures, the following adjustments need to be made:

1. Part of the public debt was indexed by RSC (a complementary index of the retail inflation index, or CPI). This indicator was subjected to manipulation after January 2007, and calculations indicate that an accumulated 30 percent gap of “unrecognized” inflation exists, as shown in Figure 17. Our measurements indicate that the annual rate would have been about 30 percent towards the middle of 2008. Although the debt adjusted by RSC was calculated using official statistical data, this increase in the debt stock was not included in the calculation of Financial Results.

Figure 17
ANNUAL INFLATION (%)



2. Although the pensions counter-reform contributes an additional income flow of about US\$ 12,000 million per year, provisions should be made to take into account the debt that will be owed to future pensioners who will receive their pensions from the public treasury, instead of the capitalized funds in the private system. This future debt should be included in the calculations to determine the Structural Fiscal Balance, since it will start generating additional outflows as time goes by. However, one of the possible future impacts could be a real dilution of the average asset's value, with the consequence that the same amount of money will need to be distributed among a greater number of beneficiaries.

Table 20
FINANCIAL IMPACT OF THE REFORMS

Projections of current value of 3 pension reforms from 2006 to 2008
(without taking into account assets stocks appropriated in the counter-reform)

		Reform 1	Reform 2	Reform 3	
	Discount rate	Impact of moratorium	Impact of PAP and undecided on old distribution scheme	Impact of 2008 counter-reform	Total impact
2009 Current value	2%	6.8%	8.1%	27.5%	42.5%
	4%	6.1%	5.1%	11.8%	23.0%
2050 (% of 2009 GDP)	6%	5.4%	3.5%	3.9%	12.8%
	8%	4.9%	2.5%	-0.1%	7.3%

Source: prepared by the author, based on FIEL.

Evaluated in their entirety, the changes imply a mitigation of short term financing needs, while generating greater commitments for the future.

- Taking into account the adjustments in present value (to 4 percent, an increase of US\$260 billion in implicit debt) and deducting the stock of financial assets

appropriated by the State in 2008 (US\$56 billion), the net debt increased by an equivalent of 20 percent of GDP.

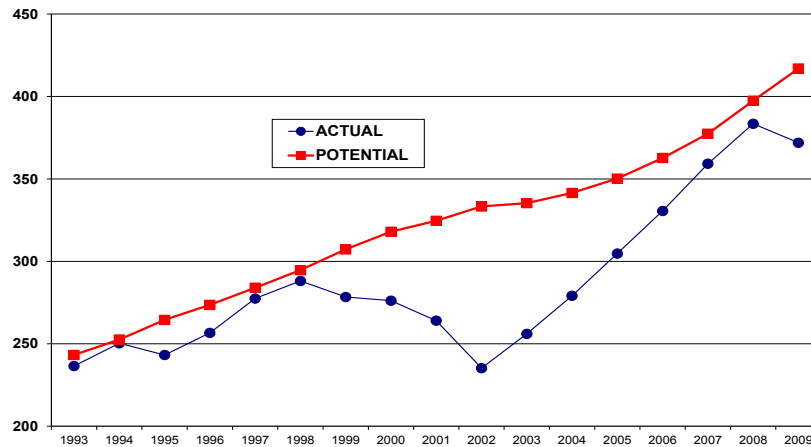
- If the surplus revenue should generate an initial greater “generosity” (extension of the moratorium, or eventual introduction of greater increases in the PAP), the fiscal problem will obviously become even greater.
 - The situation of the pension system would become even more complicated if the current assets have the size contemplated in the rights granted by that system in the past.
3. Transfers made to the private sector should decrease along with the gradual diminishing of the subsidies given for passengers’ transportation in the metropolitan area, as well as for companies that produce and distribute utilities (electricity, gas and water) who received these subsidies given that the service rate adjustments were insufficient for the companies to operate normally (see Figures 1, 2 and 3).

3.2. Cyclical and Permanent Components of GDP

During the period being examined, Argentina’ GDP grew at 3.3 percent on average, similar to the growth rate of potential GDP. This growth is explained by a 2.7 percent average annual increase in capital stock, a 2.1 percent average annual increase in the labor force, and a 1 percent average annual increase in total factor productivity. Figure 18 shows the series of potential and actual GDP.¹⁴

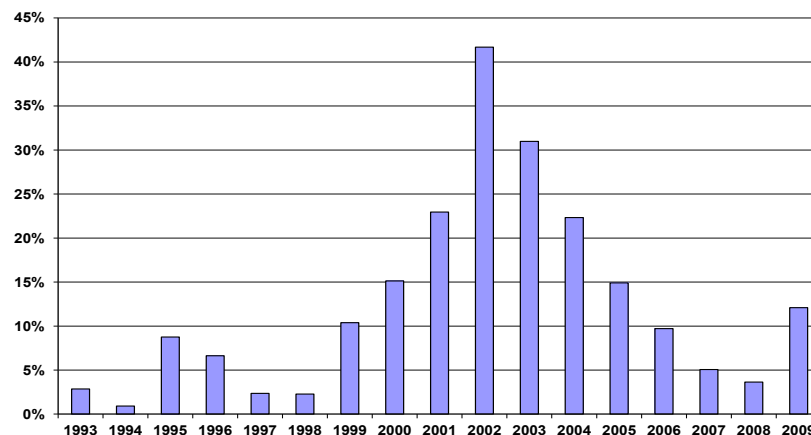
¹⁴ A private measurement was used for 2009.

Figure 18
POTENTIAL AND ACTUAL REAL GDP (1993 PRICES)



Beginning in 1999, the gap between potential and actual GDP gradually increased, and by 2002 the economy's idle capacity was close to 40 percent. Although it declined gradually from that year until 2008, this idle capacity level might be one of the main causes of the slow convergence of the real exchange rate towards an equilibrium value. In this regard, as the output gap declined (below 5 percent, according to our calculations), inflationary pressures became more apparent (2007 and 2008). The evolution of the output gap is shown in Figure 19.

Figure 19
OUTPUT GAP (% OF POTENTIAL GDP)



The GDP growth rates close to 9% that prevailed during 2003–2008 can be explained basically by a decrease of the output gap back to normal levels, since the investment rate—despite some increases after 2002—only reached levels that were slightly higher than those seen during the previous decade.

Another aspect to take into account is the increase in the public investment/GDP ratio during 2006–2008, which reached a level of 2.6 percent, substantially over the historical average (1.2 percent). This factor may be contributing to an overestimation of the Output Gap during this period, since it is generally agreed that private investment productivity is greater than that of the public sector. This calculation would indicate that for 2008 private investment relative to GDP only surpassed the level reached in 1998 by less than 1 percent, as can be seen in Figures 20 and 21.

Figure 20
INVESTMENT (% OF GDP)

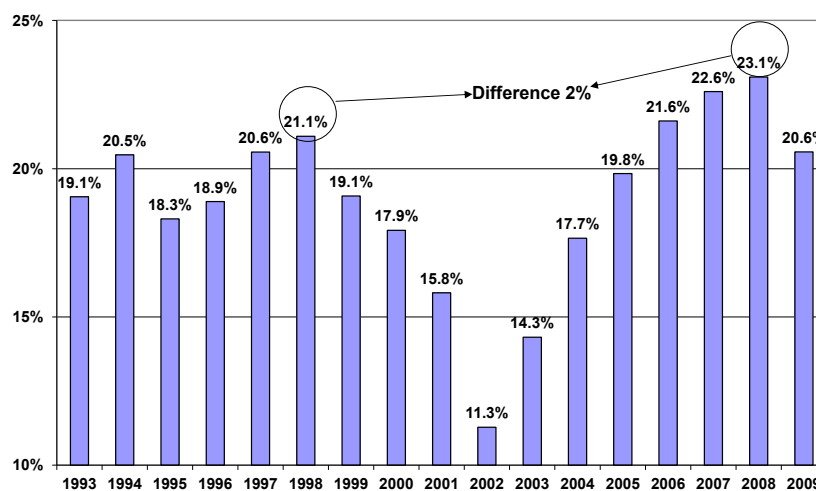
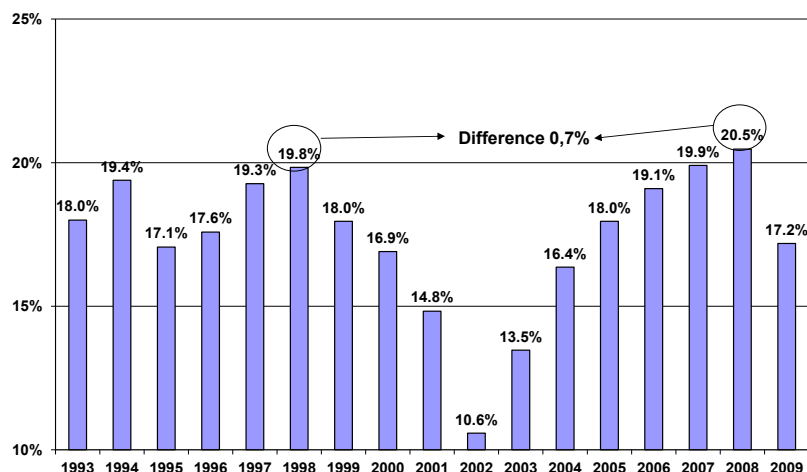


Figure 21
PRIVATE INVESTMENT (% OF GDP)



3.3. Elasticity of the Main Revenue and Expenditure Items in Relation to GDP

Structural balance estimates the fiscal revenues and expenditures that would be obtained if the effects of the business cycle be they positive or negative are isolated. To this end, a conceptual estimate is made of the fiscal revenue that would be obtained if the economy were following its trend growth path. This requires that fiscal revenues and expenditures be adjusted by a parameter that reflects the gap between actual and trend GDP. In order to calculate the elasticities of the main revenue and expenditure items, we have followed the standard methodology used by the IMF for the calculation of the SFB.¹⁵ To this end, the following steps were taken.

We began with the premise that the revenue collection for any particular tax (T) can be disaggregated into a structural component (Te) and a cyclical component (Tc), so that for every period the following is true:

$$(1) T = T_e \times T_c$$

¹⁵ Robert Hagemann: "The Structural Budget Balance. The IMF's Methodology." IMF Working Paper, July 1999.

According to the methodology used, the cyclical component (T_c) is a function of the gap between observed GDP (Y) and potential GDP (Y_p), calculating both in real terms:

$$(2) T_c = a (Y/Y_p)^\eta$$

Where η indicates the elasticity of T_c relative to the output gap or, in other words, to GDP's cyclical component.

On the other hand, it is reasonable to state that:

$$(3) T_e = b Y_p^\varepsilon$$

where ε represents the elasticity of the fiscal revenue's structural component (T_e) in relation to potential GDP (Y_p). Consequently, based on (1), (2) and (3), we can state that:

$$(4) \ln T = A + \eta \ln (Y/Y_p) + \varepsilon \ln Y_p$$

Where $A = (\ln a + \ln b)$. The parameters of expression (4) can be estimated by MCO. Additionally, from the definition of cyclical component we have that:

$$(5) \sum \ln T_c = 0$$

This implies that:

$$(6) \ln a = -\eta (\sum \ln (Y/Y_p))/n$$

From expression (6), we can then estimate parameter b as follows:

$$(7) \ln b = A - \ln a$$

Table 21 presents the estimated elasticities for the most significant tax categories.

Table 21
ELASTICITIES OF SELECTED REVENUES AND EXPENDITURES

	% GDP 2009	η	t statistic	ε	t statistic
Tax Revenue	19.8%				
Profits	4.9%	1.32	3.56	3.09	13.58
VAT	7.7%	2.22	17.63	1.39	18.04
Export tariffs	2.8%		Specific adjustment (not cyclical)		
Other tax revenue	4.4%	1.02	3.44	1.92	10.54
Property rents + other transfers	2.3%		Specific adjustment (not cyclical)		
Social Security	6.8%		Specific adjustment (not cyclical)		
Other current revenue	0.6%		Unrelated to the cycle. Not adjusted.		
Capital revenue	0.0%		Specific adjustment (not cyclical)		
TOTAL REVENUE	29.5%				
Operational expenses	4.0%	1.36	6.3	1.035	7.87
Public Sector Transfers	8.2%	1.74	8.76	1.92	15.78
Private Sector Transfers	4.6%		Unrelated to the cycle. Not adjusted.		
Social Security	7.3%		Unrelated to the cycle. Not adjusted.		
Other current expenditures	0.4%		Unrelated to the cycle. Not adjusted.		
Capital expenditures	3.4%	4.42	9.54	3.51	12.39
PRIMARY EXPENDITURES	28.0%				
Interest	2.2%				
TOTAL EXPENDITURES	30.1%				

For all the taxes selected (tax on profits, value-added tax, and other revenue collecting instruments), the estimated elasticities (η) are positive and statistically significant. We therefore used the estimated parameters for the calculation of the structural fiscal balance. For exports taxes, and for the income that comes from Social Security, specific adjustments have been made that will be discussed below. Also, corrections have been made to non-tax revenues (transfers, property revenues, and capital revenues) in order to carry out an alternative calculation of the SFB.

It should be noted that in all cases the values of ϵ are statistically significant and greater than 1, which may indicate an important degree of improvement in the efficiency of tax collection. For this reason, these elasticities should not be used for long-term projections, since doing so would tend to overestimate the growth of revenues. The cyclical adjustments of the respective revenue items were calculated using the following expression:

$$(8) \text{ Cyclical adjustment of tax revenues} = T (1 - 1/T_c)$$

Figure 22 shows the original revenues series and the adjusted series based on the estimates, both in relation to GDP. Figure 23 shows the difference between actual revenue and structural revenue.

Figure 22
ACTUAL AND ADJUSTED TOTAL REVENUE FOR THE SUM OF CYCLICAL COMPONENTS
(% OF GDP)

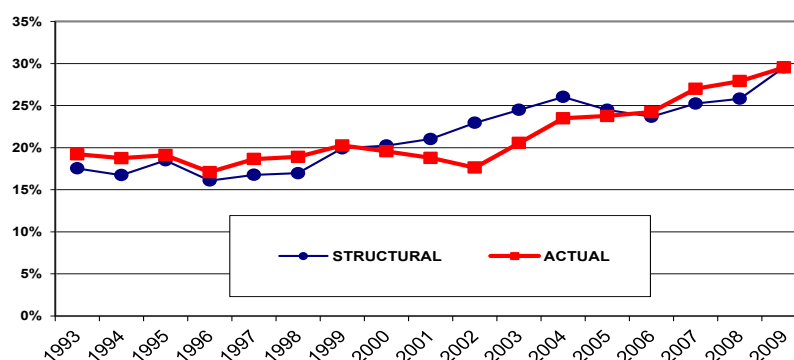
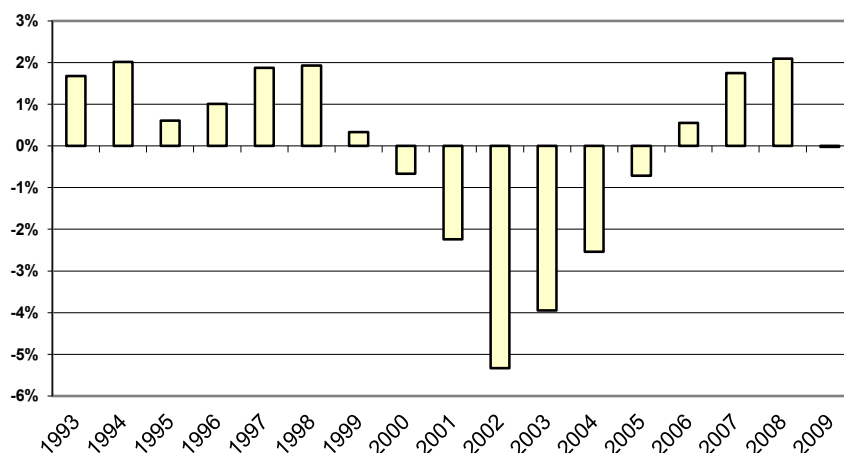


Figure 23

TOTAL REVENUE: DIFFERENCE BETWEEN ACTUAL AND STRUCTURAL (PP OF GDP)



We see in Figures 24 and 25 that during the 1993–1998 period and the 2006–2008 period the business cycle generated revenues that were greater than the structural revenue (sometimes by amounts up to 2 percent of GDP). Conversely, during the depressive and recessionary cycle that occurred between 1999 and 2002 an opposite behavior occurred (in 2002 revenues even fell 5 percent below their structural trajectory). Although the economy grew again after 2003 at significantly high rates (close to 9 percent per year), revenues took three more years to get back to its structural level.

Regarding total expenditures, the estimated values of η are statistically significant for all the tax instruments selected. On the other hand, the values of ε are also significant. These results imply that, for the calculation of the SFB, corrections must also be made on the expenditure side.

Figure 24
ACTUAL AND ADJUSTED REAL EXPENDITURES FOR THE SUM OF CYCLICAL COMPONENTS
(% OF GDP)

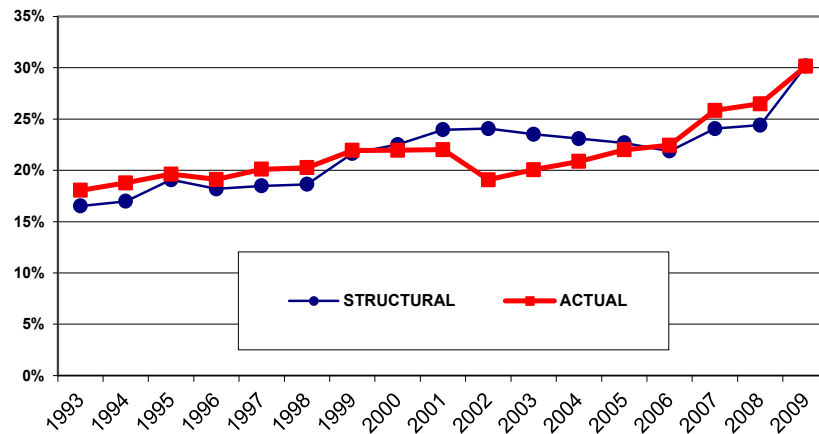
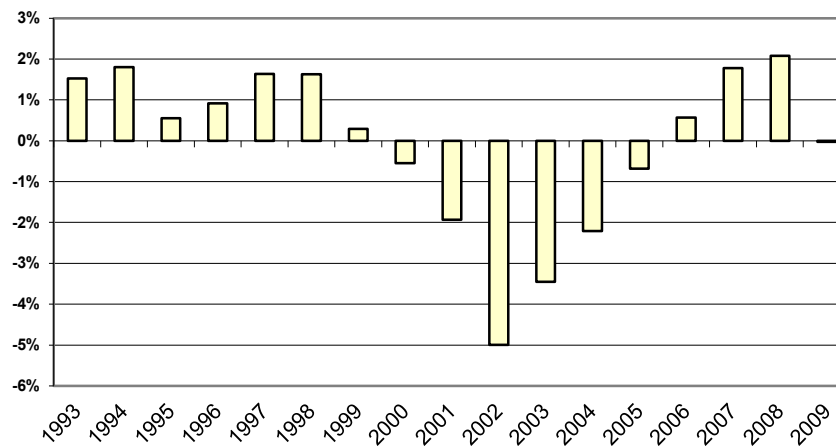


Figure 25
TOTAL EXPENDITURES: DIFFERENCE BETWEEN ACTUAL AND STRUCTURAL (PP OF GDP)



In the previous Figures the behavior of expenditures is similar to that of the revenues, overestimating their level during economic booms and underestimating them during depressions and recessions.

What follows from this is that public expenditures tend to increase during periods of expansion in aggregate demand and GDP. This policy would seem to be procyclical, inflating aggregate demand during boom periods and contracting it during recessive periods.

3.4. SFB Forecast for the 1993-2009 Period

On the basis of the results shown in Section 3.3, SFB projections can be calculated for the period being examined. The corresponding estimations are shown in Figure 26. We find that for the entire analyzed period, when adjusted for the cyclical component, the corrected results are very similar to the observed results. This happens because the business cycle has impacts on both incomes and outflows that are of an equivalent size, so the cyclical effect is almost completely cancelled out. For the period comprised between 1993 and 2009 the greatest positive difference between the actual FB and the SFB is about 0.3 percent of GDP (in 2008). The largest negative difference is observed in 2003, with a magnitude equivalent to -0.5 percent of GDP.

Figure 26
ACTUAL FINANCIAL RESULT AND SFB (% OF GDP)

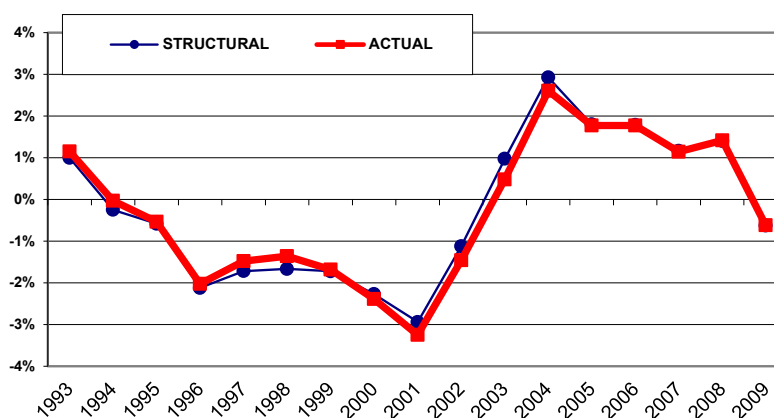
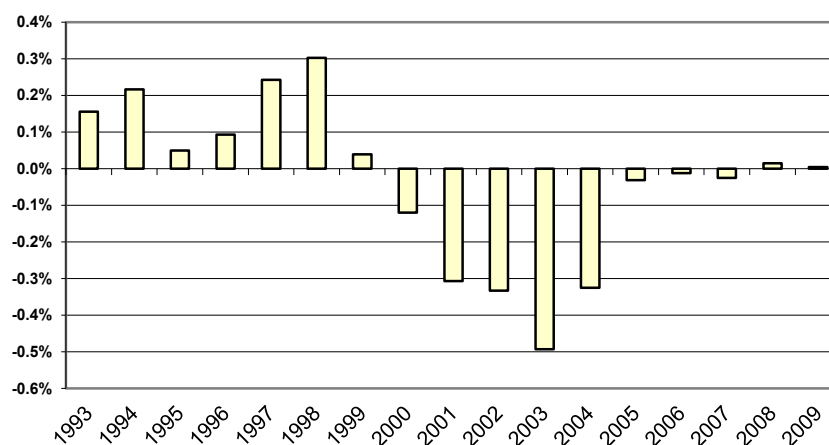


Figure 27

FINANCIAL RESULT: DIFFERENCE BETWEEN ACTUAL AND STRUCTURAL (PP OF GDP)



The first element that should be mentioned is that the performances of the national public sector before and after the 2001 crisis were quite distinct, both in terms of Financial Results and of the SFB. During the nineties, the results obtained were characterized by persistent deficits (which in 2001 even reached 3.2 percent of GDP); however, after 2003 this situation is reversed, with surpluses of over 1 percent of GDP every year up to 2008.

Although it may be redundant to say so, the SFB cannot operate as an independent policy rule unless a range or target (TSFB) is defined for that balance. This range or target is what gives substance to the policy rule, indicating the size of the adjustments in revenues or expenditures that are required to comply with the established rule. For the entire analyzed period, the recorded Result is practically identical to the SFB. This is due to the fact that the business cycle has simultaneous impacts on both revenue and expenditure items, so that positive effects neutralize each other during booms, and the same occurs with negative effects during recessions. What this seems to indicate is that adjustments are not needed; the size of the adjustment is similar when calculated on the basis of the SFB or on the basis of the recorded result.

However, in Argentina's case we believe that making noncyclical corrections to the revenues series is appropriate. Therefore, the following items were corrected:

- Social Security: Beginning in 1994, and with the instrumentation of a mixed pension system, revenues that had previously gone in their entirety to a central state collection window started to be administered by AFJPs. The pension counter-reform of 2008 restored a system that is exclusively state-managed and distributional. Therefore, for the calculation of the alternative SFB, funds transferred to private administrators during 1994–2008 have been re-categorized and defined as having entered into the public treasury.
- Capital revenues: during certain years, particularly in the nineties, public enterprises privatizations generated one-off exceptional revenues. Therefore, for the calculation of the alternative SFB these revenues have been eliminated.
- Property revenue and other transfers: During 2008 and 2009 a very significant increase is recorded in revenue generated from these sources. These revenues are mainly associated with an increase in SDR reserves (discussed in previous sections) and a distribution of BCRA dividends. These two items are extraordinary and not recurrent; therefore, for the calculation of the alternative SFB these revenues have been eliminated.
- Taxes on exports: Starting in 2002 an export tax was reintroduced (with differential rates depending on the kind of export product). This new tax became possible (initially) due to the significant increase in the real exchange rate, and later to a substantial rise in export commodity prices. Figure 28 shows the evolution of the real commodity prices index in pesos (corrected the original series in current prices by the GDP deflator published by BCRA). Although the real price index still remains at high levels (after a decline in 2009), the tensions that have arisen after 2008 would seem to indicate that collecting over 2.5 percent of GDP with this tax is not viable in the medium- and long-term. The 2008 peak was due to the extraordinarily high levels reached by these prices (a situation deemed to be exceptional and that will probably not recur). Finally, deeper declines in both commodity prices and the real exchange rate would generate untenable tensions that could lead to declines in the rate of these taxes and, consequently, in the amount of tax collected.

Therefore, for the calculation of the alternative SFB revenues that surpass 2.5 percent of GDP have been eliminated.

Figure 28
COMMODITY PRICE INDEX AND EXPORT TAX COLLECTION (% OF GDP)

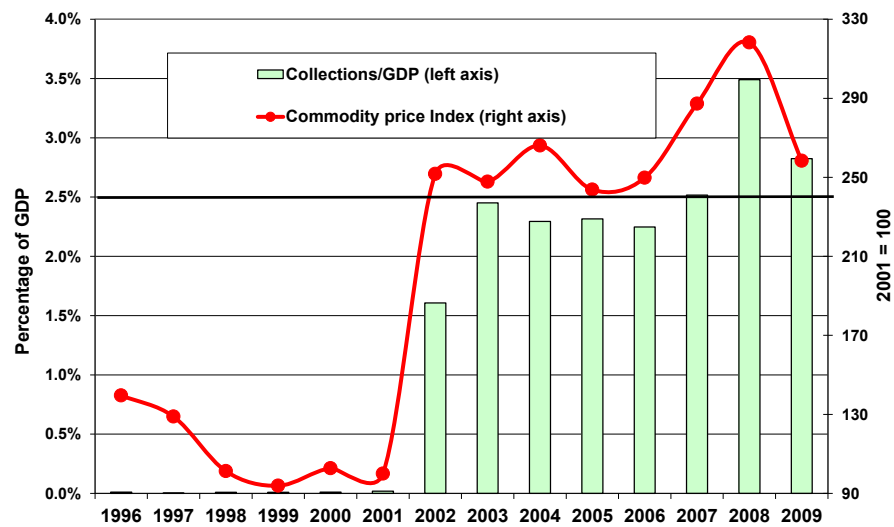


Figure 29
ACTUAL FINANCIAL RESULTS AND ALTERNATIVE SFB (% OF GDP)

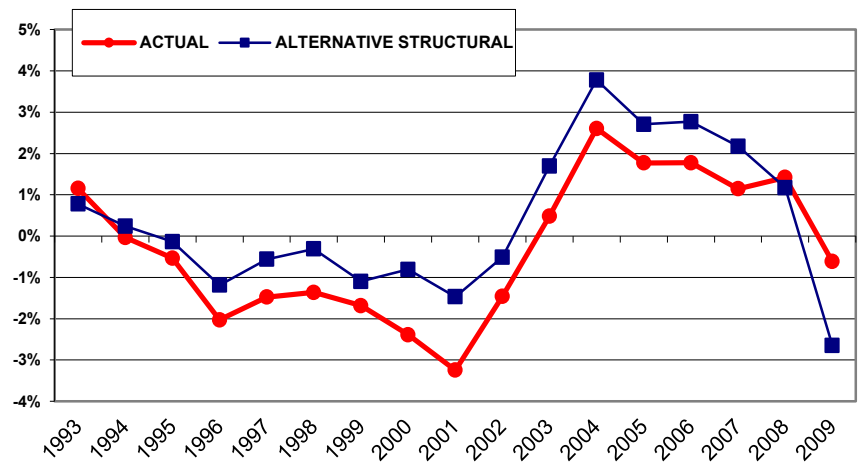
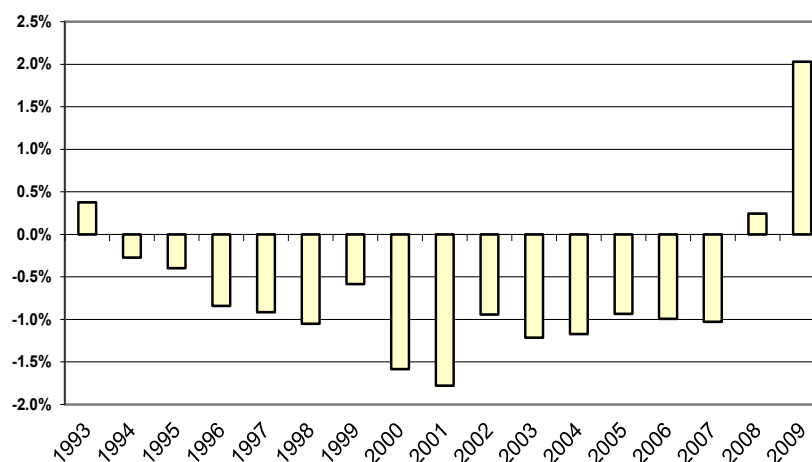


Figure 30
FINANCIAL RESULT: DIFFERENCE BETWEEN ACTUAL AND ALTERNATIVE STRUCTURAL
(PP OF GDP)



A significant aspect to be noted is that the alternative SFB is higher than the Financial Result for almost every year in the series, with the exception of 2009, when it is worse. A clear explanation of this phenomenon is that if the income that was assigned to the AFJPs is recalculated, the numbers associated with the financial results during the nineties, although still negative, would have been less so (with an average improvement of 1 percent in relation to GDP. On the other hand, starting in 2003 and until 2007, the observed surplus would have been greater than the actual surplus. A clear deterioration of the financial result is observed for 2009: the alternative SFB shows a deficit equivalent to 2.6 percent of GDP (2 percent larger than the observed GDP).

3.5. Appropriate range for the SFB, taking into account the level of debt.

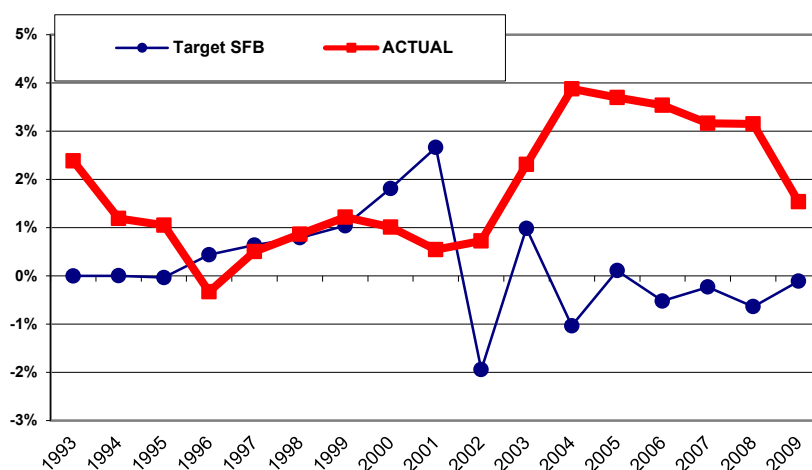
In Figure 31 we present an estimate of the SFB compatible with the sustainability of the debt level recorded for each year during 1993–2009. The target SFB was estimated à la Blanchard that is, calculating, for each year, the Result (in terms of GDP) associated with a level of constant indebtedness (in terms of GDP), assuming that the economy grows at the pace indicated by the potential GDP.

$$(1) sp = d (i - g)$$

For each of the examined years, sp represents the primary surplus compatible with inter-temporal solvency, d the Debt/GDP ratio, i the debt's average interest rate, and g the potential growth level. Alternatively, expression (13) can be presented in terms of the target SFB as:

$$(2) \text{Target SFB} = sp - id = -dg$$

Figure 31
COMPARISON BETWEEN TARGET SFB AND ACTUAL FINANCIAL RESULT (% OF GDP)



The estimated target SFB is compatible with events in Argentina's recent past. In early 2002 the public debt default was announced, after two years during which the target SFB indicated the need for a 1 to 2 percent improvement in GDP. Starting in 2004 (after a period in which comparisons lost some of their value due to the sudden dollar decline of GDP and to the payments default) the numbers associated with the target SFB were negative in amounts of around 2 percent of GDP, with which a gap between the target and the actual SFB turned out to be of about 3.5 percent. This generated the decline in debt that was observed during this period (measured in terms of GDP).

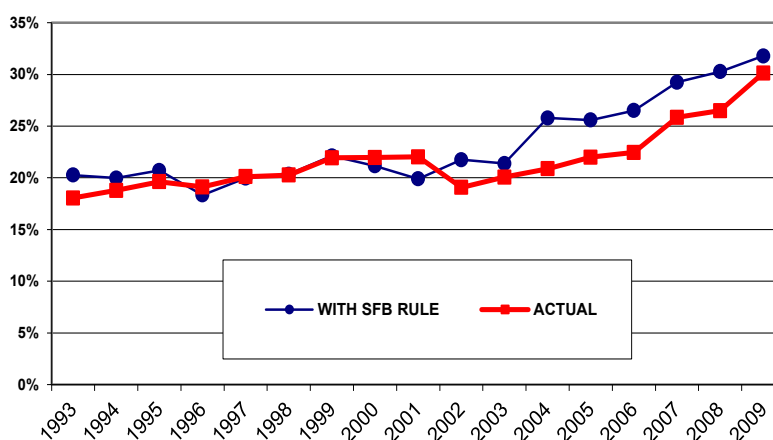
Also, these estimates do not take into consideration the revenues that originated from Seigniorage, which began to gain weight after 2002 due to the increase in the monetization of the economy. Additionally, after 2005 inflation began to consistently reach two digit levels.

3.6. Comparison between Projected and Observed Data: Volatility and Observed Level of Indebtedness: Results that Would Have Been Obtained under a SFB Rule

In Figure 32 we present the evolution that public expenditure would have had if a SFB rule had been followed. In this case, all the adjustment is done at the expenditure level, so that the observed result coincides with the target SFB.

Figure 32

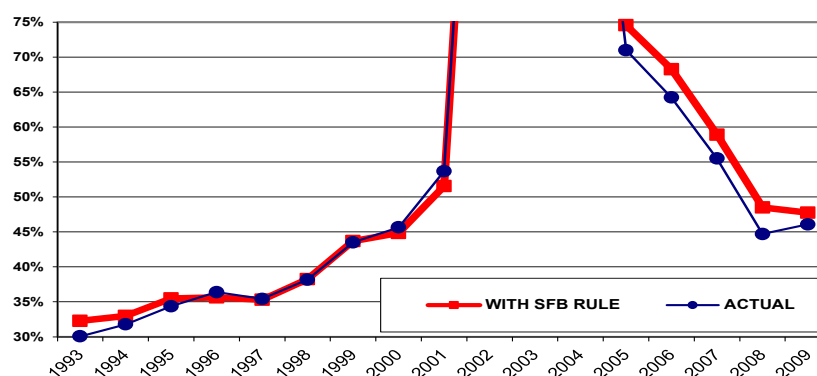
EVOLUTION OF TOTAL PUBLIC EXPENDITURE UNDER A SFB RULE (% OF GDP)



It can be seen that the significant gap between the actual financial result and the SFB result would have allowed, from 2002 on, a higher level of expenditure than that which actually occurred.

Also, the evolution of debt in relation to the output would have been very similar to what actually occurred, as can be seen in Figure 33.

Figure 33
EVOLUTION OF INDEBTEDNESS UNDER A SFB RULE (DEBT AS % OF GDP)



Note: The substantial devaluation of the Peso changed the debt/GDP ratio (for 2002–2004) by about 150 percent. The re-composition of the real exchange rate made this indicator return to more normal levels.

Although the calculation should be done by applying the difference between the observed financial result and the target SFB, in the Argentine case this exercise becomes more complicated. There are several reasons that make the debt variation not be equivalent to the stock observed at the beginning of the period plus the financial result of the year being examined. Among the reasons that lead to this we can mention the following:

- On one hand, because during the period being examined GDP fell abruptly in dollars terms due to the substantial devaluation in 2002.
- The repudiated debt was renegotiated with a significant haircut in 2005.
- Part of Argentina's debt is indexed to inflation.
- The Treasury issued debt transferred to the financial system as compensation for the conversion into pesos of instruments in their portfolios.

4. Fulfillment of Preconditions Required to Achieve an SFB and the Need for Legal Reforms

4.1. Dynamics of Indebtedness

As discussed above, although Argentina fiscal results deteriorated substantially in 2009, the country has the tools necessary to adjust its accounts from a nominal perspective, since at present fiscal revenue is registering average growth rates of about 25 percent.

Once the regularization of the still un-renegotiated portion of the debt is completed, it is believed that the debt to GDP ratio will approach 50 percent. It is also believed that in 2010 the economy will grow by about 4.5 percent, and it will later stabilize at around 3.3 percent (the calculated growth of potential GDP).

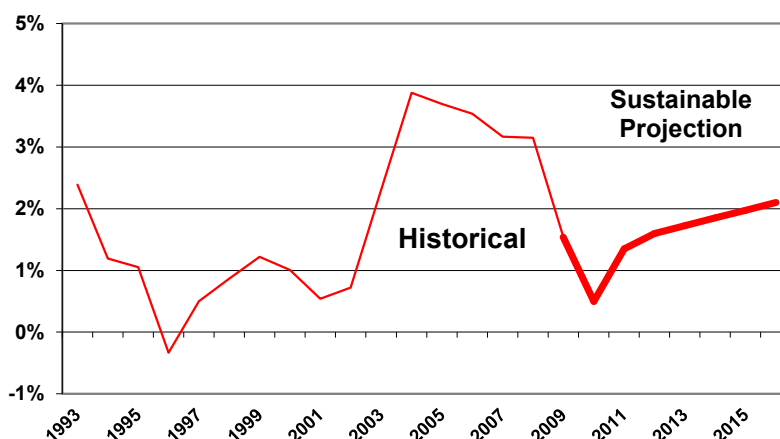
It is believed as well that the implicit interest rate of public debt will tend to increase (to an annual rate of about 50 basis points), since instruments with compulsively imposed interest rates will gradually mature and be replaced by others issued at market interest rates. If the objective were to gradually stabilize total debt at close to 50 percent of GDP starting in 2010, the target SFB would be compatible with a growing primary surplus, which could reach a level of 2.1 percent of GDP by 2016.

Table 22
EVOLUTION OF THE FISCAL SUSTAINABILITY INDICATOR

	Debt / GDP	Real interest rate	GDP % chg,		RFS
	b	r	gy	(r - gy)	(r - gy) . b
2010	50.0%	5.50%	4.5%	1.0%	0.5%
2011	50.0%	6.00%	3.3%	2.7%	1.4%
2012	50.0%	6.50%	3.3%	3.2%	1.6%
2013	50.0%	6.75%	3.3%	3.5%	1.7%
2014	50.0%	7.00%	3.3%	3.7%	1.9%
2015	50.0%	7.25%	3.3%	4.0%	2.0%
2016	50.0%	7.50%	3.3%	4.2%	2.1%

As we can see in Figure 34, securing the projected primary surpluses does not require a significant effort, should the evolution of this indicator in the recent past be any indication of its future performance.

Figure 34
PRIMARY RESULT (% OF GDP)



4.2. Fiscal Agreements between National and Subnational Governments: Legal or Economic Restrictions on Public Expenditure that can affect the SFB Rule

The fiscal relationships between the national government and the 24 provinces (subnational level) are governed by two fiscal agreements:

1. Agreement on tax collections: the Federal Tax Co-participation Law (Law 25570/2002) is an agreement between the nation and the provinces on their financial relationships and the structuring of a Federal Tax Co-participation Regime, agreed to by the national state, the provincial states and the autonomous city of Buenos Aires in February, 2002.¹⁶ The

¹⁶ The Constitutional reform of 1994 established in its text that a new co-participation law was to be discussed by Congress no later than two years after the Constitution's enactment. That deadline expired in 1996; 16 years have gone by, but none of the draft projects proposed has yet been discussed in the Chambers of Congress.

Federal Tax Administration (AFIP) collects national taxes and then makes daily revenue transfers to provincial treasuries in accordance with each province's distribution coefficient. The taxes that the AFIP collects are taxes on profits, VAT, taxes on bank deposits and withdrawals, personal taxes, taxes on assets, internal taxes, taxes on expected minimum profits, taxes on fuel, contributions deducted from wages, import and export tariffs¹⁷, and other taxes of lesser importance. Certain taxes remained under provincial control and are collected by provincial revenues bureaus, such as land taxes (both urban and rural), patents, gross income taxes and fiscal stamps. Also, portions of certain taxes (on profits, on assets, and VAT) are subjected to a subtraction before being incorporated into the pool of taxes that is to be co-participated among the parties.

2. The Fiscal Responsibility Law (LRF) of August, 2004 (Law 25917/2004) seeks to establish general rules of fiscal behavior and achieve greater transparency in public management, both national and provincial (in provinces that have adhered to this instrument). The Law establishes that in August of each year the national government shall prepare a macro-fiscal framework for the next fiscal year and present it to the Federal Council of Fiscal Responsibility (which was created through this law). That framework must include:
 - The base results – primary and financial – expected to be earned by the public sector at each governmental level.
 - The limits set on the total indebtedness of the provinces, the Autonomous City of Buenos Aires, and the national government.
 - Projections on the revenues of national origin, providing detail on their distribution by Regime and by each of the provinces and the Autonomous City of Buenos Aires.
 - The wage and tax policy that it hopes to implement, as well as projections on the following variables: prices, gross national product, and nominal exchange rate.

¹⁷ Certain tax items, such as import tariffs, export tariffs and personal asset taxes, are not included in the co-participation process.

Regarding expenditures, the law establishes that the nominal rate of increase of primary public expenditures in the budgets of the National Government, the Provincial Governments and the Autonomous City of Buenos Aires, understood as the sum of current and capital expenditures, excluding interest on public debt, expenditures financed with loans from international organizations, and capital expenditures for basic social infrastructure that is necessary for social and economic development, financed with any kind of credit, authorized in the case of the provinces and the Autonomous City of Buenos Aires in accordance with the dispositions contemplated in Article 25, shall be no greater than the nominal rate increase of the gross domestic product forecast in the macro-fiscal framework mentioned in Article 2, Literal d). When the nominal rate of variation of the GDP is negative, primary expenditure shall at most remain constant. Should the implementation of the measures foreseen in Article 20 become unnecessary, or if the nominal increase in revenues is greater than the nominal increase in the gross domestic product, this limitation shall only apply for primary current expenditures, without jeopardizing to what may otherwise be established by law.

Also, the provincial governments and the Autonomous City of Buenos Aires will take the necessary measures to ensure that the indebtedness of their jurisdictions is such that for each fiscal year the servicing of the contracted debt does not surpass 15 percent of the net current revenues obtained through co-participation transfers to municipalities. Should the debt levels generate servicing costs greater than those mentioned, these governments will need to present and execute budgets with primary surpluses (net level of expenditure excluding interest payments) that include plans to ensure a progressive reduction of the debt and, consequently, a convergence with the levels defined above.

In October 2009, the LRF was amended for the fiscal periods 2009 and 2010 (alleging problems with international markets). This reform was enacted through Law 26530/2009, thereby suspending the enforcement of the articles that governed expenditure levels and indebtedness. The LRF is a key element for the achievement of a SFB rule, since it places limitations on current expenditure and indebtedness at the various administrative levels (both national and provincial). However, the application of the LRF has remained suspended for the 2009 and 2010 fiscal periods.

Financial Assistance Program (PAF)

A third fiscal agreement exists between the national government and some of the 24 provinces, called PAF. Through this program, the national government refinances the annual amortization maturities of the provinces' previous debt, postponing the payments of financial instruments that should have been addressed during the current fiscal year and rescheduling them for later dates. Until 2009, refinancing agreements were negotiated in the modality of pesos adjusted in accordance with INDEC's CPI plus an interest rate; payment periods were stipulated within the agreement. However, beginning in 2010 the national government will now determine the adjustment modality, the interest rate and the maturity terms. This transforms the agreements with the provinces that benefit from the PAF into instruments that are more arbitrary.

4.3. Discipline and Transparency

Argentina's public sector has historically behaved in a highly procyclical manner.¹⁸ From 2003, after overcoming the crisis and in a context of increasing tax burdens that are reaching new record levels each year, the ratio between consolidated primary expenditure and GDP increased from 24.7 to 27.9 percent in 2006¹⁹. After that it continued to grow, reaching a record level in 2009 (29.9 percent).

Although attempts have been made during the last few years to implement mechanisms to generate transparency through the enactment of various laws (such as the 25.917 Fiscal Responsibility Law), and develop indicators to evaluate the efficacy and efficiency of public expenditure, both at the national and the provincial level, in practice these formal efforts have had no repercussions.

¹⁸ See FIEL (2003) for a detailed discussion on this topic.

¹⁹ Based on information from the Public Expenditure and Social Programs Analysis Bureau of the Ministry of the Economy, which is the source of the numbers presented in this introduction.

For the period that began in 1980, participation by government level in the primary expenditure total shows a sharp decline in the participation of the central government at the beginning of the nineties. This decrease continued in a gradual fashion until it was circumstantially reversed by the 2001 crisis. This reduction of the national portion of expenditures occurred due to the transfer of various functions to the provincial level, particularly in areas related to health and education services. The Nation went from executing 63 percent of primary expenditures in the 1980s to spending little more than 45 percent of the total in 2006, while during the same period the provinces increased their participation in expenditures from 31 percent to 45 percent. The municipalities maintained a contribution that was mostly stable.

The structure of expenditure by purpose and function shows that during the decade of eighties close to 50 percent of primary expenditure was dedicated to social expenditures, 30 percent to economic services and 20 percent to State operational expenses (general administration, justice, defense, and security). Starting in 1991, as the privatization process began, the weight of economic services in the total fell abruptly and the proportion dedicated to social expenditure increased, while the weight of State operational expenses remained stable. In the nineties, therefore, social expenditure represented close to two thirds of primary expenditures, and economic services fell to 10 percent of the total. Finally, during the last few years subsidies to energy and transportation made the proportion of economic services increase again to 13 percent of all primary expenditures in 2006, a ratio that would subsequently continue to increase.

Social welfare is the most relevant item within the consolidated primary expenditure, representing 30 percent of that expenditure during the nineties, although the fall in the real value of pensions that occurred due to the latest crisis made them decrease to 23 percent. Several consecutive adjustments to holdings, the instrumentation of an extensive moratorium, the future liabilities expected to be generated by the 2007 pensions counter-reform, and the 2008 nationalization of the mixed system all guarantee that this item will experience additional growth.

Institutional Questions: Superpowers and Public Sector Control Agencies

Superpowers in the Nation and the Provinces

After the crisis that unfolded at the end of 2001 the National Congress declared an Economic Emergency²⁰. Since then the National Executive Power (PEN) has excused itself from going to the legislature, arguing reasons of urgency, and has modified budget items through Decrees of Need and Urgency (DNU), with a lack of congressional intervention. But the reduction of Congress's role in the budgetary process to a state of irrelevance was "perfected" through a change in Article 37 of the National Public Sector Financial Management and Control Systems Law (LAF, N° 24.156/92)²¹.

Before the reform, the law required the national executive branch to respect the total current and capital expenditures, financial instrument totals and the distribution of expenditures by purpose. The new Article 37 creates the modality of the so-called "superpowers", that is, the national executive power's authority to modify the composition of expenditures by increasing current and capital expenditures with financial instruments, thereby modifying fiscal balance. Budget item changes or reassignments are introduced through Administrative Decisions (DA) taken by the Head of the Ministers' Cabinet, a rule whose category is below that of a law.

In accordance with information from the Argentine Budget Association (ASAP), budgetary modifications introduced in 2007 reached an amount of US\$ 31,284 million (2.7 percent of GDP), equivalent to almost a third of the original budget. None of these expansions was presented to Congress' consideration; all were done through DNUs and DAs.

Similarly to what occurs at the national level, in 18 of the 24 provincial jurisdictions²² the executive branches have the authority to re-assign budget items with no legislative control, although with a different scope: in most of the provinces, superpowers are part of budget law

²⁰ Law 25,561 of January, 2002.

²¹ By means of the Law 26,124 of August, 2006.

²² The provinces that have no superpowers are Catamarca, Cordova, Jujuy, La Rioja (where they were established but later repealed), Mendoza, and Santa Fe.

itself, so every year provincial executives need to renegotiate their approval with their legislatures.

In the City of Buenos Aires, for example, the head of government can redistribute budget items up to an amount equivalent to 5 percent of the budget; the governor of Buenos Aires Province can, besides redistributing entries, create entities and bureaus on his own volition, financing them with budget item reassignments. Other provinces incorporate restrictions into their superpowers: Santa Cruz and Tierra del Fuego cannot change their funds for health and education; in Tucuman, these powers can only be used with revenues that exceed the amounts budgeted.

Public Sector Control Agencies

The Financial Management Law mandated the creation of the National General Accounting Office (SIGEN) as the authority in charge of the internal control over the National Executive Power (PEN), as well as of the National General Auditing Office (AGN) as the authority for its external control.

SIGEN is in charge of issuing and enforcing internal control regulations, supervising and evaluating those systems, and making recommendations to the agencies that it audits, suggestions with which it seeks to ensure compliance with those rules and with criteria of economy, efficiency and efficacy. The scope of its control includes all the jurisdictions of the PEN, decentralized agencies, regulatory agencies, public enterprises (with or without majority state participation) and national universities. SIGEN's is led by the general comptroller, who is appointed by the PEN and answers directly to the National Presidency. This officer is assisted by three deputy comptrollers.

AGN is an agency that depends on the National Congress and is in charge of exercising external control over the National Administration's authority on taxation and on economic, financial, patrimonial, legal, and accounting matters; over state companies and regulatory agencies; and over private entities to which privatizations have been awarded, monitoring the obligations derived from their respective contracts.

AGN's authority is exercised by seven general auditors. One of them, who presides the agency, is appointed by the presidents of both Chambers of Congress through joint resolution. The Senate appoints half of the other auditors; the Deputies Chamber appoints the remaining three. The general auditors are appointed for eight years and can be re-elected. The Mixed Parliamentary Commission in charge of Account Review (CPMRC), composed of six senators and six deputies, prepares AGN's budget proposals and is its liaison with Congress. Both SIGEN and AGN are financed basically with figurative contributions from the central government.

AGN's control of financial statements and budgetary implementation is carried out through the Investment Report, which the National General Accountancy Office must send to Congress before the date of June 30 of the year that follows the year under evaluation. AGN also receives a report from SIGEN on the quality of the source data uses to draft the Investment Report.

The issue date for SIGEN's audit report was regularized after the 2004 fiscal year, since the reports for fiscal years 2001 to 2003 were published with delays of more than a year. The audit for 2004 was published in June, 2005, along with the Investment Report.

AGN has 120 days from the publication of the Investment Report to issue a ruling on its contents. During the last few years, AGN has systematically said it lacks the capability to offer reasoned and specific opinions about the financial statements as a whole, due to reasons it reiterates in each of its reports and among which it mentions that the Goods in Use item does not reflect the entire stock of goods in the hands of the State; that the valuation of the balances in the Credits item has high degrees of uncertainty; that significant amounts of unassigned assets and liabilities exist; that there is uncertainty on the total amount of public debt after the *default*. It also lists a large number of observations regarding the operations of different agencies (CIPPEC, 2006). According to CIPPEC (2006), a limited budget, a scarcity of personnel and a high degree of politization within the agency contribute to these delays in AGN's work.

Finally, after it is issued, the ruling should be sent to the CPMRC, which must examine it and forward it to the House of Representatives for final approval. If it is rejected, the PEN must prepare the Investment Report again. This has never happened to date. In any case, the period

within which Congress is supposed to give its final approval and the consequences that its rejection would have are matters that have not been specified through regulation. Due to these reasons, no transparent and effective process exists in the country to control the national public sector's budgetary implementation or its financial statements.

At the provincial level, mechanisms of this kind have only been partially implemented. According to an evaluation study prepared by the World Bank (Fingernail and Cogliandro, 2005) in the field of financial management, 66 percent of the provinces have reported progress in the implementation of a financial management law and an Integrated Financial Management System, therefore achieving a better monitoring of their budgetary implementation. The City of Buenos Aires was the jurisdiction that showed the greatest progress, although positive efforts have also been done in Catamarca, Chubut, Mendoza, Salta and Santa Fe. The provinces in which the least progress was achieved were Buenos Aires, Corrientes, San Juan, and Santiago del Estero, among others.

Public Enterprises: National and Provincial

After the massive privatization process undertaken during the first half of the nineties, public enterprises today occupy relatively small portions of the budget both the nation and the provinces, although at this time there is a clear upward trend, with a reversal in some of the privatized areas.

However, not all public enterprises are part of the national budget, which only includes those non-financial enterprises in which the public sector controls over 50 percent of the stock. According to SIGEN, the national state has majority participation in 42 companies, and a minority share in 22. However, the 2006 budget and investment account only lists 23 companies. Of the 42 companies in which the government has a majority participation, 12 are in the financial sector²³ and one²⁴ was created towards the end of 2006, so it was therefore not included in the year's budget. Even so, and after subtracting the 23 companies listed in the 2006 Investment

²³ BICE, Banco Hipotecario, and the members of Banco Nación group.

²⁴ ENARSA Servicios S.A.

Account, there are still 6 companies for which there is no budgetary information.²⁵ In any case, whether they are mentioned or not in the budget, public enterprises operate with almost total independence from the agencies that govern the financial management system of the state (Gadano, 2006).

In this context, the last administrations have been strongly prone to directly controlling investments in infrastructure and public services, either by transferring these drivers to the realm of regulation or by participating directly in the supply of services, thereby confusing the distinction between the roles of the state and of the private sector. Examples of this are the increasing subsidies provided for transportation, the creation of ENARSA, the termination of the contract with Aguas Argentinas, the introduction of specific fees to finance energy sector investments (gas and electricity transportation and distribution), the capitalization of arrears owed by electrical generators to CAMMESA for the construction of thermal power stations, etc.

As a result of this change in policy, the national state has again taken control of drinking water distribution and waste water facilities, servicing – through the state company AySA – areas previously supplied by the private company Aguas Argentinas S.A.²⁶; it has retaken control of the domestic post office (Correo Argentino), reconstituted an airline (LAFSA), created a company (ENARSA) dedicated to hydrocarbon development and electrical power generation, and transformed Aerolineas Argentinas into a state company (although this has still not been fully formalized)

Provincial governments include little or no information on public enterprises in their budgets or investment accounts (which are only published by some jurisdictions and not by others). Among these governments, a striking diversity exists in terms of their roles as state company managers. Río Negro and Neuquen own, respectively, 17 and 18 public enterprises; Chaco, Cordova and Santa Fe each own between 7 and 9 companies; other jurisdictions have few or no stock companies that are fully owned by the province or in which the province has a

²⁵ Corporación Antiguo Puerto Madero S.A., EUDEBA, Emprendimiento Productivo y Educativo La Gleba S.A., TANDANOR, VENG S.A., and Vientos de la Patagonia I S.A.

²⁶ This area includes the City of Buenos Aires and the 17 closest surrounding neighborhoods in the Buenos Aires metropolitan area.

majority share. In any case, and similarly to what happens at the national level, provincial public enterprises have no significant impact on fiscal accounts.

The presence or absence of public enterprises at the provincial level depends partly on each province's institutional structure. In some provinces, certain decentralized agencies – and even entire jurisdictions – are under central government management, and carry out functions that in others are performed by private companies. This is the case, for example, of lotteries and production development agencies.

On the other hand, many public enterprises have been created due to reasons associated with political strategies. Among these we can highlight the state mass communications media (National System of Public Media²⁷, the official news agency TELAM and some provincial media), and the provincial companies created to develop each region's hydrocarbon resources. Finally, state banks (Banco de la Nacion, Banco Hipotecario, BICE, and the provincial banks) and other provincial small enterprises seek to promote the development of various production activities.

In any case, generating mechanisms so that public enterprises are bound to comply with the same transparency and oversight standards applicable in the case of private enterprises, as well ensuring that their budgets are clearly included in public accounts may be a first step, which could be viably implemented.

Fiduciary Funds – Financing of Infrastructure and Services

In Argentina, the creation of Fiduciary Funds in the state sector began in 1995 with the enactment of Law N° 24.441. The goals that trusteeship funds in the public sector seek to achieve may be sensible (i.e., setting aside Treasury funds to limit the purpose for which they will be used; providing guarantees to creditors that funds will be available to pay for certain debts; ensuring, when deciding to carry out certain investments, that the work will not be paralyzed due

²⁷ Operator of Channel 7 and Radio Nacional.

to lack of funds in future years, etc.); however, in practice their actual operation has been subjected to a substantial amount of criticism.

At this time there are fifteen fiduciary funds, although only seven of them concentrate about 97 percent of the revenues and expenditures executed through these channels in the last few fiscal years. Twelve are controlled by the Ministry of Economy and the Ministry of Federal Planning; two operate under the Ministry of Education, and one under the Ministry of Social Development (MDS).

Most of them finance and execute infrastructure work in the areas of transportation – roads and railroads – and electrical generation. In recent years, some of them have been entrusted with distributing subsidies scheduled to be implemented after the imposition of price freezes in the sectors of transportation – basically passenger transportation – and power generation.

One of the largest of these funds, in terms of expenditures, is the one associated with the transportation infrastructure system. It was created in 2001 to develop road infrastructure projects, and to eliminate or limit toll payments by paying compensation to the concession holders. During the last few years this fund has been entrusted with increasingly significant functions, such as the implementation of fare compensation systems for motor vehicle and railroad transportation companies, in a context in which fares remained practically unchanged for the entire period²⁸. This item was originally financed through a diesel tax specifically created to pay the fare compensations; however, in 2003 it was decided that these payments would be made with revenues from the national highway corridor concessions (Dto. 1007/03).

The Water Infrastructure Fiduciary Fund was created for a similar purpose (Dto. 1381/01), also in 2001. The main source of its financing was a new gasoline tax, and its responsibilities included managing a compensation system to reduce the fares charged for dredging and maintaining navigation routes.

²⁸ This Fund manages the mechanism designed to provide compensation for the cost increases faced by automotive passenger transportation companies, as well as to provide financial assistance for railroad and subway companies to help cover operating expenses and recognize their debt.

Among the other funds, it should be mentioned that a part of the national government's energy policy is conducted through the Federal Electrical Transmission Fiduciary Fund (Law 25.401) created in 2001 to expand the country's power transmission network, financed through an increase in the operational fee for purchases on the Wholesale Electrical Market; and the Fiduciary Fund for Subsidies to Residential Gas Consumption (Law 25.565), which finances compensations for disadvantaged regions by imposing an extra fee on the price of natural gas at its point of entry into the national gas transportation system.

Perhaps the main problem with the fiduciary funds is that they are institutions, which, while not being part of the National Administration, manage substantial revenues not subject to the regulations that normally govern the activities of most public institutions. This becomes another way in which the comprehensiveness that should be a feature of public budgets can be eroded.

On the other hand, information on the implementation of the trusteeships is provided by the funds themselves (in compliance with Law N° 25.565, which was added to the Permanent Complementary Budget Law, N° 11.672). These operations reports are published every three months and contain sections that analyze the operations of the seven most significant funds in some detail. However, the latest reports indicate that the authorities of three funds (FONAPyME, FOGAPyME and the F.F. for Company Reconstruction) had not forwarded the relevant data; therefore, for those cases the reports only publish estimates.

Subsidies for Private Sector Enterprises

Last year one of the primary expenditure items that experienced the greatest growth was current transfers to the private sector. Although these transfers include subsidies to families, which have also experienced significant growth due to an increase in family allowances, most of this growth is associated with subsidies to economic sectors, particularly power generation and transportation.²⁹

²⁹ Although their impact was substantially smaller, we should also mention the subsidies for the food producing sector that started to be distributed during the first months of 2007.

The largest of these transfers are those associated with subsidies and loans to CAMMESA for the supply of thermal power stations and for the stabilization of prices through the Unified Electrical Fund. The remainder is distributed among beneficiaries such as the Yacyretá hydroelectric power station, the Federal Electric Transportation Fiduciary Fund, ENARSA, provincial agencies, and others.

The freeze in transportation fares, imposed at a time of significant fuel prices increases and wage hikes within that sector, also generated substantial hikes in the transportation subsidies channeled through the transport infrastructure fiduciary fund.

However, another indirect transportation subsidy mechanism allows the sector's companies to purchase diesel at differential, lower prices. In exchange for this, the oil companies receive a tax bond that they can use as a credit to reduce the export tariffs they owe.

As mentioned, large portions of these subsidies are channeled through fiduciary funds, and it therefore isn't clear if they are being entirely accounted for within the budget. Besides, these subsidies were originated the adoption of a significant portion of the budgetary adjustments introduced through the use of DAs and DNUs over the course of time.

Conclusions

In general terms, this latest period can be described as having deteriorated in comparison with the situation that existed almost a decade ago. At that time there was an ongoing discussion on the need to increase transparency in public management, as well as on seeking to use homogeneous accounting methods both nationally and within the 24 provincial jurisdictions. During the last few years legislation on some of these issues has been enacted, both at the national and provincial level; however, in practice the intended effects have not been achieved, so far at least.

But in addition, the participation of the public sector in the economy has also been increasing. One way to see this is through the ratio of public expenditure to GDP. However, this indicator does not explain everything; on one hand, because expenditure is probably not being taken into account in its entirety (a problem associated with the lack of universality in public budgets); on

the other, because some of the actions of interference in private sector decisions are only visible in the record of regulatory intervention.

In order of importance, we should mention, first of all, the increasingly blurry distinction between the executive and legislative branches, which generates as a natural consequence a lack of checks and balances. The PEN has the power to modify the budget at will (both in its composition and its results); in most of the provinces the situation is similar, although to a lesser degree.

The control agencies, on their part, face a series of difficulties. In the area of internal control (SIGEN), the most important is perhaps its lack of independence. But the AGN (external control) has its own problems, and cannot make pronouncements on the reports provided by SIGEN because it finds recurring flaws in its own budget reports.

Regulatory roles are mixed and confused with service provision roles (ENARSA is an example of this), and even with roles related to infrastructure building (OCCOVI), implementing subsidy policies for the primary sector (ONCCA), or imposing sanctions that should be the purview of a specialized court (National Commission for the Defense of Competition – CNDC). Besides, several regulatory entities have been intervened, and those for which this has not occurred do not comply with all applicable regulations. Their authorities are all directly appointed and removed by the PEN, a situation that weakens their autonomy, while no mechanisms exist to help improving their efficiency and transparency.

Public enterprises, for which it is extremely difficult to find economic justifications, have been gaining greater space with each passing year (either by the establishment of new ones, the termination of existing service provision contracts or concessions, or a greater state participation in mixed enterprises). These entities are managed with total autonomy in budgetary terms, are not subject to examination by public control agencies and are present in many sectors of the economy. In some cases they have begun to play a double role, acting both as producers and regulators of the markets in which they operate, even in cases in which they are not acting as monopolies in their respective sectors.

Fiduciary funds, which in many cases operate as branches of the Central Administration for the management of growing private sector subsidies, provided as result of a policy of not

renegotiating contracts and/or imposing price freezes on utilities or fuel sector companies, also operate outside the purview of the general regulations applicable to most public sector activities.

Finally, indicators on public sector behavior prepared by the National Budget Office – some related to efficiency, but others only to economic performance – are only available up to 2004, even though significant changes in the public sector's role have taken place since then. Besides, this only refers to data at the national level; for the provinces there are no indicators that reflect this kind of information.

In summary, significant improvements have occurred in Argentina's public accounts during the last few years, particularly at the national level; however, this has been a consequence of an increasing tax burden which has been increasingly sustained by inadequate taxes (export tariffs, in particular), as well as by the transfer of private savings to public sector pension capitalization accounts. The provinces, however, are facing increasingly greater difficulties, since 47 percent of its expenditure is used to pay wages, which have been growing faster than provincial revenues in a context characterized by inflation and significant increases in real wages.

This improvement of fiscal outcomes in an environment of increasing inflation distracts attention from institutional issues related to the efficiency and transparency of public expenditures, and has therefore contributed to its recent deterioration.

4.4. Risk Factors to the Financial System that Can Affect the SFB

In 2009 the financial system continued to increase the levels of financial intermediation with the private sector. During the year, the assets of the financial institutions grew by 14.2 percent. Along with the increase in banking activity, the financial system's asset composition and total lending capacity continues to improve. Financing for the private sector represents 41 percent of assets; liquid assets are the second item in importance, representing 21 percent of all assets and reaching a level of 31 percent if we include the Lebac and Nobac holdings not linked to transfers with the BCRA.

An increase in deposits by companies and households contributed to an improvement in the banks' lending capabilities, which reached levels of 55 percent. The low indebtedness of the banks with foreign lenders is a strength in the context of an international environment that continues to be volatile. Besides, in December, 2009, the last bank that was still holding rediscounted debt instruments granted by BCRA in 2001–2002 paid the entirety of the obligations it had within the matching scheme, bringing that regime to an end.

The financial system's foreign currency mismatch continued to be limited at the end of the year. The banks' mismatch in December was close to 38.3 percent of their net worth. The proportion of private loans and deposits denominated in foreign currency is fairly low.

In 2009 the net balance of total deposits grew by 15.1 percent, slightly more than the previous year. Lending denominated in national currency increased by 12 percent during the year, while the net balance of collections in foreign currency grew by 27 percent.

The banks closed the year maintaining liquidity levels similar to those of 12 months before. The liquidity ratio (taking into consideration items denominated in both national and foreign currencies) reached 28.6 percent in December, 2009. During the last few months, delinquency rates in private sector financing have gradually diminished. In December private sector portfolio irregularities were around 3.5 percent of the total. In December, the level of provision coverage for credit of the private in irregular situation was around 126 percent.

The financial institutions continue to improve their net worth composition. In 2009 the consolidated net worth of the financial system increased by 21 percent, due mainly to the performance of private banks. The financial system's capital integration was around 18.7 percent of risk-weighted assets. The financial system's capital integration practically doubled the levels required by regulation for the end of the year, with a generalized integration surplus among financial institutions.

The accounting profits accumulated by the financial system reached 2.4 percent of assets in 2009, larger than the ones achieved in 2008, in a context in which improvements in the results obtained through stocks (due to the price recovery after the 2008 declines), interest and services were greater than the increase in administrative costs and the expenses associated with

uncollectible accounts receivable. In a context of gradual reduction of the financial system's leverage, in 2009 the financial result in terms of net worth (ROE) was around 17.9 percent.

Capitalization

The financial system has a reasonable capitalization level, when compared with the indicator's historical average.

	System
CAPITAL/ASSETS	12.5%
CAPITAL/RISK ASSETS	23.4%
TOLERANCE TO LOSSES	12.7%

Private entities with tolerances to losses lower than 8 percent represent only 2.2 percent of total deposits, equivalent to 3.6 percent of BCRA's international reserves.

Assets

Also, the system shows no evident signs of potential risk in terms of asset composition. It has suitable liquidity in available funds and public bonds. Its total financing burden is slightly over half its total assets. Immobilized assets and other assets are less than 10 percent of the total.

ASSET COMPOSITION	System
IMMOBILIZED ASSETS/ASSETS	2.7%
AVAILABLE FUNDS/ASSETS	16.6%
PUBLIC BONDS/ASSETS	22.5%
LOANS/ASSETS	41.6%

OTHER CREDIT/ASSETS	11.7%
OTHER/ASSETS	5.0%

Irregular Portfolio and Provisions

The dimension of the irregular portfolio is slightly below 5 percent of the entire portfolio, 3 percent of which is very irregular (of much lower collection probability). Also, the portion of the irregular portfolio covered with preferred guarantees is slightly below 50 percent.

	System
IRREGULAR PORTFOLIO/TOTAL	4.7%
VERY IRREGULAR PORTFOLIO/TOTAL	3.0%
PREF. GUARANTEES/IRREGULAR PORTFOLIO	48.2%

The total provision funds set aside to anticipate loan defaults cover three-fourths of the total irregular portfolio, and is greater than the entire very irregular portfolio.

	System
PROVISIONS/IRREGULAR	76.8%
PROVISIONS/VERY IRREGULAR	120.5%

	System
PREFERRED GUARANTEES/TOTAL FINANCING	24.2%
NORMAL PREFERRED GUARANTEES/NORMAL PORTFOLIO	23.0%
IRREGULAR PREFERRED GUARANTEES/IRREGULAR PORTFOLIO	48.2%

Dividends

The dividend level is high by international standards, although it is influenced by the appropriation by the financial system of the inflationary tax on immediately available deposits.

	System
DIVIDENDS/NET WORTH	17.9%
DIVIDENDS/ASSETS	2.2%

Liquidity

The system has high indicators of liquidity.

AVAILABLE FUNDS	System
AVAILABLE FUNDS/DEPOSITS	23.8%
AVAILABLE FUNDS IN BANKS/DEPOSITS	19.1%
CASH/DEPOSITS	4.7%

	System
BONDS/LIABILITIES	25.7%

The Argentine financial system is showing (both in the aggregate and in individual institutions) suitable indices of capitalization, assets quality, profitability and liquidity, and no relevant risk factors exist that could significantly affect it.

5. Fiscal Rules: Is it the Time to Introduce them?

Argentina's fiscal accounts are supported by a very deficient tax structure that distances itself both from the principles of fiscal federalism and from long-term sustainability, since it can have very negative effects on private activity. In particular, export tariffs are only sustainable while international prices remain strong and internal cost structures do not increase.

The country clearly needs new fiscal rules and an adjustment of the public sector's expenditures and revenue, a prospect, which does not seem to be on the current administration's agenda. The federal tax system must also be discussed and redesigned; again, this is not a topic on the governmental party's political agenda. The preservation of fiscal solvency depends on maintaining the current tax structure, which includes collections derived from the new distortionary taxes equivalent to 4.6 percent of GDP.

Current primary expenditure also has significant distortions, associated mainly with subsidies to public utilities granted due to insufficient adjustments to service rates. In 2009 these subsidies were equivalent to 2.9 percent of GDP.

In 2009 the NFPS's result reported a deficit equivalent to 0.6 percent of GDP. If distortions had been corrected, both in terms of revenue (4.6 percent of GDP) and expenditure (2.9 percent) the result would have been -2.6 percent of GDP, compatible with a negative primary result of -0.5 percent of GDP. A SFB compatible with long-term solvency is close to 2 percent of GDP: this indicates that a fiscal adjustment of 2.5 percent of GDP is required.

The first important observation is that for the medium-term distortionary taxes can only be reduced in half, since their elimination would imply generating deficits that the country could not finance due to its very limited access to capital markets. It would also not be advisable, in the present context, to increase other taxes or cut expenditures, since either of these alternatives could have serious impacts on aggregate demand.

We conclude that it will not be possible to eliminate the distortionary taxes in the medium-term. We also observe the presence of a distinctly procyclical policy that inflates aggregate demand during periods of expansion and reduces it during periods of contraction. This

leads us to believe that the fiscal rule that Argentina would need the most is one that stabilizes primary expenditure by establishing growth ceilings in the budget laws, in order to ensure that expenditures remain, at most, constant in real terms. In addition to this, a utility and transportation rates adjustment policy could be promoted to significantly diminish subsidy transfers, with the goal of bringing closer a time in which financial results could be compatible with long term solvency, making it possible to begin, at a later stage, to dismantle the deficient tax structure that exists today.

At the subnational level, a quick return to the application of the “original” Fiscal Responsibility Law should be encouraged in order to ensure that fiscal discipline is also being advanced at the provincial and municipal level. In terms of institutional issues, very negative situations still remain, such as the existence of superpowers, the role played by public sector control agencies, both at the national and provincial level, and the extra-budgetary – or insufficiently controlled – management of the fiduciary funds used to finance infrastructure and services.

Regrettably, we believe the country does not yet have the conditions required to consider establishing a SFB type fiscal rule. The economic moment is not favorable; and in terms of the political moment, we have seen before that during electoral years expenditure increases significantly, and presidential elections are scheduled for 2011.

6. Outlook for Argentina’s Financial Stability

Table 23 presents the status of the preconditions that would be required to establish a SFB rule in Argentina.

Table 23

**LEVEL OF FULFILLMENT OF PRECONDITIONS REQUIRED TO ESTABLISH A SFB
RULE**

	Preconditions	Fulfillment	Observations
1	Debt sustainability	Yes	The deficient tax structure currently in place needs to be maintained.
2	Compatibility with other fiscal rules	No	Superpowers, public sector control agencies, fiduciary funds to finance infrastructure and services. A quick return to the “original” Fiscal Responsibility Law would allow a consolidation of fiscal discipline.
3	Compatibility with transfers	No	Significant problems with subnational entities; transfers are discretionary
4	Consistency with stabilizers	No	What exist are procyclical mechanisms that increase expenditure and revenue
5	Compatibility with the budget of a commodity exporting country	No	Exports retentions do not follow a Chilean style rule
6	Fiscal Lags	No	The pensions counter-reform generated an increase in income, while generating medium- and long-term liabilities.
7	Transparency and credibility	No	Significant problems exist with official statistics, particularly with those that have an impact on public debt indexation.
8	Policy coordination	No	BCRA is subordinated to the Treasury.
9	Contingency previsions	No	Claims may arise from non-performing debt holders, as well from holders of RSC updated debt.
10	Coverage of public sector transactions	No	There are many extra-budgetary trusteeships associated with infrastructure investments.
11	Soundness of the banking system	Yes	The system has good solvency and liquidity indicators and does not present currency mismatches. The system could be affected by the potential appropriation of BCRA reserves to finance public expenditure.

Of the 11 preconditions required to establish a SFB type rule, Argentina only complies with two, and in both cases important caveats exist:

- In order to preserve the sustainability of indebtedness it becomes necessary to maintain a deficient tax structure.
- The bank system's soundness could be impacted by the BCRA's lack of independence from the executive branch.

Argentina's fiscal accounts depend on a very deficient tax structure that is against the principles of fiscal federalism as well as to long term sustainability. At this time the country's political agenda does not include the need to review existing fiscal rules, or the federal tax system. The preservation of fiscal solvency relies on maintaining the current tax structure.

In the medium-term, distortionary taxes can only be reduced by half, and only if the subsidies granted to public utilities to compensate for the insufficient adjustment of service rates are gradually eliminated. In the past we have observed a distinctly procyclical policy, inflating aggregate demand in periods of expansion and reducing it in periods of contraction. We have also observed that during electoral years public expenditure experiences a substantial increase, and presidential elections will take place in 2011.

In terms of institutional issues, very negative situations still remain, such as the existence of superpowers, the role of public sector control agencies, both at the national and provincial level, and the extra-budgetary – or insufficiently controlled – management of fiduciary funds used to finance infrastructure and services. Due to the considerations described above, we believe the country does not yet have the conditions required to establish a SFB type fiscal rule.

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