PROVINCIAL SOCIAL SECURITY SECTOR REFORM PROGRAM

(AR-0201)

EXECUTIVE SUMMARY

BORROWER: The Argentine Nation

EXECUTING AGENCY: The Ministry of Economic Affairs and Public Works and Services (MEyOSP) and the National Social Security Administration (ANSeS)

AMOUNT AND SOURCE:

IDB:	US$320 million (OC)
World Bank:	US$320 million
Total:	US$640 million

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	15 years
Disbursement period:	2 years
Grace period:	5 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75% per annum on undisbursed balances

CURRENCY SELECTION: The Argentine government has decided that this loan be denominated, in its entirety, in U.S. dollars.

OBJECTIVES: The main objective of the program is to support the Government of Argentina in: (i) strengthening social security institutions and consolidating reform nationally by, first, improving equity through consistency in regulations and their application and, second, supporting capital market development with the stimulus for private savings and investment provided by allowing provincial employees to join the system of pension fund administrators (AFJP); and (ii) helping to balance provincial budgets by lessening the significant impact exerted on provincial finances by deficits run by provincial retirement funds (CPPs). In addition, the program will support strengthening for ANSeS administration and controls to prevent fraud and evasion within the consolidated system.

DESCRIPTION: This sector loan would be disbursed in three tranches, the first for US$160 million and the second and third for US$80 million each. Disbursement of each tranche will be justified by the transfer of CPPs to the ANSeS in a transferrable amount equivalent to the tranche concerned. Disbursements under each tranche will be contingent on maintaining a satisfactory macroeconomic

setting and carrying out the reforms outlined in the policy letter (Annex III-1), the conditionality matrix (Annex III-2), and the eligibility criteria (Annex III-3). The program components would be as follows: (i) transfer of CPPs to the ANSeS; (ii) restructuring and institutional strengthening of the ANSeS; and (iii) control and cut-off of benefits dispensed to ineligible parties. The first component involves the transfer of active and noncontributing members and the related revenue and expenditure. This component also supports capital market development by allowing provincial employees to join the AFJP system. The second component focuses on restructuring the ANSeS to improve its administrative and financial operations, efficiently absorb the CPPs, and lessen the fiscal impact of the social security deficit. The third component calls for cutting off benefits to ineligible payees in order to generate significant savings for the system. For the two latter components, a US$40 million strategic plan for institutional strengthening has been designed, to be financed in equal proportions by local funds and the World Bank, to improve the operation of ANSeS administration and control systems (see Annex II-1).

THE BANK'S COUNTRY AND SECTOR STRATEGY: The Bank's strategy in Argentina provides support for three main areas: to continue with State reforms; to reduce poverty and raise the quality of life by creating jobs and increasing service coverage; and to boost productivity and competitiveness in the tradable goods sectors.

The proposed program is justified because it is consistent with the strategy of the Argentine government and the Bank with respect to modernizing the public sector and streamlining the administrative apparatus of the State, as well as supporting and consolidating the process of social reform, in particular through the ANSeS restructuring. The program is in line with the priorities established and agreed upon with the country during the programming mission of November 11, 1995.

ENVIRONMENTAL CLASSIFICATION: The Environment Committee, at its meeting of February 6, 1996, classified this as a Category II operation.

POVERTY TARGETING: The main purpose of the program is to contribute to reforming the Argentine State and, in particular, to consolidate the social security system. Accordingly, it does not meet the criteria set under the Eighth General Increase in Resources with respect to pursuing

the objectives of social equity and poverty reduction (document AB-1704).

BENEFITS: Transferring the CPPs to the national system will bring major economic benefits to Argentina. The most significant of these are as follows: (i) to help increase consolidated public savings through lower costs as a result of eliminating the CPPs and requiring the provinces to reduce their fiscal deficits; (ii) to contribute to expanding the capital market and promote investment and savings by allowing provincial employees to opt into the AFJP system to manage their retirement funds; (iii) to improve equity in the social security system in terms of benefits by expanding the coverage of national rules governing pension and benefit payments, which has been eroded by the fragmentation of the system; and (iv) to reduce fraud and evasion in the payment of contributions by making the Internal Revenue Bureau (DGI) responsible for collecting them and securing payment by the provinces with tax revenue share-outs. Over the long term, consolidating social security reform will narrow the overall fiscal deficit and improve the investment profile, since social security reserves will be administered largely by market criteria.

RISKS: One risk that would affect the size of the program is that some provinces could decline to transfer their CPPs to the national system. However, a good number of provinces have expressed interest in joining the program. This will make it possible to reduce provincial outlays, given the commitment not to incur additional expenditure as a result of this fiscal relief. A second risk is that the Federal Supreme Court could decide to declare unconstitutional certain articles of the Social Security Solidarity Act (Law 24,463) relating to the maintenance of vested rights. This decision could affect the adjustment of provincial pension benefits to conform to the national system. There is also a risk of a substantial change in the macroeconomic situation, which would impede project implementation. The government has however indicated that it is prepared to hold the present course of economic policy, as evidenced by the renegotiation of targets for 1996-1997 under the standby agreement with the IMF, which is expected to be approved by the IMF Executive Board in October of this year. Two fundamental contingencies that could impair the macroeconomic situation are: (i) a steady increase in evasion in the payment of taxes and social security contributions as a result of the recession that began in 1995; and (ii) the possibility that the transfer of outlays and deficits from the CPPs to the federal

government could give rise to an increase in other provincial expenditure. Also, any setback in the restructuring and streamlining of ANSeS activities could limit its ability to effectively administer the consolidated social security system.

In order to minimize the latter risks, the program calls for the loan to be disbursed as it is verified that the CPPs have been transferred to the national system. In connection with the other risks, the program conditionality includes obligations of the national government and of the ANSeS, as well as eligibility requirements and commitments by the provinces to take part in the program and be able to effectively transfer the CPPs. These obligations minimize the risks outlined and would help improve fiscal discipline in the provinces.

SPECIAL CONTRACTUAL CONDITIONS: The special conditions included in the loan contract are outlined in Appendix II.

I. FRAME OF REFERENCE

A. Macroeconomic setting

1.1 Since 1991, Argentina has been engaged in a process of deep-seated structural reforms on the economic and social front, to entrench macroeconomic gains and attain a level of self-sustainable development. The reforms have centered on privatization, the opening of the economy, tax reform, regional integration, and market deregulation. The centerpiece of the program was the 1991 Convertibility Act, which assures full convertibility of the Argentine peso at a fixed rate of exchange (one peso = one U.S. dollar), authorizes dollar transactions, and forbids the creation of money unless used to purchase foreign exchange.

1.2 The results of the program to date are impressive. Hyperinflation of 2,314% in 1990 had been driven down to 1.7% by 1995, a trend which continued in the first eight months of 1996. Fueled by higher consumer spending, the economy grew by an average of 7.7% yearly from 1991 to 1994. A large-scale program to privatize public enterprises has been carried out. The country cleared up arrears with its foreign creditors, opening the way for a huge influx of foreign capital.

1.3 However, economic growth slowed beginning in mid-1994, and a recession set in during 1995 following the financial crisis unleashed when foreign investors lost confidence. As deposits dwindled, credit to producers and consumers was tightened, aggravating the recession and taking a toll on businesses, many of which had to close. Unemployment reached 18% in May 1995, and remained at 16.4% in October. Gross domestic product (GDP) fell 4.4%; the financial system plunged into crisis and was revamped; and the country's budget deficit stood at 1% of GDP, owing to (i) falling social security receipts as plan members cut back their contributions and moved over to funded systems, and (ii) lower revenues from consumption taxes, particularly the value-added tax (VAT). Results were better in 1995: inflation held at 1.7%, exports were up 31.5% over 1994, and the current-account deficit was pared from US$11.91 billion in 1994 to US$3.56 billion in 1995.

1.4 To contend with these fiscal problems, in early 1995 the government raised the VAT rate from 18% to 21%, declared a tax moratorium, 1/ and cut civil-service payroll spending, social security, and other outlays; but the saving thereby produced was offset by a sharp falling-off of economic activity. The government injected liquidity into the financial system and set up two trust funds to rescue commercial banks and expedite the privatization of

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1/ In the October 1995 moratorium, taxpayers declared US$4 billion in taxes owing, which are to be paid in 1996.

government-owned provincial banks. These measures calmed the financial markets, induced investors to put their money once again in banks, and remonetized the economy.

1.5 According to forecasts for 1996, the economy should see a moderate recovery this year, with expected annual growth not exceeding 2.5%. The public accounts of the National Treasury reveal a deficit of about 4.5 billion pesos a month for the January to September 1996 period, owing to sluggish fiscal revenues. The US$2.5 billion deficit in June 1996 was over the US$1.475 billion target that had been agreed to with the IMF for that date, and the IMF thus reviewed in August the program targets set under the standby arrangement approved in April 1996. The IMF Executive Board is expected to approve the revised targets in October of this year. The IMF has indicated that it will be continuing its support to Argentina.

B. The Argentine social insurance system

1. Background

1.6 Argentina's pay-as-you go national pension system faced a serious crisis in 1992, owing to a confluence of factors: (i) a falling ratio of contributors to payees, which stood at barely 1.5:1 in December 1995; (ii) widespread nonpayment of required contributions; (iii) low retirement ages and shorter length-of-service requirements; (iv) a high salary replacement ratio, calculated on the basis of net earnings in the three years preceding retirement or in the three best of the last 10 years of contributions; (v) benefits being awarded to ineligible payees; (vi) inadequate disability-determination rules and procedures; and (vii) a number of plans favoring certain pressure groups. As a result, 5% of the country's retirees and pensioners receive close to one third of total benefit outlays. As the financial situation of the system became unsustainable, the national government had to put in additional funds to pay 50% of total retirement and pension benefits.

2. Pension reform

1.7 To address the above-described situation, the government pushed for the approval of Law 24,241 in October 1993, creating a universal-coverage scheme called the Integrated Retirement and Pension System (SIJP). Its aims are to (i) bring back the equitable treatment that had eroded under the fragmented system then in place, and (ii) restore the financial stability of the pension system for the long term. The new system, in force since July 1994, replaced the pay-as-you-go approach with a system combining pay-as-you-go elements and a defined-contribution system of individually funded accounts. Retirement benefits would henceforth not be tied to previous net earnings, and intergenerational transfers were in part replaced by personal pension savings. Under the terms of

Decree 507 of 1993, responsibility for the intake of payroll contributions passed from the National Social Security Administration (ANSeS) to the Internal Revenue Bureau (DGI).

1.8 The pension system set in place after the 1993 reform rests on two pillars:

a. The first pillar is a universal, mandatory, State-administered system (by the ANSeS) affording three kinds of benefits: (i) a basic universal benefit (PBU) equal to 2.5 times the mandatory average social insurance contribution (AMPO), 2/ that is, 27.5% of average taxable earnings, 3/ with a contribution period of 30 years, paid to persons reaching retirement age (65 for men, 60 for women); (ii) a transitory pension supplement (PC) for contributions paid in to the previous system, which is 1.5% of average adjusted earnings for the last 10 years of employment, multiplied by number of years (maximum 35) of contribution to the previous system; and (iii) benefits paid to current retirees. Employers contribute 16% to this pillar.

b. The second pillar has both publicly and privately administered components, at the employee's option. The private component is managed by pension fund management companies (AFJPs) through a defined-contribution system with individually funded accounts. The AFJP system also offers disability and life insurance with defined benefits. The public component of this pillar, administered by the ANSeS, affords an "additional service benefit" (PAP) equal to 0.85% of average earnings in the last 10 years multiplied by years of service under the new system. The second pillar is funded through an 11% payroll contribution paid by employees. The AFJP system covers administrative expenses and disability and life insurance premiums estimated at 3.5% of earnings. The remaining 7.5% of AFJP contributions is left to accrue in individual accounts. The State requires AFJPs to guarantee a minimum return and protect against insolvency of insurance companies.

1.9 Workers can elect to join an AFJP or take part in the PAP program under the second pillar. Members of one AFJP are free to transfer their account to another. PAP participants may subsequently join an AFJP, with no time limitation, but AFJP members may only return to the PAP system until September 1996.

2/ The AMPO was Ar$72.00 in March of 1995; the PBU (2.5 times the AMPO) thus was Ar$180.00 at that date.

3/ Individual contributions are 11% of taxable earnings. The AMPO is calculated twice yearly by dividing individual contributions by the number of active contributors. With this fixed 11% contribution, the AMPO is 11% of average taxable earnings, and 2.5 times the AMPO equals 27.5% of average taxable earnings.

3. Retirement benefits

1.10 According to the social insurance scheme approved in 1993, plan members would draw the following benefits when they retire:

a. **Under the publicly administered system**: a basic universal benefit (PBU), a supplementary benefit for contributions made into the old system (PC), and an additional service benefit (PAP).

b. **Under the private system**: a basic universal benefit (PBU), a supplementary benefit for contributions to the old system (PC), and a funded benefit (HC). The PBU and PC pertain to the publicly funded system; the HC would be based on the amount built up in an individual pension account (CCI).

1.11 Law 24,347 of 1994 brought in an old-age benefit payable at age 70 to persons with 10 years of contributory service. Five of the years of service must have been within the eight years preceding the end of employment. This benefit is 70% of the PBU (Ar$126).

4. Changes in the system in 1995

1.12 The Social Security Solidarity Act (Law 24,463) of March 1995 introduced a number of changes to the State-administered system described above. New provisions were as follows: (i) the State guarantees that it will award and dispense benefits until the appropriation in the Budget Act is exhausted, doing away with the updating of AMPO-based PBU calculations previously required under Law 24,241, and linking benefits to the performance of the public finances; (ii) the monthly benefit is capped at Ar$3,100; and (iii) the new pension plans affording favorable treatment to some groups are dismantled.

1.13 The Social Security Solidary Act also amended the federal government's pact with the provinces in the matter of vested rights, since there now are caps on national pensions, and periodic increments are contingent on the health of the public treasury. This could pose a problem for the transfer of provincial pension funds (CPPs) to the national system, if provincial retirees object.

5. Court challenges

1.14 The government's efforts to lower benefits to levels that the system can afford have been challenged in court by persons who feel they stand to lose. Most of those drawing benefits have also seen the real value of their payments drop as a result of imperfect indexation mechanisms during times of high inflation. Such an erosion of pensions entailed a breach of the laws that tied pension income to previous employment earnings.

1.15 In the context of stability created by the Convertibility Plan, the affected retirees and pensioners successfully sued the system administration for the indexing of pension benefits. The government acknowledged a liability of US$13.347 billion, to fulfill that obligation. 4/ Part of the payment was made in cash and part in debt consolidation bonds (BOCONs). A total of US$8.3 billion in bonds were placed. Cash payments to individual benefit recipients who agreed to that option were capped at US$1,560. In light of this situation, the government passed the Social Security Solidarity Act in March 1995, setting ceilings on pension benefits and acknowledging payment obligations, in line with national budget availabilities.

6. Financial condition of the social security system

1.16 The greatest challenge facing the new social security system is the financial stability of the State-run pay-as-you-go pillar, which is far from being consolidated. Three areas that require particular attention are (i) the funding of obligations of the old pay-as-you-go system for retirees and pensioners; (ii) a resolution to the legal action brought against the ANSeS on account of cuts in pension benefits and loss of preferential status of some plans; and (iii) problems facing the ANSeS for the efficient administration of the consolidation of the various pension plans for which it is responsible. 5/

1.17 Problems with the funding of obligations of the old system stem from (i) the slim ratio of contributors to payees (1.5:1), which is attributable in turn to widespread evasion, low retirement ages, and loose retirement and disability rules; and (ii) a high salary replacement ratio (81%). In addition, a Federal Supreme Court ruling is pending as to the constitutionality of a number of sections of Law 24,463 regarding vested rights and estoppel by judgment.

1.18 The 1993 pension reform (paragraph 1.7) included two measures to improve the contributions-to-benefits ratio. First, it raised the retirement age to 60 for women and 65 for men. Second, it

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4/ US$8,081,800,000 under Law 23,982 and US$5,265,300,000 under Law 24,130.

5/ The pension system's finances deteriorated sharply between 1991 and 1994, before the social insurance reform. Pension outlays went from the equivalent of 3.8% of GDP in 1991 to 4.9% in 1994, whereas contributions to the system edged up very slightly, from 3.1% of GDP in 1991 to 3.6% in 1994. Consequently, the deficit swelled from the equivalent of 0.7% of GDP in 1991 to 1.3% of GDP in 1994. This 1994 deficit was equal to 26% of pension payouts that year, and 36% of contribution intake. The deficit was made up largely by increasing Treasury transfers.

lengthened the minimum contributory period required to draw a pension under the publicly administered pillar from 15 to 30 years.

1.19 In the long run, the financial stability of the basic pension plan will be contingent upon (i) increasing compliance, (ii) unemployment rates, (iii) strict application of the principles of the Social Security Solidarity Act, particularly doing away with automatic pension indexing, and (iv) strict retirement rules and their enforcement.

1.20 As for resolving the legal problems confronting the ANSeS, the purpose of the suits brought against the agency is to reverse the changes instituted by the reform. The new system triggered a huge number of lawsuits against the ANSeS, as benefit recipients protested cuts in their payments and the loss of favored status (125,000 suits in all, aggregating US$2.5 billion). Some 60,000 of these cases are awaiting a Supreme Court ruling.

1.21 Lastly, the administrative difficulties being experienced by the ANSeS have come about as a result of efforts to consolidate the retirement funds in place in 1991, the National Employment Fund, family allowances, and funds administered by third parties. These problems would be addressed by the strategic plan for ANSeS institutional strengthening (Annexes II-1 and II-2).

C. The provincial reform program

1. Finances

1.22 Argentina's public sector is highly decentralized: the provinces and municipalities account for around 45% of total public expenditure. In 1994, the provinces were paying for 97% of basic education, 92% of health spending, and 84% of social assistance costs. Provincially-raised revenues accounted for only 18% of total public revenues and were equal to 37% of expenditures. The deficit was made up through transfers and tax revenue share-outs. The provinces have run deficits for some time, but the gaps have widened in the past five years. After the Convertibility Plan was brought in, total revenues and direct provincial revenues — particularly the latter — went up sharply, in real terms, but were outstripped by the increase in real expenditure. Personnel costs climbed 38% between 1991 and 1995, partly because of the 1992 decentralization of basic education and health services and partly because of salary increases. By 1995, the provinces' financial situation was untenable, with a 4.4% fall in GDP and the effects of the financial market crisis.

1.23 The consolidated provincial deficit stood at US$3.1 billion in 1995 (1.2% of GDP). The deficit funding requirement, including amortization, was US$5 billion (1.9% of GDP). To make up these deficits, the provinces have resorted to (i) borrowing from banks at high interest rates, secured by future tax revenue share-outs;

(ii) delaying payment of salaries and old-age and retirement pensions; and (iii) making part payments by means of provincial promissory notes and coupons. The 1995 aggregate consolidated debt of the 24 territorial divisions stood at US$14.217 billion, or 55% of provincial revenues that year.

1.24 The provinces rely heavily on national government transfers, which, including share-outs and grants, accounted for 58% of their overall 1995 revenues. However, this indicator is influenced by the heavy relative weight of the larger provinces, which receive smaller percentages. In 1995, only four provinces were below the average (Municipality of Buenos Aires 8.4%, Province of Buenos Aires 46%, Córdoba 53%, Santa Fe 58%). The others were higher, the extremes being Formosa (92%), Catamarca (93%), La Rioja (92%), Santiago del Estero (87%), and Chaco (85%). In 15 provinces, national funds accounted for over 70% of total revenues in 1995.

2. Provincial reforms

1.25 The situation described above is the result of deficient administration, weak fiscal discipline, and lack of an economic base in some of the poorer provinces. To address these problems, the national government sought to create inducements for tighter spending controls, a review of provincial taxes, and promotion of modern accounting systems. This intention was embodied in periodic agreements between the national government and the provinces. In practice, the strength of the reforms has varied from one province to another, depending on the specific circumstances of each.

1.26 In 1993 the national government and the provincial governors concluded the Federal Pact on Employment, Production, and Growth, whereby the national government pledged to consent to the transfer of provincial pension funds (CPPs) to the national social security system (ANSeS) when the provinces voluntarily joined that national plan. The signatory provincial governments, for their part, agreed to work on the following areas: (i) overhaul of provincial taxes (repeal of stamp taxes, fuel transfer tax, electricity tax, and tax on bank deposit interest, and substitution of a general consumption tax for the existing gross receipts tax), and curbing of tax evasion; (ii) privatization of companies, banks, and other provincially owned establishments; (iii) removal of restrictions on the supply of goods and services and elimination of market intervention; and (iv) agreement that national procedures, criteria, and actions will be applied directly in the provinces, including those pertaining to work accidents. In addition, the Act regarding Financial Administration and National Public Sector Control Systems (Law 24,156) promoted the adoption of modern financial administration and control systems in the provinces.

1.27 Reforms at the provincial level have moved fairly slowly, despite support from multilateral organizations on the provincial government revenue and expenditure side and for the privatization

of banks and provincial public enterprises. On the privatization front, a total of 35 State companies are being privatized, and 17 of them are now in private hands. Eighteen provincial and municipal banks are being privatized or closed. Two provinces plus the Municipality of Buenos Aires have transferred their retirement funds, and another four are awaiting approval from their respective legislatures. As for the institution of modern financial administration and control systems, five provinces have laws concordant with Law 24,156 and others have brought in reforms without the need for specific statutes.

1.28 The provincial deficit situation is very serious. As part of the Fiscal Pact, the national government thus is encouraging the transfer of provincial retirement plans to the ANSeS. The objectives of this move are (i) to enhance the stability of the consolidated public finances; (ii) to narrow disparities in pension benefits and contributions between provincial legislation and the national pension system; (iii) to avert local pressures that distort pension plans and contribute to provincial budget deficits; (iv) to require provinces to actually make payment of employer and employee contributions to the ANSeS rather than accruing such obligations on paper, as is the case at present. To this end, eligible provinces will undertake to pay contributions, pledging tax revenue share-outs as security.

D. <u>The Bank's strategy, and rationale for its participation</u>

1.29 It is recommended that in its activities with Argentina the Bank continue to focus on the following three basic aims, to support the government's investment priorities for the coming three years, and in accordance with Eighth Replenishment guidelines: (i) deepen and consolidate efforts made in the area of **modernization of the State** at the central level and extend them to provincial and municipal governments; (ii) **reduce poverty** and **improve the quality of life of the Argentine people** through actions seeking to create productive employment and improve the quality and expand the coverage of social programs; and (iii) **boost productivity and competitiveness** in the tradable goods sectors, with an environmental-protection focus, through support for infrastructure and activities to speed up the modernization of the production apparatus and regional integration.

1.30 The proposed program is justified because it is concordant with the strategy of the Argentine government and the Bank in terms of modernization of the public sector, strengthening of the State apparatus, and support for and consolidation of social reforms, notably through the restructuring of the ANSeS. The program falls within the established priorities, as agreed upon with the country during the programming mission on November 11, 1995.

E. IDB experience in similar operations

1.31 The Bank gained experience in the area of social security reform through an investment sector program (loan 733/OC-AR) which funded studies on the financial and actuarial status of several provincial pension systems and, on the basis of the studies' recommendations, helped draw up action plans for six provinces. Likewise, the Bank has been involved in social security reform programs in Mexico and Uruguay. This experience has equipped the Bank to examine the operation proposed herein. In 1993, the Bank also produced a publication on social security systems in Latin America, which looked at social security problems in Argentina and explored solutions.

1.32 The World Bank has a great deal of experience with pension system reforms, dating back to the 1980s. *Aging without Crisis*, a recent publication by this organization, recounts its work in this area. 6/ Among the countries receiving World Bank support for reforms and/or studies of social security systems are Costa Rica (1984), Chile (1986, 1992), Uruguay (1987, 1989, 1994), China (1990), Poland (1992), Turkey (1993), Tunisia (1993), Brazil (1994), and Argentina (1994).

1.33 In Argentina, the IDB has afforded support for the national government's program of structural reforms on the economic and social front, to make for lasting economic stability. Its assistance has been provided through the following operations: a public sector reform program (633/OC-AR) for US$325 million to help revamp the public sector and eliminate the structural deficit in the public accounts; a US$400 million debt and debt-service reduction loan (734/OC-AR); an investment sector program (733/OC-AR) to boost private-sector participation in the economy and make for more efficient management of provincial finances; a national electrical utility reform program for US$300 million (682/OC-AR and 684/OC-AR) in support of privatization initiatives for that sector; a State administrative and financial reform program for US$47.5 million (826/OC-AR), now in its first stage, which is to consolidate and expand administrative and financial reforms, provide support for the audit and internal management control system, and strengthen the systems of national and international accounts and statistics; a program furnishing US$450 million in funding in support of fiscal adjustment and social reform (871/OC-AR), to shield poverty-targeted social programs from budget cuts; and a program to privatize provincial banks, for US$750 million (865/OC-AR).

6/ World Bank Policy Research Paper, 1994.

II. THE PROGRAM

A. Objectives

2.1 The main objective of the program is to support the Government of Argentina in (i) strengthening social security institutions and consolidating reform nationally by, first, improving equity through consistency in regulations and their application and, second, supporting capital market development with the stimulus for private savings and investment provided by allowing provincial employees to join the pension fund administrators (AFJP) system; and (ii) helping to balance provincial budgets by lessening the significant impact exerted on provincial finances by deficits run by provincial retirement plans (CPPs). In addition, the program will support strengthening for ANSeS administration and controls to prevent fraud and evasion within the consolidated system.

B. Description

2.2 This sector loan would be disbursed in three tranches, the first for US$160 million and the second and third for US$80 million each. Disbursement of each tranche will be justified by the transfer of CPPs to the ANSeS in a transferrable amount equivalent to the tranche concerned. Disbursements under each tranche would be contingent on maintaining a satisfactory macroeconomic setting and carrying out the reforms described below and outlined in the policy letter (Annex III-1), the conditionality matrix (Annex III-2), and the eligibility criteria (Annex III-3). The program components would be as follows: (i) transfer of CPPs to the ANSeS; (ii) restructuring and institutional strengthening of the ANSeS; and (iii) control and cut-off of benefits dispensed to ineligible parties. The first component involves the transfer of active and noncontributing members and the relating revenue and expenditure. This component also supports capital market development by allowing provincial employees to join the AFJP system. The second component focuses on restructuring the ANSeS to improve its administrative and financial operations, efficiently absorb the CPPs, and lessen the fiscal impact of the social security deficit. The third component calls for cutting off wrongly granted benefits to generate significant savings for the system. For the two latter components, a US$40 million strategic plan for institutional strengthening has been designed, to be financed in equal proportions by local funds and the World Bank, to improve the operation of ANSeS administration and control systems (see Annex II-1). Details of each program component are provided in the following paragraphs.

1. <u>Transfer of CPPs to the ANSeS</u>

2.3 Transferring the CPPs to the national system would ensure that standards are applied across the board to all active and noncontributing members in the pension system, eliminating existing inequities and weaknesses in the CPPs; would bring in a centralized system like those of most other countries and therefore avoid the complication of having to ensure portability between systems; and would prevent further deterioration in provincial public finances. The total cost of the transfer to be incurred by the ANSeS during the first 12 months for the 15 provinces expected to join the program has been estimated at US$1,094 million, of which US$754 million represents the CPPs' deficit if they remain in the provinces and US$340 million the cost of transferring members to AFJPs. The multilateral organizations would cover just 55% of the 12-month amount required by the ANSeS to absorb the CPPs. The national government has undertaken to cover any additional cost of the transfer in the case of CPPs in provinces that join the national system after the IDB and World Bank loan proceeds have been used up (see paragraphs 2.9 to 2.13).

a. <u>Transfer of contributors</u>

2.4 The impact on contributions of transferring CPP contributors to the ANSeS would vary, since employer and employee contributions are not identical in the CPPs and the national system. Also, younger contributors, once within the federal system, could opt to join the individually-funded system administered by the AFJPs. As a result, not all of the revenues now flowing into the CPPs from provincial governments would reach the ANSeS.

b. <u>Transfer of retirees</u>

2.5 Transferring retirees and pensioners would reduce expenditure by the provinces significantly by passing on their pension deficits to the national government. The transfer of noncontributing members would increase ANSeS expenditure substantially, even though pension benefits could be adjusted under the Social Security Solidarity Act and new retirees would be subject to stricter requirements in the granting of pensions and lower benefits under the national system.

c. <u>Impact of the transfer</u>

2.6 As indicated, the short-term impact of the transfer would be positive for the provinces and negative for the national system. The overall result would be an increase in the public sector deficit owing to the transfer of contributors to AFJPs and, to a lesser extent, lower employer contributions. Also, the program would attempt to ensure that the provinces use the decrease in expenditure to reduce their deficits rather than finance any additional outlays. For the ANSeS, the transfer would mean a larger deficit initially; a substantial reduction in benefits paid

to existing pensioners would not be possible in the short term, and revenues could be eroded by active members moving to AFJPs. 7/ However, as new retirements take place based on stricter national requirements as to age, years of service and maximum benefits payable, and current retirees gradually conform to the same requirements, pension payment outlays will follow a downward trend over the medium term.

2. Restructuring of the ANSeS

2.7 Since the ANSeS would take on additional responsibilities with a larger number of contributors and beneficiaries following the reform, refinements to its administrative and financial operations are paramount. ANSeS is currently revamping its operating, computer and internal audit systems. The reforms will streamline ANSeS administration and introduce systems to identify and cut off unjustified benefits awarded.

3. Control and cut-off of benefits

2.8 The high degree of irregularity in awarding and dispensing benefits is a matter of concern. With the restructuring of the ANSeS, it will be possible to verify legitimacy and eligibility of benefits, including benefits awarded by CPPs transferred. A survey of 2.9 million beneficiaries turned up 500,000 cases of possible irregularities. The ANSeS is finalizing several methods (an audit of 500,000 files, a review of disability cases, refinements to the beneficiary survey) to detect irregularities. The government would strengthen DGI controls to cut down on evasion, particularly by the self-employed. 8/ Additional efforts would be made to improve the database on active members in the ANSeS system and the flow of information from the DGI to the ANSeS and the AFJPs.

C. Scaling

2.9 Calculations of the program amount needed to cover the two years of execution were based on the following costs to the system administered by the ANSeS: (i) the cost to the national pension system of absorbing the CPPs; and (ii) the additional deficit generated for the ANSeS by adjusting the CPPs to conform to the regulations currently prevailing nationally as a result of the

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7/ The deficit resulting from the transfer would initially be larger than the deficit the CPPs could incur if they remained under provincial administration, since some members would opt for the private system and pay into the AFJP system. The situation would reverse itself within about three years, for a scenario with the transfer resulting in a smaller deficit than the scenario without the transfer.

8/ The World Bank has granted a technical assistance loan to strengthen the DGI (Tax Administration II 3460-AR).

social security reform (Laws 24,241 of July 1994 and 24,463 of March 1995, and Decree 292 of August 1995). Under the latter regulations, members are allowed to choose between the public and private pillars for administration of their own pension contributions. In addition, the program includes the cost of technical cooperation to improve ANSeS administration and management.

2.10 As to the increase in the ANSeS deficit as a result of CPP reform and absorption, the project team, together with technicians from the World Bank and the Ministry, identified the provinces that would be eligible for the program. For each of them they performed a statistical survey of state finances and the respective CPP, a review of the legal framework governing pensions in the province, and a computation of the cumulative annual deficit that would be incurred by each CPP in 1996 and subsequent years under two scenarios: with and without the transfer.

2.11 The cumulative 12-month deficit of the 15 CPPs without the transfer was an estimated US$754 million in 1996, or greater than the US$677 million deficit posted in 1995. Covering the latter entailed: (i) significant delays in retirement and pension payments; (ii) partial payments using provincial funds obtained by resorting to bank loans at high interest rates, with adverse effects on provincial indebtedness and future debt service; (iii) limited pension and benefit payments using promissory notes issued by the provinces; and (iv) delaying payments and thereby increasing outstanding debt. The cumulative deficit for the initial 12 months that would be incurred by the ANSeS to absorb the 15 CPPs would be greater than the deficit incurred by them, at between US$1.094 billion (under the alternative selected) and US$1.277 billion, depending on the percentage of provincial employees opting to join the private AFJP system. Under an intermediate scenario, whereby the percentage of provincial employees transferred to the AFJPs is similar to experience at the national level, the cost to the ANSeS would be US$1.203 billion (see Annex II-3). The cost to the ANSeS is greater under all the scenarios due to: (i) lower intake of contributions following transfer of some active members to the AFJPs, an option not currently open to provincial employees; and (ii) the net result of the differences between employer and employee contributions under the provincial and national systems.

2.12 The cumulative marginal cost of converting the 15 CPPs 9/ over three years, as shown in Table 1, ranges between US$649 million and US$1,038 million, depending on how many members move to AFJPs. Under the intermediate scenario, the transfer will give rise to a total cumulative marginal cost for the three years on the order of

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9/ Measured as the difference between ANSeS projected expenditure and current CPP expenditure.

US$931 million. This scenario is based on the experience with the national system, which saw 65% of its members transfer to AFJPs during the first two years of operation under the new system.

Table 1
FINANCIAL REQUIREMENTS FOR TRANSFERRING CPPs UNDER DIFFERENT SCENARIOS
(in US$ millions)

YEAR	SCENARIO 1	SCENARIO 2	SCENARIO 3
1	340	449	523
2	266	337	352
3	43	145	163
Total	**649**	**931**	**1,038**

SCENARIO 1: Assumes that the percentage of members moving to AFJPs is 30% the first year and 35% of the reduced base the second year, for a final cumulative figure of 55%.

SCENARIO 2: Assumes that the percentage of members moving to AFJPs is 45% the first year and 36% of the reduced base the second year, for a final cumulative figure of 65%, as with experience at the national level.

SCENARIO 3: Assumes that the percentage of members moving to AFJPs is 55% the first year and 27% of the reduced base the second year, for a final cumulative figure of 70%.

2.13 The program would cover up to US$620 million equivalent of the cost of CPP reform, based on the cumulative 12-month deficit generated for the ANSeS by the absorption and conversion of CPPs from provinces meeting the program eligibility criteria. The unfinanced portion of deficits, plus any funding shortfall generated by provincial employees moving to the national system (given the net difference in contributions and payments between the provincial and national systems, moves to AFJPs, and other additional expenses), would be covered with own resources under the national budget, as indicated in the policy letter, as per the government's commitment towards the IMF, the World Bank and the IDB. In addition, the national government has undertaken to cover any deficits that may be generated in years subsequent to the transfer as a result of transferring CPPs to the ANSeS system (Annex III-1, policy letter). Such deficits will be reduced significantly in the future by the effects of social security reform and the execution of technical support for the ANSeS to be financed by the IDB and the World Bank.

D. Participating organizations

1. Provincial retirement funds (CPPs)

2.14 The provincial retirement funds set up for public employees, teachers and policemen provide coverage for some 1.4 million active members and 0.5 million noncontributing members under pay-as-you-go

plans with administrative and financial autonomy. Approximately 3,200 people work for the CPPs, which feature the following: (i) solidarity among members under a straightforward pay-as-you-go system; (ii) provincial government guarantees to cover any shortfalls that could affect the payment of benefits; and (iii) different provincial requirements as to age and years of service, and a high average pension as compared to the average pension under the national system. Table 2 presents the major features of CPP pensions.

2.15 As to their financial position, the CPPs generally run deficits that prevent both the provinces and the public sector overall from balancing their budgets. The reasons for this are as follows: (i) preferential regimes whereby generous pensions are granted to staff of provincial judiciaries and legislatures, equivalent to 85% of earnings after two years of service; a mismatch between years of service and years of contributions required; and high income replacement ratios; (ii) a minimum retirement age for teaching staff that is markedly lower in the provinces; (iii) the housewife retirement system that is run at a deficit using general provincial revenues; (iv) a failure to keep pension deficits under control and to remedy the shortcomings noted; (v) a lack of modern means of monitoring the roster of noncontributing members and of plans to control fraud at several CPPs; and (vi) a lack of actuarial reserves and high administrative expenses at CPPs.

2.16 One assessment of the financial position of the 15 CPPs that may potentially be transferred to the national system calls for a deficit of US$754 million for 1996 if the CPPs remain in the provincial system. The largest deficits are posted by the provinces of Río Negro, Córdoba, Santa Fe, San Juan, Tucumán, Jujuy and Salta (see Table 3).

2.17 At present, two provinces (Santiago del Estero and Catamarca) and the municipality of Buenos Aires have transferred their CPPs to the national system prior to implementation of the program. The provinces of Mendoza, La Rioja, Salta, San Juan, Jujuy, San Luis, Tucumán and Río Negro have signed transfer agreements that meet the eligibility criteria established, and fulfill the requirements set under the program to justify disbursements.

Table 2
FEATURES OF CPP SYSTEMS

PROVINCE	MINIMUM RETIREMENT AGE, GENERAL PENSION SYSTEM 1/	MINIMUM RETIREMENT AGE, TEACHERS 1/	AVERAGE MONTHLY PENSION IN 1995
Buenos Aires	60/60	50/50	581
Catamarca 2/	same as national	same as national	same as national
Córdoba	58/55	55/50	1,017
Corrientes	65/60	65/60	709
Chaco	60/60	No min.	851
Chubut	55/55	No min.	n.a.
Entre Ríos	62/57	57/52	971
Formosa	n.a.	n.a.	798
Jujuy	55/60	No min.	814
La Pampa	60/55	57/57	n.a.
La Rioja	60/55	No min.	576
Mendoza	65/62	52/52	625
Misiones	60/55	55/52	876
Neuquén	n.a.	n.a.	n.a.
Río Negro	60/60	52/52	1,080
Salta	60/58	55/53	594
San Juan	63/58	n.a.	914
San Luis	65/60	55/52	563
Santa Cruz	n.a.	n.a.	n.a.
Santa Fe	60/55	50/50	733
Santiago del Estero 2/	same as national	same as national	same as national
Tucumán	55/51	55/50	672
Tierra del Fuego	55/50	43/43	n.a.
MCBA 2/	same as national	same as national	same as national
ANSeS	65/60 3/	65/60	299

1/ For retirement age, the first figure is for men, the second for women.
2/ Already converted to the national system.
3/ Retirement age in the national system (ANSeS) is currently 62/58 but will be raised to 65/60 in the year 2003.
n.a. = Not available **Source:** World Bank

Table 3
ARGENTINA: FINANCES OF PROVINCES AND CPPs
(in US$ millions)

Province	CPP deficit in 1995	Provincial administration deficit in 1995	Ratio of CPP deficit to provincial admin. deficit (%)	CPP deficit in 1996	
				With transfer	Without transfer 1/
Municipality of Buenos Aires 2/	--	-38	--	--	220
Buenos Aires	65	280	30.4	117	116
Catamarca 2/	--	64	--	--	92
Córdoba	79	397	20.0	109	194
Corrientes	34	60	56.7	33	60
Chaco	28	110	24.5	29	55
Chubut	--	202	--	--	--
Entre Ríos	46	160	30.0	54	81
Formosa	13	151	11.3	21	21
Jujuy	58	193	30.0	50	81
La Pampa	--	3	--	--	--
La Rioja	26	53	49.1	26	39
Mendoza	36	34	105.9	36	92
Misiones	29	145	20.0	34	31
Neuquén	--	256	--	--	--
Río Negro	90	208	43.3	89	81
Salta	52	99	52.5	50	68
San Juan	62	164	37.8	94	141
San Luis	6	-50	12.0	4	12
Santa Cruz	--	38	--	--	--
Santa Fe	62	215	28.8	57	57
Santiago del Estero 2/	--	23	--	--	155
Tucumán	56	227	24.7	58	80
Tierra del Fuego	--	66	--	--	--
TOTAL	743	3,066	30.4	754 3/	1,094 3/

1/ Considers Scenario 1. Transfer of provincial employees to AFJPs: 30% the first year and 35% of reduced base the second year. The cumulative figure for two years would be 55%, or less than the 65% posted by the national system in May 1996.
2/ The municipality of Buenos Aires, Catamarca and Santiago del Estero have already been absorbed into the national government's finances.
3/ The total excludes, aside from those already absorbed by the ANSeS, the provinces of Buenos Aires, Chubut, La Pampa, Neuquén and Tierra del Fuego, as they will not be joining the program.

Source: National Directorate of Fiscal Coordination with the Provinces, Ministry of Economic Affairs and Public Works and Services.

2. National Social Security Administration (ANSeS)

a. Background

2.18 The Unified Sole Social Security System (SUSS) was created in 1991 as a result of merging the National Social Security Institute and

several family allowance funds. Its administration was entrusted to the ANSeS, an agency of the Ministry of Labor and Social Security whose president is appointed by the Minister of Labor and Social Security. The ANSeS administers the current Integrated Retirement and Pension System (SIJP), which includes: (i) funds from the pay-as-you-go system and the public pillar components; (ii) the National Employment Fund, which provides unemployment benefits and finances job training; (iii) family allowances; and (iv) third-party funds (from ANSSAL, the National Health Services Administration, and INSSJP, the National Social Security Institute for Retirees and Pensioners).

b. Staff and duties

2.19 The ANSeS has 8,550 employees, 3,730 (43.6%) working at the regional branches and offices, 4,123 (48.2%) at the head office, and 698 (8.2%) in the other category (on leave, development leave, executive staff, etc.). The distribution of employees at the branch offices does not match the geographical distribution of ANSeS clients, which causes serious discrepancies in the ratio of employees to beneficiaries, affecting the quality of service. Since there are sufficient staff to deal with the increased workload as a result of absorbing the CPPs, the ANSeS does not plan to hire the staff of the CPPs except for a small number of key employees needed to effect the transfer.

c. Administrative structure

2.20 The administrative structure is appropriate to the functions of the ANSeS: awarding and dispensing benefits to retirees, pensioners and active workers. The ANSeS does not collect contributions and has no legal authority to prosecute evaders (those functions fall to the DGI); does not administer any reserve funds as there are none of these in a pay-as-you-go system; and performs minimal cash management by outsourcing benefit payments to commercial banks. The ANSeS operates in a relatively decentralized manner, in that the regional offices have functional autonomy to offer customer services through their branches and integrated service units (UDAIs).

2.21 Budget decisions made each year by the Congress determine the financial situation of the system according to the rule of benefit mobility. Accordingly, the ANSeS is not responsible for actuarial imbalances within the system.

d. Management

2.22 The current authorities of the ANSeS have undertaken determined reform initiatives to put the organization back on track. Two international firms of recognized expertise have performed a complete diagnosis. Based on their findings, the ANSeS authorities have adopted two strategies: (i) development and implementation of

an emergency plan to gain an adequate measure of control at the institution by the end of 1996; and (ii) a reform plan whereby at the end of two years the ANSeS would be running efficiently and well equipped to perform its specific duties. At present, the authorities have set clear criteria as to the agency's future organization, lines of authority, and the accountability of its officials. Steps are also being taken to review accounting systems and reinforce internal auditing, as well as to identify and correct procedures and establish safeguards in the information technology area. Among the more important initiatives adopted by the current administration are the following: (i) creation of a new administrative and management structure; (ii) review of accounting and auditing systems; (iii) review of processes to award and dispense benefits; (iv) restructuring of information systems; (v) reorganization of UDAIs; (vi) staff training; (vii) fraud control; (ix) updating the database on active workers; and (x) cutting down on evasion in contribution payments. The above actions and plans are included in the strategic plan for institutional strengthening (Annexes II-1 and II-2). Progress and satisfactory implementation of the plan is a condition precedent for disbursement under all tranches of the proposed sector loan.

e. Financial situation

2.23 The programs administered by the ANSeS run a deficit and require additional transfers from the government in order to meet expenses. The ANSeS obtains its funding from: (i) contributions equal to 11% of earnings from workers affiliated with the public system; (ii) employer contributions of 16% of payroll for all public and private employees covered by the national system; 10/ (iii) 9.9% of VAT revenues; (iv) 90% of personal property tax revenues; (v) 20% of capital gains tax revenues; (vi) 30% of privatization revenues; and (vii) 15% of tax revenue share-outs after deducting DGI operating expenses. In 1995 contribution revenues accounted for 63% of the total. Direct retirement and old-age pension payments stood at US$13,486 million and total outlays for services (retirement and old-age pensions, family allowances, National Employment Fund and third-party funds administered) totaled US$20,166 million. ANSeS outlays account for 40% of the national budget, and direct retirement and old-age pension payments for 28%.

2.24 In 1995 the pension system posted an accounting surplus of US$411 million as a result of a special Treasury transfer of US$1.43 billion and an advance of US$1.35 billion in respect of delinquent employee and employer contributions cleared under a tax amnesty. This development should have a favorable impact on 1996.

10/ The actual rate is 14.7% after discounts granted to certain sectors and regions. Decree 292 of August 1995 lowered employer contributions by between 30% and 80% depending on the province of intake.

Without it, the ANSeS cash deficit would have been US$2,369 million (see Table 4). The deficit is attributable to several factors beyond ANSeS control. The first has to do with the members' option to choose between the public and private pillars, which since the second half of 1994 has pushed down revenues without lowering pension benefit payments. The second was the government's decision to reduce employer contributions for certain sectors and locations, which in turn lowered revenues. The third factor was the economic recession in 1995, when unemployment increased considerably and contribution revenues fell.

TABLE 4
ANSeS: PENSION SYSTEM CASH FLOW
(in millions of pesos)

	1995
Total current revenue	13,329
Contributions	8,401
Tax revenues	2,972
Other tax revenues	1,956
Total current expenditure	16,260
Retirement and pensions benefits	13,486
Noncontributory pensions	468
Poverty subsidies	225
Rate subsidies for noncontributing members	44
Operating expenses	246
DGI	133
Military — noncontributing members	1,617
Other expenditure	41
Net capital revenue	298
Deficit (-)	-2,369
Treasury transfers	1,430
Debt 2/	1,557
Increase in asset financing	-697
Intersystem transfers	79
Total financing	2,369

1/ Includes 15% of tax revenue share-out and noncontributory pensions.
2/ Includes Ar$1.35 billion in loans secured by promissory notes in connection with the amnesty.

Source: ANSeS

2.25 Administrative expenses, including transfers to the DGI for intake of contributions, accounted for 2.3% of total outlays and do not represent a significant burden on system finances.

f. System coverage

2.26 As of December 1995, the ANSeS system was making pension payments of 3.6 million. There were 7.4 million active members, of whom only 60% were paying into the pension system. The degree of compliance by active members seems to be determined more by the type of employment (employee or self-employed) than on the type of system (pay-as-you-go versus fully funded) as well as employment status. The World Bank has provided technical cooperation for the DGI (Tax Administration II, Loan AR-6034) to alleviate the problem of evasion. The percentage of contributors is considered low compared to other countries, which suggests possible problems with follow-up and control of granting benefits.

g. Actuarial situation

2.27 The ANSeS does not currently have a system of actuarial analysis. It is essential that such a capacity be developed for the pension system which it administers, and a component has been included for this purpose in the strategic plan for institutional strengthening.

3. Pension fund administrators (AFJPs)

2.28 The AFJP system has met with wide acceptance. There are 24 AFJPs, many of them associated with national and foreign banks and insurance companies. There are 5.3 million members affiliated with the private system, of whom 2.8 million (53%) make regular contributions. The AFJPs held savings of approximately US$3.9 billion as of June 1996.

2.29 Investment policy has been conservative. As of year-end 1995, the AFJPs held 46% of their portfolios in government bonds, 27% in bank deposits, 6% in municipal bonds, 7% in corporate bonds, 2% in stocks, 4% in mutual funds, 3% in foreign securities, 3% in regional projects, and 2% in cash. Average returns have been high, at over 13% since July 1995 and a high peak of 20% in December 1995. Differences in returns between the AFJPs mean that members frequently move from one fund to another.

2.30 Operating expenses of the AFJPs have been calculated as 3.5% for premiums and expenses, leaving 7.5% for capital formation based on the contribution rate of 11% of payroll. According to the report of the AFJP Superintendent, the cost of disability and life insurance premiums has been less than projected, giving the AFJPs a substantial margin of earnings. The funds have recently begun to compete on lower premiums.

4. The national government

a. Impact on national finances

2.31 Transferring all 15 CPPs will have a significant impact on national system finances. The option selected for scaling the operation is the one that requires the least financing to transfer the 15 CPPs. Under this option, impact is calculated on the basis of the cost of the transfer in the first year (US$754 million) and the marginal cost of the option selected (US$340 million) based on a 55% level of moves to AFJPs. Consequently, the total cost of the first 12 months of the transfer, distributed over 1996 and 1997, would be US$1.094 billion, of which US$600 million (55%) would be financed by international organizations. The impact on the national finances would diminish gradually to disappear within nine years. The national government has undertaken to provide sufficient resources and to include the necessary items in the national budget beginning in 1997. These appropriations will also cover the cost of transferring provinces joining the national pension regime once the IDB and World Bank loan proceeds have been used up. Table 5 shows national government projections for 1996-1997, which are consistent with carrying through the IMF stand-by program and absorbing the deficit of the CPPs.

TABLE 5
NATIONAL GOVERNMENT FINANCES
(in millions of pesos)

	1995	1996 1/	1997 1/
Total revenue	47,950	48,644	54,669
Taxes	30,816	32,941	38,141
Social security contributions	12,703	11,062	12,493
Other revenue	4,432	4,641	4,035
Total expenditure	53,008	55,397	57,457
Payroll	7,156	7,221	6,704
Goods and services	2,499	2,160	2,496
Retirement and pensions benefits	16,300	17,232 2/	16,828 3/
Current transfers	19,307	19,686	21,407
Interest	4,228	4,942	5,860
Other expenses	3,518	4,116	4,162
Deficit (-)	-5,057	-6,752	-2,789

1/ Figures consistent with the IMF, agreement.
2/ Includes deficits of CPPs in Catamarca, Santiago del Estero and the municipality of Buenos Aires, transferred prior to the program, as well as the deficits of CPPs transferred under the program in 1996: Rioja, Jujuy, Mendoza, Salta, San Juan, San Luis, Tucumán and Río Negro.
3/ Includes financing of the deficits of CPPs transferred in 1996 under the program. Financing of CPP deficits of Santa Fe, Corrientes, Chaco, Entre Ríos, Misiones, and Formosa, to be transferred in 1997, totaling US$372 million overall, would be included in the national budget as each transfer is effected.

Source: National Directorate of Fiscal Coordination with the Provinces, Ministry of Economic Affairs and Public Works and Services.

2.32 The annual cost of the transfer for subsequent years would be more manageable given: (i) smaller deficits (US$674 million in the year 2001); and (ii) efforts by the ANSeS and the DGI to control fraud and evasion. The restructuring of the ANSeS alone is expected to save more than US$300 million each year by eliminating irregular benefit payments. In addition, collections would rise thanks to improved evasion control by the DGI.

b. Analysis model

2.33 The model was designed jointly with experts from the World Bank and the Argentine government to determine the effect of the transfer on the deficits of CPPs in the 15 provinces which are prepared to participate in the program (see Annex II-3). The model uses a comparison of two scenarios to compute the deficits. Under the first, the CPPs are transferred to the ANSeS; under the second, they remain under provincial administration. Estimates were done of the impact of the transfer on ANSeS finances and the amount by which the provincial deficits would be reduced as a result. The analysis shows that eliminating the provincial regimes would initially affect the national government finances adversely,

followed by a positive effect in the medium term through a reduction in consolidated pension expenditure, and an eventual reduction of the fiscal deficit. The transfer for the 15 provinces will require an initial national effort of US$754 million, equivalent to the deficits of the CPPs without the transfer, not including the need for additional funds to offset provincial employees moving to the private AFJP system. This marginal cost would be US$340 million in 1996 for the alternative selected, which calls for the lowest number of employees moving to AFJPs. The cumulative cost over the next three years would range from US$649 million to US$1.038 billion, depending on the assumptions used. The intermediate result, consistent with the experience at the national level with members moving to AFJPs, would be a marginal cost of US$931 million for the three years (see Table 1).

2.34 The alternative selected (which calls for 35% of provincial employees to move to AFJPs in the first year and 30% of the reduced base the second) yields the following results: (i) the scenario with the transfer carries a higher cost in the first three years, primarily as a result of members moving to AFJPs; (ii) the situation improves as of the fourth year, when costs with the transfer are lower than without it; and (iii) the scenario without the transfer deteriorates rapidly beginning in the fourth year, while the scenario with the transfer improves gradually.

E. Institutional strengthening program

2.35 The program includes support for the strategic plan for ANSeS institutional strengthening, to be financed by the borrower with local funds of US$20 million and World Bank funds in the same amount (Annex II-1). The targets included in the execution schedule for this plan are part of the conditionality to be fulfilled prior to disbursement of each tranche. Progress on meeting the targets will be measured using benchmarks in several areas: (i) institutional restructuring; (ii) review of processes followed in awarding and dispensing benefits to reduce fraud and error; (iii) adjustments in computer systems; (iv) incorporation of CPPs; (v) reorganization of decentralized integrated service units (UDAIs); (vi) satisfactory performance of audits of noncontributing members; (vii) staff training; and (viii) updating the database on active members. The execution timetables for the plan are outlined in the strategic plan included as Annex II-2.

III. FINANCING AND PROGRAM EXECUTION

A. The borrower and executing agency

3.1 The Government of Argentina has requested financing from the IDB and from the World Bank in support of the transfer of CPPs to the national pension system and the ANSeS institutional strengthening. The banks would lend US$320 million each.

3.2 The borrower would be the Argentine government and the executing agencies would be the Ministry of Economic Affairs and Public Works and Services (MEyOSP) and the National Social Security Administration (ANSeS). The IDB loan would be disbursed as the CPPs are transferred to the national system. Each disbursement would be linked to the 12-month cost of the reform generated for the national government by each transfer (see Table 3, column headed "With Transfer"). The Argentine government would contribute additional funding: Conditions would be placed on the national government and the ANSeS, as detailed subsequently. The provinces will be required to meet specified eligibility criteria to be admitted to the program (see paragraphs 3.23 to 3.27).

B. Program execution

3.3 The MEyOSP will designate a program coordinating unit which will be responsible for: (i) compiling and presenting information to the Bank in support of disbursement for each tranche, including compliance with the appropriate conditionality; (ii) following up on actions by institutions participating in the program; (iii) administering the program's finances in accordance with the Bank's guidelines; (iv) ensuring proper and timely implementation of the reforms agreed upon; and (v) preparing any reports requested by the Bank.

3.4 For implementation of the strategic plan, the Social Security Secretariat will be the supervisory institution project execution will be by an executing unit within the ANSeS, which will carry out the strategic plan and coordinate with the Bank on the various aspects of execution. The unit will be responsible for hiring consulting firms and ensuring that work is completed on a timely basis according to Bank-approved procedures, arranging for training for ANSeS staff, purchasing equipment for integrated service units, and preparing any information requested in connection with the plan and monitoring thereof against the targets agreed upon.

C. Rationale for transferring the CPPs

3.5 The basic reason for transferring the CPPs to the national pension system is to standardize application, benefit payments, and eligibility requirements for benefits as stipulated under national

provisions. The transfer is justified by the following: (i) the national government has demonstrated a political will to reform the pension system which is not evinced by the provinces; (ii) the reform undertaken by the national government is intended to finance the pension deficit in a manner consistent with the prevailing macroeconomic policy framework; (iii) the reform would normalize provincial pension payments; (iv) centralizing the pension system will eliminate the inequities and weaknesses already noted in the CPPs and improve administration of the consolidated system; (v) the countries in the European Community and most of the countries in the region have centralized pension services that enable workers to move from one region to another with portability of contributions and benefits; a decentralized system made up of separate provincial systems would bring the unnecessary complication of having to establish portability between systems, opening the way for distortion and irregularities, particularly since the provinces have very different rules on calculating pension payments, length of service required for eligibility, and income replacement ratios. Provincial public employees in provinces that do not join could see their rights eroded by the problems affecting the CPPs, the impossibility of joining AFJPs, and the lack of portability.

3.6 The option of improving the CPPs without transferring them to the federal system is unjustified both politically and technically, since: (i) the CPPs cannot be restructured financially until the legal structure at the root of their insolvency is modified; (ii) the administrative restructuring of the 15 CPPs would require an equal number of technical-assistance operations, thus multiplying the required technical support; (iii) the decentralized CPPs are a financial burden on provincial treasuries that will grow more onerous as the number of retirees and pensioners rises; and (iv) the current distortions would persist, and portability would have to be established between systems differing significantly in terms of contributions and benefits.

D. Disbursements, records, auditing and control

3.7 The sector loan disbursements will be used to finance the CIF value of imports of eligible goods, with the exception of imports specifically excluded by the Bank, upon verification that they have been paid for and cleared through customs; and inspection and supervision expenses of US$3.2 million equivalent. Retroactive financing of up to 20% (US$64 million) of the loan could be applied to eligible imports in the six months prior to operation approval.

3.8 For procurement of imports under US$5 million, the imports may be justified according to established national procedures, provided they are consistent with the Bank's procedures. Procurement in smaller amounts from the private sector is to take place in accordance with commercial practices based on quotations from suppliers from at least two member countries of the Bank.

3.9 For each disbursement, the executing agency is to provide documentation listing the goods imported during each period, the country of origin, and the date and amount of the transaction. For accounting and control purposes, the borrower is to open a special account at the Central Bank, keep separate accounting records for the program, prepare and remit disbursement requests with lists of eligible transactions, and keep all relevant supporting documents.

3.10 The borrower is to present to the Bank, within 90 days after disbursement of each tranche, a statement of account for that tranche drawn up in accordance with Bank-approved terms of reference and certified by an independent auditing firm designated by the borrower and acceptable to the Bank.

E. Inspection and supervision

3.11 The Bank will establish such inspection procedures as it may deem necessary to ensure satisfactory execution of the program. The borrower and the executing agency will collaborate as necessary to perform the proposed tasks.

3.12 The borrower, the executing agency and the Bank will hold meetings from time to time, at the request of any of the parties, to exchange views on the progress made on program implementation and fulfillment of the disbursement conditions and eligibility criteria. The program's consistency with the economic policy framework will also be reviewed at the meetings. To this end, the borrower undertakes to provide the Bank during program execution with adequate information on developments and results.

F. Ex post evaluation

3.13 Following Bank policy, in consultation with the borrower and the executing agency, it was decided not to include an ex post evaluation in program activities. However, such an evaluation could easily be performed if desired since the necessary information will be available.

G. Conditions for the three tranches

1. Conditions to be met by the national government (Annex III-2, conditionality matrix)

a. Macroeconomics

3.14 Maintain an appropriate macroeconomic framework consistent with program implementation, in accordance with the objectives set forth in the policy letter drawn up by the national government.

b. Legal, administrative and financial reform

3.15 Uphold the principles of the Social Security Solidarity Act.

3.16 Fulfill at least the conditions of the 1993 Fiscal Pact currently in force.

3.17 Restructure the ANSeS to enable it to absorb the CPPs efficiently, for which the national government undertakes to:

(i) Present the national and ANSeS budgets and amendments thereto, to demonstrate that sufficient financing is available to cover ANSeS consolidated deficits.

(ii) present quarterly a budget performance statement showing that funds have been transferred to the ANSeS to finance the deficits generated by transferring the CPPs.

(iii) set up and maintain a special account to deposit the proceeds of the international loans to be used to finance part of the ANSeS deficits generated by transferring the CPPs.

(iv) Make satisfactory progress on the ANSeS reform. Proper implementation of the reform program will be verified during a review prior to each disbursement, as measured by benchmarks agreed upon in the strategic plan (Annexes II-1 and II-2) included in the matrix. The benchmarks will be used to monitor progress in several areas: management strengthening and implementation of the new management structure; adjustment of information technology; equipment and restructuring of integrated service units; review of asset base; control of irregularities; and cleanup of CPP files.

(v) Sign an agreement with the Central Bank whereby the Central Bank undertakes to fulfill its obligations under the loan contract.

c. <u>Reform of CPPs through transfer to the ANSeS</u>

3.18 The national government will: (a) admit to the program only those provinces which meet the eligibility criteria (Annex III-3); (ii) sign a transfer agreement with each eligible province that includes at least the provisions established under the second point of the eligibility criteria; (iii) ensure that provincial deficits are reduced by an amount at least equivalent to the fiscal relief provided through the transfer of the CPP concerned.

3.19 With respect to transferring the CPPs, the ANSeS will satisfactorily perform the following actions: (i) apply the Social Security Solidarity Act to the noncontributing members of the CPPs transferred, to adjust benefits to the national system; (ii) absorb the transferred CPPs administratively; (iii) update the database of active members and their vested rights; and (iv) establish mechanisms to ensure proper intake of employer and employee

contributions. Prior to the second disbursement, the ANSeS will begin the process of selecting specialized firms acceptable to the Bank to conduct the census of beneficiaries and review disability benefits. Prior to disbursement of the third tranche, the ANSeS will hire the firm in accordance with the terms of reference agreed upon with the Bank.

3.20 Present the findings of the audit of noncontributing members and the actual position of each CPP transferred.

3.21 The national government is to present a positive evaluation of compliance by the provinces with the obligations set forth in the eligibility criteria and transfer agreement agreed upon. Also, prior to disbursements subsequent to the first tranche, the national government is to present evidence of compliance by the provinces included in the previous tranche, in respect of: (i) lowering the ratio of staff to net income (current income plus contributions less transfers to municipalities). The weighted average of the aforesaid ratio in the provinces included in the previous tranches is to have been lowered prior to the next disbursement. In particular, provinces with a ratio of greater than 85% in 1995 are to lower the ratio by at least 10% prior to disbursement of the following tranche; (ii) reducing the province's fiscal deficit by an amount at least equivalent to the fiscal relief provided by the transfer of CPPs according to the measuring methods agreed upon with the Ministry of Economic Affairs and Public Works and Services; (iii) lowering or improving the provincial debt profile in the context of the August 12, 1992, agreement between the national government and the provincial governments; and (iv) presenting budget projections for the provinces included in the respective tranches for the next three years, demonstrating a sustainable fiscal policy and the effect of transferring the CPPs.

d. Supervision

3.22 Reach agreement with the IDB and the World Bank on a mechanism to verify fulfillment by the provinces with the obligations set forth in the eligibility criteria and transfer agreement reached with the participating provinces.

2. Eligibility criteria applicable to provinces (Annex III-3)

3.23 The national government will require provinces and municipalities to take certain steps in order to be eligible to transfer their respective CPPs to the federal system:

a. Legal instruments

3.24 Obtain authorization from the provincial legislature to transfer retirement funds to the national system.

3.25 Pass a special law, sanctioned by the provincial legislature pursuant to the constitution, ratifying the transfer agreement and containing the following provisions: (i) delegating to the federal government the power to legislate social security matters and an unrestricted commitment to refrain from issuing regulations of any kind that would allow new general or special retirement funds to be organized, directly or indirectly, within the provincial territory; (ii) providing for the dissolution of all ordinary or special regimes in the province; (iii) maintaining at the provincial level any claim or suit in respect of obligations existing prior to the transfer; (iv) maintaining at the provincial level obligations in respect of any increase in the amount of liabilities subsequent to the 1993 Fiscal Pact, as established in said Pact; and (v) according preference to the payment of employee and employer contributions in respect of provincial public employees using tax share-outs to secure compliance through deductions made automatically by the national government.

b. Compliance with the Federal Pact and Law 24,156

3.26 Present evidence of satisfactory compliance with the commitments undertaken by the provinces in the Fiscal Pact of August 12, 1993, concerning tax and regulatory reforms.

c. Privatization program

3.27 Have a privatization program under way in the framework of the August 1993 Federal Pact on Employment, Production and Growth.

H. Monetization of disbursements

3.28 The disbursements would be monetized in a special fund and the proceeds used to cover ANSeS deficits as the CPPs are brought in. These funds would be replenished upon depletion. The loan would be disbursed in three tranches, the first for US$160 million and the second and third for US$80 million each, subject to compliance with the conditions agreed upon.

3.29 The monetization of disbursements would be used to cover any cash deficits run by the ANSeS as a result of transferring the CPPs. Disbursements by the national government to the ANSeS would be made as the CPPs are transferred to the national system. Each disbursement would be tied to the first-year deficit generated for the ANSeS by the transfer.

3.30 The cost of implementation of the ANSeS strategic plan is US$40 million. The national government will provide local funding of US$20 million, to be complemented by a technical assistance loan for the same amount from the World Bank.

I. Strategic plan

3.31 The main objective of the strategic plan is to standardize benefits and eligibility requirements for the pension system nation-wide. Accordingly, the funds earmarked for hiring consultants will be used to: (i) strengthen ANSeS administration and control procedures; (ii) facilitate absorption of the CPPs transferred to the ANSeS; and (iii) strengthen control and elimination of irregular benefits. The administrative restructuring and reorganization of the systems by the ANSeS commenced at the beginning of this year.

3.32 The principal components of the strategic plan are as follows: (i) reform the ANSeS organizational and management structure; (ii) review of processes and procedures to detect and correct weaknesses; (iii) adjustment of computer systems and creation of a new management information system; (iv) absorbing the CPPs administratively and functionally and exchanging information with ANSeS records; (v) reorganization of the network of branches (UDAIs); (vi) screening and monitoring by auditing of dossiers on beneficiaries; follow-up on possible irregularities detected in the survey of beneficiaries and review of disability cases to eliminate any irregularities detected; (vii) improvement in technical quality and update of the active member database, and review and development of individual contributor accounts, with special emphasis on those six months away from retirement; and (viii) reduction of evasion in paying contributions by standardizing definitions using a unified ANSeS/DGI language, and procedures and resources to effect an exchange of information between the ANSeS and the DGI. The components of the strategic plan to be financed by local funds and the World Bank technical assistance loan are detailed in Annex II-1.

J. Environmental classification

3.33 The Environment Committee has classified this as a Category II operation. The environmental brief was approved by the Committee on February 6, 1996.

K. Policy letter

3.34 The Bank concurs with the borrower on the policies outlined in the development policy letter attached as Annex III-1 hereto. In that letter, the government provides definitions of macroeconomic and financial policy and of specific social security reforms at the national and provincial level, and undertakes a commitment towards the Bank to carry them out.

IV. RISKS AND BENEFITS

A. Risks

4.1 One risk that would affect the size of the program is that some provinces could decline to transfer their CPPs to the national system, owing either to a lack of political will or an inability to recognize that direct management generates deficits and has a definite present and future impact on provincial finances. However, a good number of provinces have expressed interest in joining the program. This will reduce provincial outlays, given the commitment not to incur additional expenditure as a result of this fiscal relief. A second risk is that the Federal Supreme Court might decide to declare certain articles of the Social Security Act (Law 24,463) unconstitutional, in matters relating to maintenance of vested rights. Such a decision could affect the adjustment of provincial pension benefits to conform to the national system.

4.2 There is also a risk of a substantial change in the macroeconomic situation, which would impede project implementation. However, the government has indicated that it is prepared to hold the present course of economic policy, as evidenced revised in the stand-by agreement which is to be approved by the IMF Executive Board in October of this year. Two fundamental contingencies that could impact the macroeconomic situation are: (i) the steady increase in evasion in the payment of taxes and social security contributions as a result of the worsening recession; and (ii) the possibility that the transfer of outlays and deficits from the CPPs to the federal government could give rise to an increase in other provincial expenditure. The conditionality of the sector loan addresses the latter risk, and the ANSeS strategic plan financed with local and World Bank funding calls for updating the active member database and for controlling irregularities. The World Bank technical cooperation for the DGI now under way will facilitate better evasion control.

4.3 Lastly, any setback in the restructuring and streamlining of ANSeS activities could limit its ability to effectively administer the consolidated social security system. The strategic plan for institutional strengthening would minimize this risk.

4.4 In order to mitigate the risks indicated, the program calls for the loan to be disbursed as the CPPs are transferred to the federal government. The provincial authorities have stated that they are prepared to transfer the CPPs to the federal government in view of the large share of their budgets now represented by the CPP deficits. In connection with the other risks, the program conditionality includes obligations of the national government and of the ANSeS, including specific schedules governing progress on

the results of the ANSeS strategic plan in the various areas covered, as well as eligibility requirements and commitments by the provinces to take part in the program and effectively transfer the CPPs. These obligations minimize the risks described and would help improve fiscal discipline in the provinces.

B. Benefits

4.5 Transferring the CPPs to the national system will bring major economic benefits to Argentina. The most significant of these are as follows: (i) to help increase consolidated public savings through lower costs as a result of eliminating the CPPs and requiring the provinces to reduce their fiscal deficits; (ii) to contribute to expanding the capital market and promote investment and savings by allowing provincial employees to opt into the AFJP system to manage their retirement funds; (iii) to improve equity within the social security system in terms of benefits by expanding the coverage of national rules governing pension and benefit payments, which has been eroded by the fragmentation of the system; and (iv) to reduce fraud and evasion in the payment of contributions by making the Internal Revenue Bureau (DGI) responsible for intake and securing payment by the provinces with national tax revenue share-outs. Over the long term, consolidating social security reform will narrow the consolidated fiscal deficit and improve the investment profile, since social security reserves will be administered largely by market criteria.

STRATEGIC PLAN TO PROVIDE INSTITUTIONAL STRENGTHENING FOR THE NATIONAL SOCIAL SECURITY ADMINISTRATION (ANSeS)

I. SUMMARY

A. Background

1.1 The provincial social security sector reform program being carried out by the Argentine authorities will include institutional strengthening for the National Social Security Administration (ANSeS) intended to modernize its administrative structure and information systems and strengthen control of fraud and evasion.

1.2 The federal government, with the support of international agencies, has therefore drawn up a strategic plan for institutional strengthening of the ANSeS (hereafter, the plan), the purpose of which is to restructure and streamline operations in that Administration. Successful execution and progress in implementing this plan, along with subsequent adoption by the ANSeS of the required reforms, will constitute prior conditions for disbursements under each tranche of the provincial social security sector reform program. The Bank will conduct technical reviews to ensure satisfactory performance before actually releasing the funds under each tranche. Technical reviews will be conducted in cooperation with the World Bank, based primarily on the goals and project timetable shown in Annex II-2.

B. Overall objective

1.3 The objective of the plan is to support restructuring of the ANSeS to correct deficiencies in the Administration's management organization, operations and information systems, enabling it to better absorb provincial retirement funds (CPPs) that are transferred to the national pension system. The plan also includes resources to cover the cost for control and elimination of wrongly granted benefits.

C. Project participants

1.4 The ANSeS will be responsible for carrying out the plan by creating a project executing unit to: (i) hire consulting firms and (ii) make the necessary arrangements to secure training for its personnel. The plan will benefit all participants in the publicly funded retirement system by strengthening the system's administrative authority (ANSeS) and providing support for the introduction of more efficient management, while at the same time helping the federal government through lowering of the social security deficit and the positive impact that this will have on the nation's fiscal accounts.

D. Costs

1.5 The total cost for implementing this plan is equivalent to US$40 million, half of which will be provided in local resources and the other half by the World Bank.

II. BACKGROUND ON THE ANSeS

2.1 The National Social Security Administration (ANSeS) is an agency of the Ministry of Labor and Social Security which administers: (i) the funding for the government's pay-as-you-go pension plan and the components of the publicly-managed social security pillar created under the 1993 reforms; (ii) the National Employment Fund, which awards unemployment benefits and underwrites job training programs; (iii) family allowances; and (iv) the resources for other public programs, viz, the National Health Services Administration (ANSSAL) and the National Social Security Institute for Retirees and Pensioners (INSSJP).

2.2 Given the additional responsibilities that will accompany the increase in the number of the ANSeS's contributors and beneficiaries as CPPs are transferred to the national system, improving the ANSeS's administrative and financial operations is of vital importance. To begin gearing up, the ANSeS has already hired two internationally recognized consulting firms to overhaul its computer and internal control systems. The reforms will make it possible to introduce systems to detect and eliminate benefits that are dispensed without proper entitlement (e.g. undocumented disability, ineligibility for retirement, failure to report death, benefits exceeding legal limits). These administrative improvements are capable of producing savings on the order of US$315 million per year. The plan will support development and implementation of the proposed reforms and streamlining of the ANSeS's infrastructure.

III. OBJECTIVE AND DESCRIPTION OF THE STRATEGIC PLAN

A. Objective

3.1 The objective of the plan is to support the development and application throughout Argentina of national standards for social security benefits with universal eligibility requirements for access to the pension system by successfully restructuring the ANSeS and thus eliminating deficiencies in its management organization, operations and information systems; improving its capacity for effective and efficient administration of the nation's

social security system; and enabling it to easily absorb those CPPs that are transferred to the national system.

3.2 The general aims of the plan are to: (i) establish efficient organization; (ii) improve services; and (iii) make financial flows transparent. Its basic purpose is to generate a new management focus and administrative structure to replace obsolete organizational features of the ANSeS and eliminate redundancies in the CPPs that are transferred to the ANSeS; standardize the awarding and determination of benefits, as well as payments under CPPs absorbed by the ANSeS; and optimize, reassign or reduce staff within the ANSeS and agencies reporting to it. The reorganization will thus enable the Administration to efficiently absorb the CPPs that are transferred to the national system.

B. Description

3.3 The plan has two components: (i) support for restructuring the management, operations and information systems used by the National Social Security Administration (ANSeS); and (ii) assistance in absorbing the provincial retirement funds (CPPs), detecting and eliminating benefits dispensed to ineligible parties, and updating the database of contributing members. Each of these components is in turn divided into various subcomponents.

3.4 The goal of the ANSeS restructuring is to design and adopt new standards for: (i) the basic principles and objectives of the renewed organization; (ii) the products and services to be provided; (iii) the quality of these products and services; (iv) the lines of authority and organizational structure of the social security services; (v) the legal framework for restructuring of the Administration; and (vi) options and plan of action. To do this will require a number of activities aimed at implementing both the strategic plan drawn up by the consulting firm McKinsey & Co., and the initial plan of action prepared by Andersen Consulting.

3.5 In order to maintain control of its information processing systems during the transition, the ANSeS began by replacing its data systems personnel. The Administration was aided in this by Andersen Consulting which helped plan and carry out the changeover to ensure control of computer systems. This measure was necessary due to the proliferation of irregularities in benefit payments and the need to prevent destruction of data files and the catastrophic effects this would have on the country's social security system. For this reason, the consultant was hired without the normal bidding process to avoid announcing publicly in advance the purpose and contents of the work to be performed.

IV. COMPONENTS AND SUBCOMPONENTS OF THE STRATEGIC PLAN

A. Restructuring of the ANSeS and its operations

1. Basic proposal

4.1 The basic proposal is based on work already carried out by a consultant of recognized expertise and includes a diagnostic study of the ANSeS, determination of the basic principles of the new organization, its response to the demand for services, assessment of the legal framework and available technology, and designing of a code of best practices and new organizational structure. A working group made up of three ANSeS officials – one from the Integrated Service Unit (UDAI), and one each from the Benefits and Planning Divisions – has been set up to provide internal support for the consultant. The essential aim is to define the basic products and services to be provided by the ANSeS.

2. Review of key operations

4.2 This task, which requires a qualified consultant, includes development of an emergency plan and redesigning of key operations of the ANSeS. This is expected to do two things: establish management control in specified areas, and reorganize key operations within the institution. The latter task should be completed by December 1996.

a. Emergency plan

This plan will: (i) ensure at least a minimum level of reliability for key operations of the ANSeS, and (ii) improve management control mechanisms. The contingency plan is intended to identify those operations that require improvement, with a view to their redesign. To do this will require identifying the key elements of the reform process, such as establishing control groups within each UDAI, improving monthly auditing procedures, barring access by computer personnel to the database of benefit recipients, and standardizing the criteria used by the various operating units.

b. Redesigning key operations

Studies to establish the details of current operations will be followed by efforts at redesigning them to improve reliability, lower costs and reduce the amount of time needed to carry them out. This will include operations relating to both the award process and the payment of benefits. For the payment process, mechanisms will be developed to ensure that monitoring in client service units (UDAIs) meets minimum requirements, that specific examinations are carried out by audit teams where warranted, and that controls based

on sampling and cross-sectional profiling of files are stepped up. For operations relating to the award process, work will include the development of standard criteria for decisions, strengthening the central interpretation area, setting minimum requirements for the monitoring of benefits granted in the UDAIs, and the mandating of spot checks by audit teams. In the initial stage, consultants were limited to designing work methods, control mechanisms and overall operations, without participating directly in audits or decision-making issues. The next stage (redesigning the organization) involves implementing controls, introducing changes in the data processing system and creating new areas of responsibility, such as the UDAI control groups. This stage includes dealing with personnel requirements, standardizing decision-making criteria between units, planning organizational changes and overhauling the information system before launching the new processing operations. It also includes the installation of suitable equipment and distribution of detailed work plans. As a result of these efforts, the consultant recommended deleting one stage of the redesign program since the controls implemented up to that point had achieved a higher level of control than originally expected and are deemed sufficient as is.

4.3 The subprocedures labeled "Benefits Determination and Payment" and "New Claims" were identified as critical areas for ensuring reliability in benefits.

B. Upgrading of computer systems

4.4 The senior management of the ANSeS decided it needed an immediate emergency plan for control and reorganization of management levels at its data processing units that exercise discretionary control over ANSeS operational and accounting information. It was felt that this plan should concentrate on data security and integrity, as well as putting in place mechanisms that will facilitate access by managers and the public at large. To this end, an international consulting firm was hired (paragraph 3.5) to do two things:

(i) draw up an emergency plan recommending changes in the information processing system to help regularize the flow of information to the authorities, and tighten controls in the preparation and storing of data on plan members; and

(ii) conduct planning, implementation and initial execution of the data control plan; these tasks were completed in March 1996. As a result, the ANSeS has reestablished control of its information system and now has reliable data services which will enable it to conduct reviews of files in order to determine the validity of retirement and benefit claims.

4.5 At the next stage, this part of the plan will include defining components for systems planning, restructuring and professional development, standardization of databases, data protection, applications security, and optimization of applications, as follows:

a. Systems component

This component will include two modules: (i) applications and data, and (ii) systems architecture. The objective of module (i) is to determine overall system and data applications requirements of the ANSeS's Information Systems Division (SGI), for information processing purposes. This first module will be carried out in three phases whose objectives are to identify system requirements, define the data and applications strategy and draw up a plan of activities. The consultant will be expected to supply four specialists to work full time, and one senior supervisor on a part-time basis, all of whom must be highly qualified and have strong backgrounds in the design of computer applications for complex environments. The objective of module (ii) is to verify the systems architecture and communications required by the ANSeS for the new processing operations decided on. For this module, the consultant will have to provide five full-time specialists to work under the supervision of one part-time senior expert, all highly qualified and with broad experience in strategic planning within complex environments.

b. Restructuring and professional development component

This component is intended to deal with changes in management personnel, the strengthening of middle-level managers and the establishment of the interdependence between technicians and expertise. It marks a transition to the second phase of organizational development in the information systems section, analyzing gaps between the existing system and the goal of restructuring, and then devising the necessary plans for closing the gaps identified in the areas of human resources, recruitment plans and planned changes to the organizational structure. The following stage will seek to give a more important role to teamwork management methods. Scheduled activities include development of a plan to incorporate existing human resources, and a plan to streamline the organizational structure through transfers to the UDAIs, as well as through training and attrition. The consultant for this component will supply a team of four specialists working under the supervision of a senior expert for a period of six months, ending in November 1996 (the bulk of the work is to be carried out in the second half of 1996).

c. Component for standardization of databases

The objective here is to design a standardized database that can be used to update the personal data contained in ANSeS records. The tasks under this component will include the design and development of a personal data management system; implementation as a pilot program in one UDAI; and development of programs for converting data to the new system. The training of operators will be included under this component. The performance objectives will be: (i) submission of detailed plans; (ii) testing of data integration; and (iii) placement on-line. The consultant will provide a team of eight full-time specialists for a period of six months, with the work to be carried out in the latter half of 1996.

d. Data protection component

In this case, the objective will be to define and implement the necessary data security measures within the ANSeS's information systems center, based on the organization's software systems protection plan. The parameters of the required security measures will be determined, along with the policies and procedures for administering and maintaining data security in both the central computer and the server. This component will require four specialists provided by the consultant, and one part-time expert to work under the supervision of a member of the consultant's senior management, on a part-time basis. Again, the work itself will be carried out in the latter half of 1996.

e. Applications security component

The objective of this component is to ensure internal security and control of critical processes dealing with family allowances, deaths, unemployment, payment periods, refunds, adjustments and settlement of benefits. Crucial processes will be chosen in each of these applications, based on monetary amounts and volume of transactions, for examination to identify the most important risks facing the ANSeS. The consultant will then be responsible for the design, implementation and monitoring of the necessary controls. The work will be carried out in the second half of 1996, and will require five full-time specialists, supervised by a senior expert also provided by the consultant.

f. Optimization of applications

The aim of this component is to improve service to the public, reduce the workload and shorten processing times. The initial study will center on problems encountered by the UDAIs, their requirements and the prioritizing of same (to be carried out in the second half of 1996).

C. Equipping and restructuring the UDAI network

4.6 The goal in this component is to decentralize and devolve activities to the Integrated Service Unit (UDAI) network, at the same time upgrading that network for the processing of benefits and payments in order to improve service to clients. Studies will be conducted to determine the optimal size and organization of units, the number of units necessary, and possible locations for new UDAIs. In the meantime, the 46 existing UDAIs are introducing standardized practices, and efforts are being made to open new UDAIs in the greater metropolitan area of Buenos Aires.

4.7 Redesigning the UDAI network, and classifying and determining the ideal number and location of units requires specialized methods not unlike those used to reorganize bank branches. The goal here is to review the object, organization and operations of UDAIs, design appropriate changes and put them in place as quickly as possible. The specific objective is to have a redesigned UDAI in operation as a pilot project in greater metropolitan Buenos Aires within a period of two months.

4.8 The results of computer analyses of the problems and requirements facing the UDAIs will, in large measure, serve as the basis for the second phase of this component, namely, the introduction of changes in the applications and equipment requirements of individual UDAIs. Local support will consist of four experts on social security benefits, the UDAIs and planning.

D. Incorporating the CPPs into the national system

4.9 Incorporating the CPPs into the National Social Security Administration includes the transfer of active and noncontributing members of the provincial plans, along with the corresponding revenues and expenditures, plus all relevant files. The transfer also requires the review of records of past benefit awards, straightening out of the files on years of service and the entitlements of contributing plan members, adjustment of benefits, etc. This vetting of CPP files thus affords an opportunity to correct and update records before incorporating them into the ANSeS procedures.

E. Other components

4.10 The strategic plan to provide institutional strengthening for the ANSeS will include the following components as well:

1. Retraining program for personnel

4.11 The administrative reforms and changes in management, data processing and other procedures will require the redefinition of duties

and retraining of personnel. The size of this program will depend upon the extent of the restructuring process.

2. Prevention of fraud

4.12 One cause for concern is the high number of irregularities in the payment of benefits. The objective of the plan is to develop the methods to be used in reviewing files and to conduct a sample-based pilot project of monthly audits to assess potential risks in the files, the results of which will undergo subsequent analysis. The consulting firm will also be asked to estimate both the time required to extend this approach throughout the system, and the resultant cost savings for the ANSeS.

4.13 Results of studies by consultants indicate that the files are likely to contain numerous cases of fraud such as payment of benefits to deceased persons, incorrectly calculated benefits and other types of irregularities. The ANSeS has begun an audit of 500,000 files in 10 benefit categories in which possible irregularities had been identified during interviews and sampling. The ANSeS plans to complete the review of these files by December 1999 (i.e. proceeding at a rate of 10,000 files per month) and will take legal action to recover payments where irregularities are discovered.

4.14 A preliminary survey of 2.9 million benefit recipients turned up approximately 500,000 cases with possible irregularities. Some 250,000 of these with the highest incidence of irregularities – the ones will be scheduled for review. This program will examine 8,000 files per month, including records analysis and home visits, and is due to be completed by the end of 1998. From the irregularities detected in disability claims, it is estimated that 30% of these cases may be fraudulent. The ANSeS has therefore asked the Superintendency of Pension Fund Administrators to review disability claims.

4.15 In all, these review exercises are expected to produce savings in excess of US$315 million per year for the ANSeS. This operation will be aided by the restructuring of the Administration, which will make it easier to audit prior entitlements to determine whether they are legitimate or no longer valid, including those awarded under the CPPs that are transferred to the national system.

3. Updating the registry of contributing members

4.16 The ANSeS will need to re-examine the database of contributing members in order to reconstruct the employment history of each contributor prior to the 1993 reforms.

4. Reducing levels of evasion

4.17 The Internal Revenue Bureau (DGI) has been responsible for the collection of social security contributions since 1993. At present, the DGI is not transferring the payments of unidentified contributors. To resolve data processing problems, an agreement will be signed between the ANSeS and the DGI establishing a common definition of data systems, a standardized language for the exchange of information, and formulas for such exchanges. It is not necessary to include a support component for the DGI under the present plan since the Bureau is already receiving technical cooperation from the World Bank under another loan.

V. COST OF THE PROGRAM

5.1 The cost of carrying out the strategic plan is US$40 million, which is in line with the figure suggested by the Ministry of Economic Affairs and Public Works and Services.

FINANCING OF THE STRATEGIC PLAN
(US$ thousands)

Category	Total
Institutional restructuring and review of processing operations	8,500
Upgrading of information systems	6,920
Equipping and restructuring the UDAIs	5,622
Incorporation of the CPPs	6,200
Retraining for personnel	3,020
Elimination of fraud	6,104
Monitoring of financial records	815
Administrative unit	1,100
Registry of contributing members	700
Supervision and contingencies	1,020
Total cost	40,000

Source: ANSeS.

VI. EXECUTION AND ADMINISTRATION OF THE STRATEGIC PLAN

6.1 Acting through an executing unit created for this purpose, the ANSeS will be the supervisory institution and project execution will be by an executing unit within the ANSeS, which will be responsible for hiring the consulting firms, making the necessary arrangements to secure training for its personnel, and procuring equipment for the UDAIs. The executing unit, will coordinate and follow up on the technical cooperation activities. This unit will submit quarterly reports to the Bank on the progress and performance of activities in accordance with the agreed work schedule.

6.2 Local procedures will be used for the contracting of consulting firms and procurement of goods. However, the Bank reserves the right to review the names and qualifications of the respective firms, their terms of reference and proposed fees prior to the signing of contracts.

6.3 The schedule of activities under the plan is set out in Annex II-2.

**NATIONAL SOCIAL SECURITY ADMINISTRATION (ANSeS)
GOALS OF THE STRATEGIC PLAN**

OBJECTIVE	ACTIVITY	PERFORMANCE INDICATOR	MEASURE OF IMPACT	DATE
A. RESTRUCTURING OF THE INSTITUTION				
Strengthening of management	a. select new managers; assign areas of responsibility for the reform process	a. 30-50 managers selected	a. management reform process fully on line	Aug. 6
	b. managers attend 2-4 week courses	b. 30-50 managers receive training	b. all project activities and terms of reference defined by the responsible manager	Nov. 96
	c.1 adopt new structure	c. new structure submitted for approval	c. reform activities implemented by managers in their areas of responsibility	Aug. 96
	c.2 new structure implemented	d. new structure implemented		Feb. 97
	c.3 monitoring to determine effectiveness of new structure	e. analysis and solution of problems encountered		June 97
B. NEW OPERATING STRUCTURE TRAIN-ING AND UPGRADING OF HUMAN RESOURCES	a. design and implement a system of staff incentives that takes into account operations, training, promotions and pay	a.1 system implemented on a pilot basis in UDAIs	a.1 increase in client satisfaction as measured by survey	Dec. 97
	b. develop the new system of duties and responsibilities; design staff training plan based on these new responsibilities	a.2 system implemented throughout organization	a.2 internal surveys show increase in motivation and efficiency	Jan 98
		b.1 50% of staff assigned new duties according to the plan and given training as set out in the training plan agreed to	b.1 improvement in staff efficiency seen in indicators of productivity	Sept. 97
		b.2 joined by rest of personnel		Dec. 97

OBJECTIVE	ACTIVITY	PERFORMANCE INDICATOR	MEASURE OF IMPACT	DATE
C. REVIEW OF PROCESSING OPERATIONS	a. review and improve pay operations; conversion to electronic payment system	a.1 percentage of payment orders handled in electronic format versus paper checks	a.1 increase from 0% to 85%	June 97
		a.2 percentage of payment orders cashed within 15 days, as reported to the ANSeS by banks (per type of benefit)	a.2 change in accounting methods and form of payment	Dec. 97
	b. review and improve the benefit award process	b.1 percentage of files with legally correct benefits in 3% sample of new awards (per type of benefit)	b.1 increase from 60% to 90%	Dec. 97
	c. review and improve the processing of new claims	c.1 average number of days between occurrence and recording of events in database, in a 3% sample of new claims (per type of benefit)	c.1 reduction from 110 days to 45 days	Dec. 97
D. UPGRADING OF INFORMATION SYSTEMS	a. design strategy; information systems plan; improvement in telecommunications	a.1 planning of the new strategy	a.1 information systems plan completed	Oct. 96
		a.2 improvement of communications with UDAIs	a.2 160 UDAIs on line	July 97
	b. implement intermediate stage	b. beginning of transition to client/server relationship	b. terminals replaced by PCs, departmental servers	July 97
E. IMPROVING OF SERVICES AND REORGANIZATION OF UDAIs	a. improve processing of payments	a.1 average number of days between award of benefit and payment order (per type of benefit)	a.1 55-65 days reduced to 30 days	June 97
		a.2 number of payments not cashed per month (per type of benefit)	a.2 nonpayment only in the case of deaths	June 97
	b. improve the benefit award process	b.1 average number of days between receipt of file and awarding of benefits (per type of benefit)	b.1 retirement benefits waiting period reduced from 180 days to 30 days; pension benefits delay reduced from 30 to 5 days, except for disability benefits	June 96
	c. improve client access to information	c.1 sending of contribution information to client	c.1 information sent to contributors	Dec. 96

OBJECTIVE	ACTIVITY	PERFORMANCE INDICATOR	MEASURE OF IMPACT	DATE
		c.2 average response time for clients to consult their contributions file	c.2 consultations take place on-line	June 96
		c.3 number of visits necessary to answer client's enquiry	c.3 current rate of 1-2 visits reduced to 1-0 with creation of UDAIs	Dec. 96
	d. establish the UDAIs	d.1 10 pilot agencies	d.1 preliminary survey and formulation of extension plan based on client responses	June 97
		d.2 replication at 150 UDAIs	d.2 final survey to measure degree of satisfaction with the services	Dec. 97
F. CONTROL OF IRREGULARITIES	audit files in categories with a high incidence of fraud	audit 700,000 files until cost-benefit ratio reaches zero	achieve pace of 3,000 files per month	Mar. 97
G. REVIEW OF DATABASE OF CONTRIBUTING MEMBERS	improve controls over the awarding of benefits and the database of contributing members	quarterly increase in the number of files examined, up to 99.5%	improved award process leading to increased confidence in the system	Dec. 97
H. POLICY ANALYSIS AND DEVELOPMENT	recruit and train personnel that will be responsible for decision-making	annual publication giving detailed breakdown by function, plus actuarial statistics	increased perception of transparency and responsibility as measured in client surveys	Dec. 97
I. TRANSFER OF PROVINCIAL RETIREMENT FUNDS	vet files received from provincial retirement funds	a. six provinces	a. reduce outlays by at least $50 million	Aug. 97
		b. five other provinces	b. additional reduction of $50 million in outlays	Dec. 97

I. THE MODEL

A. Objectives of the model

1.1 The objectives of the model are to estimate: (i) the impact that transfer of the CPPs will have on cash flow within the ANSeS; (ii) the impact of the transfers on the fiscal position of the provinces; and (iii) the costs and benefits produced by the project. The model was developed by the Ministry of Economic Affairs and Public Works and Services with support from of the IDB and the World Bank. Projections have been made for each of the CPPs taking part in the program and cover a period of eight years. All estimates are based on constant prices at year-end 1995. The principal assumptions and results generated by the model are summarized below.

B. Principal assumptions

1.2 The model assumes that the five CPPs will be transferred to the ANSeS in the first 12 months of the forecast period. It further assumes that upon their transfer to the national system, the former CPP members will have to adjust to national social security rules covering employer and employee contributions, retirement age, pension benefits, maximum payouts and other points. The transfer from the provincial to the national system also means that contributors can choose to have their employee contributions directed to individually-funded pension accounts administered by an AFJP.

1. Revenues

1.3 The amount of revenues which CPPs receive by way of individual contributions varies according to their circumstances, and this difference must be taken into account by the model. First, individual contribution rates for persons transferring from CPPs will be adjusted as needed in each case in order to bring them into line with those required by the Integrated Retirement and Pension System (SIJP), as explained in the text of the proposal. A second major influence on ANSeS revenues is the fact that a large number of contributors will choose to direct their individual contributions into individually-funded accounts, judging by what has happened with the national system. Various figures have been plugged into the model for the proportion of contributors opting for AFJPs in the first year, and for the percentage of remaining members choosing to transfer in the second year. 1/ The results of running the projection model with these different variables are

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1/ Contributors to the policemen's fund are excluded from these calculations since they are not eligible to transfer to an AFJP.

presented in Table 2 of the loan proposal. A third influential factor is the payroll, which is expected to experience an initial drop of 5% in real terms during the first year, and a further 1% in the second year of the projection period, as a result of agreements signed between the provinces and the national government.

1.4 Finally, it is assumed that the transfer of CPPs will raise efficiency with respect to the collection of contributions. Although the percentage gain in collections efficiency will vary by province (according to the information gathered on their levels of arrearages) it is guaranteed by the fact that the DGI can automatically collect the contributions for employees of the provincial government by withholding pertinent amounts from tax revenue share-outs. The amount withheld would be transferred to the ANSeS. This will result in a significant increase in revenues compared to CPPs whose members do not move to the national system, since provincial governments are currently very behind in the transfer of contributions. The impact of this gain in collections efficiency is felt only in the first year of the projection period.

1.5 Employers' contributions will have to match the 16% rate required under the SIJP, which means a rise from current levels in seven provinces, no change in four others, and a drop in rates for five provinces.

2. Expenditures

1.6 Expenditures with or without the transfer of CPPs include: (i) benefit payouts (both retirement and pension benefits); (ii) personnel costs for administration of the CPPs; (iii) cost of nonpersonnel goods and services; and (iv) other outlays. To estimate the number of noncontributing members in the CPPs (new retirees), tables were drawn up based on gender-specific population pyramids for each province and using data from the 1991 population and housing census, together with life expectancy figures. Retirement benefits for new retirees are estimated at the national average ($299/month in December of 1995) for transferred CPPs, and at the provincial average for CPPs that do not opt into the national system. As of December 1995, the average for provincial benefits ranged from a low of $563/month to a high of $1,080/month (see Table 2). The model assumes that the Social Security Solidarity Act will apply in the case of transfers.

1.7 To estimate the number of retirees to be removed from the rolls each year, gender-specific mortality tables were drawn up for each province using information from the 1991 census. The model also generates a corresponding rise in pension benefits as a result of retiree deaths. Net year-on-year growth in benefits paid to pensioners (new claimants less separations) is based on the ratio of pensioners to retirees at the national level in 1995 (57%). The model assumes that this rate is the same for all provinces, and

that it will remain constant throughout the forecast period. Pension benefits are equal to 75% of the average amount for retirement benefits.

COST OF TRANSFERRING 15 CPPs (US$ millions)	
ORIGINAL DEFICIT	754
TRANSFERS TO AFJPs	
1st scenario	340
2nd scenario	449
3rd scenario	523
TOTAL DEFICIT FOR FIRST PERIOD	
1st scenario	1,094
2nd scenario	1,208
3rd scenario	1,277
Source: Table 2.	

POLICY LETTER

DRAFT

Mr. Enrique Iglesias
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Iglesias:

The Government of the Argentine Republic is requesting that the Inter-American Development Bank provide a loan for US$320 million equivalent which, together with a like amount of financing requested from the World Bank, will serve to partially fund a program to transfer provincial social security systems to the national social security system. The resources provided will be used to cover the deficit generated by the transfer of these funds, and to support the restructuring and strengthening of the ANSeS. This financial support will enable the Argentine government to consolidate its reform of the social security system at the national level, promote greater equity by eliminating special privileges and inequities under provincial retirement funds, and help balance national and provincial budgets by closing the gap in social security funding over the long term.

The proposed program will reinforce reforms and policies already carried out or currently being developed with the Bank's support. The economic strategy adopted by the government places greatest priority on maintaining macroeconomic stability under an open and regionally integrated economy, with emphasis on the export sectors and sustained support for private enterprise. Argentina's current economic conditions make it particularly necessary to seek financial assistance for this program from the multilateral agencies. With this in mind, outlined below is a brief description of the country's current macroeconomic circumstances and the reform program for which we are requesting assistance.

I. MACROECONOMIC SETTING

Price stability and sustained growth continue to be key elements of the government's economic program, with significant progress having been made on both fronts since 1991. To eliminate the fiscal deficits which had in the past led to high rates of inflation, the government undertook a

series of far-reaching structural reforms. I am pleased to report that increases in Argentina's monthly price index have been reduced from the potentially hyperinflationary levels recorded at the beginning of 1991, to a minimal rate of 1.6% – below the average international inflation rate in 1995.

Having achieved price stability, the government is committed to pursuing the following objectives in future:

- Maintain monetary stability through strict compliance with the 1991 Convertibility Act (Law 23,928).
- Continue to operate a free-market economy in which only restrictive trade practices are regulated.
- Encourage economic growth by promoting a rise in private-sector productive activity and exports, together with further liberalization and integration of the economy in regional and world markets. In order to ensure that the private sector remains the driving force behind the nation's economy, the government is committed as well to both maintaining an open trade policy free of regulations and barriers and maintaining a sound financial system to strengthen intermediation of savings and investment.
- Increase employment levels and improve income distribution, building on the above-noted gains in economic growth and stability.

II. THE REFORM PROGRAM

The program of reforms for 1996 is designed to deepen change in a number of areas, such as:

- Modernization of the State, which seeks to consolidate or eliminate unnecessary public enterprises and restructure or discontinue inefficient programs and redundant agencies. To this end, efforts are under way to overhaul the administrative organization and operations of the Executive Branch in order to improve the efficiency and consistency of its actions.
- Amendment of regulations governing collective bargaining, workman's compensation and other work-related benefits, to make labor markets more flexible by decentralizing the negotiation of labor agreements, breaking the cycle of automatic renewal of labor agreements and introduce some latitude in this regard – all with a view to reducing direct and indirect labor costs.
- Ensuring that the country's monetary policy continues to be governed by the Convertibility Act, which will limit net domestic

central bank (BCRA) lending. In addition, the capacity of the BCRA to supervise financial institutions and enforce prudential, capitalization and reserve requirements will be strengthened, and its authorities will take an active role in the restructuring of the private banking sector and the privatization of provincial banks.

- The transfer of provincial retirement funds (CPPs) to the national system, on which further details are provided below.

III. PUBLIC SECTOR FINANCES

The national government has made every effort to increase tax revenues and is taking steps to improve the efficiency of its fiscal administration, including in the area of audits and controls. At the same time, Congress has passed laws which broaden the base of the personal asset tax and increase the rate for Argentina's value added tax (VAT) to 21%; place a cap on social security payments and lower employer contributions to the system; and reorganize the public sector in order to strengthen government finances. In addition, the national government declared a tax moratorium, the results of which will generate approximately US$4 billion in revenues over the next 30-36 months.

At the provincial level, the reforms agreed to in August 1993 under the Federal Pact on Employment, Production and Growth have moved more slowly. Following on the financial imbalances seen in 1995, the provincial authorities have taken financial restructuring measures during the current year. These measures have brought down deficits and, in conjunction with the structural reform programs under way, augur well for acceptable financial performance by the provinces in the years to come. From a structural standpoint, provincial administrations play an increasingly important role following decentralization of various national functions, particularly public health and education, so that the provinces are now the main providers of public services in the areas of health, education, public security, and infrastructure.

To keep inflation down and bolster the financial system, the national government undertook to improve the financial position of the public sector in 1996, based on estimates of national and provincial fiscal deficits at 1995 levels. To this end, it is finalizing a medium-term strategy with the provinces to reinforce their finances and narrow provincial deficits significantly. The national government plans to bring down its own fiscal deficit in line with its agreements with the IMF. This excludes charges in connection with the transfer of CPPs and trust funds set up to restructure the provincial banking system and replenish private bank capital. These efforts will complement those carried out pursuant to the 1993 Federal Pact to shore up the provincial

finances with respect to tax and spending and to standardize accounting systems.

IV. SOCIAL SECURITY REFORM

The national social security system faced a serious crisis in 1992 which required major reform and led to Congress's passage of Law 24,241 in October 1993. The new social security system replaced the pay-as-you-go approach with a system combining pay-as-you-go elements with a system of individually funded accounts. This system has two primary components: (i) a public pillar which provides a basic benefit, a transitory pension supplement, and benefits paid to current retirees and pensioners; and (ii) a second, defined-contribution and individually-funded-accounts pillar, at the employee's option.

The ANSeS is responsible for the old pension system and the public component of the new system, as well as other social security benefits such as unemployment insurance. At present, the bulk of pension benefits paid by the ANSeS correspond to the old pay-as-you-go system, to which must be added liabilities of up to US$7.5 billion in bonds issued in 1991 to cover debts to pensioners, and maturing over the next few years. Consequently, the ANSeS requires large transfers from the national government to cover its expenditures, even though the Social Security Solidarity Act of March 1995 introduced measures aimed at reducing such transfers. The law imposed a cap on social security benefits, eliminated automatic indexing of benefits, amended the legal provisions for determining the level of benefits, and established maximum levels of social security expenditures. In addition, the government is carrying out a complete restructuring of the ANSeS in order to eliminate fraud, assign responsibilities, reduce administrative costs, improve procedures and establish control measures. The government is also considering a program to reduce evasion and harmonize the data systems used by the Internal Revenue Bureau (DGI) and the ANSeS.

The actions described above will help to reduce the ANSeS's dependency on transfers from the government. In this regard, the ANSeS is preparing projections of revenues and expenditures broken down by those corresponding to the old pay-as-you-go system and those that correspond to the public pillar of the new system. These projections will be sent to the multilateral financial agencies, along with a program of measures aimed at gradually reducing the deficit of the ANSeS, and the respective financing program.

The restructured system for which the ANSeS is responsible could be improved over the long term to reinforce the objectives for which it was created. For this reason, the ANSeS will conduct regular actuarial studies to detect these problems and provide the basis for developing a

consensus on how to go about improving the public social security system and reducing the future drain on public sector finances.

V. TRANSFER OF THE CPPs

The government intends to maintain its support for the structural and financial reforms of eligible provinces by incorporating the CPPs into the national social security system and absorbing their deficits in keeping with its commitment under the Federal Pact of 1993 to accept those CPPs that are able to reach agreement with the national authorities, provided the respective agreement is ratified by the provincial legislature. Transferring the CPPs will bring substantial fiscal relief to the provinces, since CPP deficits account for about 30% of the consolidated provincial deficit. Also, the transfer will allow provincial benefits and contributions to be adjusted to conform to those of the new national system, and will make it easier for provincial employees to move to the funded system.

The transfer of the CPPs will increase the deficit of the national ANSeS-administered system by a substantial amount in the first few years, but it will gradually diminish thereafter. The size of the additional deficit that the ANSeS would have to absorb would be covered by the national government, necessitating the request for financing we are presenting to both multilateral financial institutions. The request is justified by the fact that unless action is taken as quickly as possible, the deficits of the CPPs will continue to grow, thus endangering the fiscal stability of the public sector as a whole. For this reason, the government will utilize the loan proceeds to support the transfer of the CPPs, covering the costs incurred by the ANSeS during the first 12 months. In addition, the national government undertakes to: (i) provide the ANSeS with the necessary resources to cover the deficits incurred as a result of the transfer of the CPPs in 1997 and subsequent years; and (ii) make the required budget appropriations in 1997 and 1998 to cover the cost of transferring the CPPs of any provinces that opt to join the national system after the resources provided under the IDB and World Bank loans have been exhausted.

Verifying the files on provincial contributors and beneficiaries will require considerable administrative effort on the part of the ANSeS since this represents a 33% rise in its number of contributors and 15% growth in beneficiaries. The ability of the ANSeS to carry out this task will be greatly affected by the progress made under its own reforms and the effectiveness of the technical assistance it receives.

The national government will encourage the provinces to develop policies that meet the criteria outlined below in order to be eligible to participate in the program.

a. Legal instruments

- Obtain authorization from the provincial legislature to transfer the provincial retirement fund to the national system.

- Enact a special law which must be duly approved by the provincial Congress pursuant to the constitution, ratifying a transfer agreement which: (i) delegates to the national government the power to legislate social security matters and contains an unrestricted commitment to refrain from issuing regulations of any sort that would lead directly or indirectly to the establishment of any new social security system, whether general or special in nature, within that province; (ii) provides for the dissolution of all ordinary or special regimes in that province; (iii) accepts liability on behalf of the province for all claims and rulings arising prior to the transfer; (iv) accepts responsibility on behalf of the province for any increase in liabilities subsequent to the Federal Pact of 1993, in accordance with the provisions of that instrument; and (v) grants priority to the payment of employer and employee contributions for provincial civil servants, guaranteeing payment using the province's share of national tax revenues and therefore authorizing the national government to automatically deduct such payments from the province's share-out where necessary.

b. Compliance with the Federal Pact and Law 24,156

- Substantially satisfactory compliance with its obligations under the Fiscal Pact of August 12, 1993, concerning taxation and regulatory reforms.

c. Privatization program

- Have launched a privatization program under the August 1993 Pact on Employment, Production, and Growth.

Monitoring of compliance

The national government is to present, prior to disbursements subsequent to the first, evidence that the provinces having transferred their CPPs under the previous tranche are in compliance with the following:

- Have reduced the ratio of personnel expenses to net income (current income plus contributions, less transfers to municipalities).

- Have reduced the province's fiscal deficit by an amount which is at least equivalent to the fiscal relief obtained through transfer of the CPP, as measured in the manner agreed upon in advance with the Ministry of Economic Affairs and Public Works and Services.

- Have reduced or improved the province's debt profile pursuant to the agreement between the national and provincial governments of August 12, 1992.

- Have submitted provincial budget projections for the next three years showing the effects of transferring its CPP to the national system and demonstrating sustainable fiscal policy.

In the context of the present loan, the Government of Argentina will, in addition to the specific conditions for reporting to the Board of Executive Directors, ensure that the following conditions are met with respect to disbursements of resources under each tranche of the loan:

a. Macroeconomic conditions

- Maintain a macroeconomic policy which is consistent with the provisions of this policy letter.

b. Legal, administrative and financial reforms

- Uphold the principles of the Social Security Solidarity Act.

- Fulfill at least the conditions of the 1993 Federal Pact.

- Submit budget projections for the next three years demonstrating sufficient resources to cover the consolidated deficits of the ANSeS.

- Strengthen the ANSeS so that it is able to efficiently absorb the CPPs, providing it with resources from the international loans to cover the deficit generated under the ANSeS by the transfer of CPPs.

- Take steps to ensure that the technical support program for the ANSeS is carried out in a satisfactory manner.

c. Reform of CPPs through transfer to the ANSeS

- The national government undertakes to sign an agreement with each eligible province for the transfer of its social security system in accordance with the legal instruments stipulated in the eligibility requirements agreed upon with the Bank. The ANSeS will successfully complete the following actions relating to the transfer of CPPs: (i) perform an audit of noncontributing members of CPPs to be tranferred; (ii) apply the provisions of the Social Security Solidarity Act to the noncontributing members of transferred CPPs in order to bring their benefits in line with those of the national system; (iii) take over the administration of all transferred CPPs; (iv) update the database of active members and their vested rights; (v) establish the means for ensuring proper intake of employee and employer contributions; and

(vi) exchange information on active and noncontributing members of CPPs with the ANSeS.

d. Supervision

- In consultation with the multilateral agencies, the national government will assign the necessary supervision mechanisms to ensure compliance with the obligations set out in the eligibility criteria and transfer agreements with participating provinces.

VI. STRATEGIC PLAN TO PROVIDE INSTITUTIONAL STRENGTHENING

The government is currently executing a strategic plan to provide institutional strengthening for the ANSeS to assist the Administration in absorbing the CPPs. This plan also includes a major effort to eliminate fraud in the award of benefits and eliminate evasion. To this end, a special fund will be created in an amount equivalent to US$40 million to cover the costs of this program.

The above description demonstrates the importance of the proposed reform program which – in the view of this government – justifies consideration for financial assistance from the Inter-American Development Bank and the World Bank.

Such assistance is essential for successful completion of reforms undertaken by the Government of Argentina and consolidation of the country's finances and social security system.

Please accept the renewed expression of my highest esteem and consideration.

Roque Fernández
Minister for Economic Affairs and
Public Works and Services

Original: Spanish

Ministry of Economic Affairs and
Public Works and Services
Economic Programming Secretariat

Buenos Aires, October 4, 1996

Mr. Ricardo Santiago
Manager, Regional Operations Department 1
Inter-American Development Bank

Dear Sir:

This is to inform you of the intention of the Argentine Government that the loan for US$320,000,000 for the transfer of provincial social security systems be in United States dollars.

Yours truly,

[signature]

Eugenio Pendas
Secretary for Economic Programming

ARGENTINA
PROVINCIAL SOCIAL SECURITY SECTOR REFORM PROGRAM
CONDITIONALITY MATRIX

ACTIVITY AND OBJECTIVES	ACTION TAKEN	CONDITIONS FOR DISBURSEMENT
Macroeconomic stability:		
ntain macroeconomic policies that are sistent with the objectives of the gram.	In April 1996, the IMF Executive Board approved a stand-by program covering a period of 18 months ending in December 1997.	Maintain an appropriate macroeconomic framework which i consistent with program implementation, in conformity with the objectives set forth in the Government of Argentina's policy letter.
Legal, administrative and financial reform: ntain a legal framework which is ducive to the consolidation and ension of the national social security tem.	Law 24,241 was passed in October 1993 creating the Integrated Pension System (SIJP); the Social Security Solidarity Act (Law 24,463) was passed in March 1995 establishing new retirement and pension benefit rules, creating the legal framework of the present social security system, and limiting pension increases to national budget availabilities; and Decree 292 was enacted in August 1995, reducing employer contributions under the social security system.	Uphold the principles of the Social Security Solidarity Act. Fulfill at least the conditions of the Federal Pact of 1993.
vide the financial resources required cover the cost of the consolidation integration of the national social urity system.	The national government has submitted budget projections for the next three years demonstrating sufficient resources to cover the consolidated deficits of the ANSeS and the cost of transferring the CPPs of any provinces that join the national system after the resources provided under the IDB and World Bank loans have been exhausted.	The national government will present, prior to each disbursement, the national and ANSeS budgets and amendments thereto, demonstrating that sufficient financing is available to cover the ANSeS consolidated deficits. The national government will present quarterly a statement of budget performance showing that funds have been transferred to ANSeS to finance the deficits generated by transferring CPPs. A special account will be set up to deposit the proceeds of the international loans which are to finance part of the ANSeS deficits generated by transferring the CPPs.

VITY AND OBJECTIVES	ACTION TAKEN	CONDITIONS FOR DISBURSEMENT
nd institutional ng of the ANSeS.	The ANSeS has hired two consultants to modify its operating systems and internal controls, and boost its information processing capacity. At the same time, it is taking steps to reduce fraud, review and reform procedures for the granting of benefits, improve accounting controls, and reduce the level of evasion.	The reforms to the ANSeS are progressing satisfactorily. The progress implementing these reforms will be reviewed prior to disbursements usin previously-agreed performance indicators as set forth in the strategic (Annexes II-1 and II-2). These indicators will make it possible to ass gress in several areas: (i) bolstering of administration and implement a new management structure; (ii) new functions and training programs; (iii) upgrading of computer system; (iv) equipping and restructuring of UDAIs; (v) review of the database of contributing members; (vi) control irregularities; and (vii) vetting of CPP records.
f CPPs through transfer to S: ework and reforms: rdization of social ules at the national level; er equity by eliminating vileges, distortions and es between the CPPs and the ocial security system; and ening the long-term impact deficits at the federal and levels. n: mpliance with the and eligibility criteria rovinces joining the e subject.	The Federal Pact was approved in August 1993, permitting transfer of the CPPs to the national government. Draft agreements have been drawn up to facilitate the transfer of the CPPs to the national system. Requests to join the national system have been received from three provinces and are under consideration.	The national government is to: (i) admit to the program only those pro that meet the eligibility requirements attached as Annex III-3; and (ii agreement with each eligible province for the transfer of its social se system subject to the minimum eligibility requirements established in t point of the eligibility criteria. The ANSeS will successfully complete the following actions relating to transfer of CPPs: (i) apply the provisions of the Social Security Soli Act to the transferred CPPs in order to bring their benefits into line those of the national system; (ii) take over the administration of all transferred CPPs; (iii) update the database of contributing members wit DGI; and (iv) establish the means for ensuring proper intake of employe employer contributions. Prior to the second disbursement, the ANSeS wi the process of selecting specialized firms acceptable to the Bank to co census of beneficiaries and review disability benefits. Prior to disbu of the third tranche, the ANSeS will hire the firm in accordance with t of reference agreed upon with the Bank. Present the findings of the audit of noncontributing members and the ac position of each CPP transferred. The national government is to present a positive evaluation of complian provinces with the obligations set forth in the eligibility criteria an transfer agreement agreed upon. Also, prior to disbursements subsequen first tranche, the national government is to present evidence of compli the provinces included in the previous tranche, in respect of: (i) low ratio of staff to net income (current income plus contributions less tr to municipalities). The weighted average of the aforesaid ratio in the provinces included in the previous tranches is to have been lowered pri next disbursement. In particular, provinces with a ratio of greater th 1995 are to lower the ratio by at least 10% prior to disbursement of th following tranche; (ii) reducing the province's fiscal deficit by an am least equivalent to the fiscal relief provided by the transfer of CPPs to the measuring methods agreed upon with the Ministry of Economic Affa Public Works and Services; (iii) lowering or improving the provincial d profile in the context of the August 12, 1992, agreement between the na government and the provincial governments; and (iv) presenting budget projections for the provinces included in the respective tranches for t three years, demonstrating a sustainable fiscal policy and the effect o transferring the CPPs.

PROVINCIAL SOCIAL SECURITY SECTOR REFORM PROGRAM ELIGIBILITY CRITERIA FOR PROVINCES	
Legal instruments:	
FIRST:	Obtain authorization from the provincial legislature to transfer the provincial retirement fund to the national system.
SECOND:	Enact a special law which must be duly approved by the provincial Congress pursuant to the constitution, ratifying a transfer agreement which: (i) delegates to the national government the power to legislate social security matters and contains an unrestricted commitment to refrain from issuing regulations of any sort that would lead directly or indirectly to the establishment of any new social security system, whether general or special in nature, within that province; (ii) provides for the dissolution of all ordinary or special social regimes in that province; (iii) accepts liability on behalf of the province for all claims and rulings arising prior to the transfer; (iv) accepts responsibility on behalf of the province for any increase in liabilities subsequent to the Federal Pact of 1993, in accordance with the provisions of that instrument; and (v) grants priority to the payment of employer and employee contributions for provincial civil servants, guaranteeing payment using its share of national tax revenues and therefore authorizing the national government to automatically deduct such payments from the province's share-out where necessary.
Compliance with the Fiscal Pact 1/	
THIRD:	Substantially satisfactory compliance with its obligations under the Fiscal Pact of August 12, 1993, concerning taxation and regulatory reforms.
Privatization program:	
FOURTH:	Have launched a privatization program under the August 1993 Pact on Employment, Production, and Growth.
1/ Federal Pact on Employment, Production, and Growth.	

Appendix I
AR-0201
LEG/RG1/0983
Original: Spanish

PROPOSED RESOLUTION

ARGENTINA. LOAN /OC-AR TO THE NACION ARGENTINA
Sectoral Reform Program for the Provincial Pension Funds

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Nación Argentina, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the Sectoral Reform Program for the Provincial Pension Funds. Such financing shall be for the amount of US$320,000,000 or its equivalent in other currencies, except that of Nación Argentina, which are part of the Ordinary Capital resources of the Bank. The financing shall be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.

Provincial Social Security Sector Reform Program

The loan is to be disbursed in three separate tranches, the first in the amount of US$160 million equivalent, and the second and third each in the amount of US$80 million equivalent. The following is a list of conditions that must have been performed to the Bank's satisfaction before each tranche may be released.

A. Conditions precedent to release of each of the three tranches

1. The borrower must have made progress on implementing the program and on the actions agreed upon in advance in the strategic plan.

2. The borrower must maintain an appropriate macroeconomic framework consistent with program implementation, in accordance with the objectives set forth in the policy letter from the borrower.

3. The principles of the Social Security Solidarity Act (Law 24,347) must be upheld.

4. The conditions of the 1993 Fiscal Pact must remain in force.

5. The borrower must maintain and assure budget allocations sufficient to cover the consolidated ANSeS deficits and the cost of transferring the CPPs to the national system, and must present quarterly budget performance statements confirming that funds were transferred to the ANSeS.

6. The borrower must maintain a special account to which sums equivalent to the proceeds of the IDB and World Bank loans are deposited.

7. The borrower must sign transfer agreements only with provinces that have satisfied the agreed program eligibility criteria.

8. The borrower must demonstrate that transfers from CPPs eligible for the program to the national ANSeS system will together require funds equivalent to the tranche in question, exclusive of amounts being financed by the World Bank. The amount of each tranche may not exceed the aggregate of the amounts so justified.

9. The borrower must ascertain that the participating provinces have satisfied (a) requirements relating to the above-mentioned eligibility criteria and (b) obligations assumed by the provinces under the respective CPP transfer agreements.

10. In the process of transferring the CPPs to the national government, the borrower, through the ANSeS, must perform the following

satisfactorily: (a) apply the Social Security Solidarity Act to the noncontributing members of CPPs transferred, to adjust benefits to the national system; (b) absorb the transferred CPPs administratively; (c) update the DGI database of active members, and (d) establish mechanisms to ensure proper intake of employer and employee contributions.

B. Special conditions precedent to release of the first tranche (US$160 million equivalent)

1. The borrower must sign an agreement with the Argentine Central Bank (BCRA) under the terms of which BCRA undertakes to perform its obligations associated with the program.

2. The program's executing unit and coordinating unit must be in place and operating properly.

3. The special account mentioned above must have been opened.

4. The borrower must present an evaluation showing that the provinces whose transfers are the basis for disbursements under the first tranche have satisfied the requirements relating to eligibility criteria and those in the transfer agreement for each CPP.

C. Special conditions precedent to release of the second tranche (US$80 million equivalent)

1. The borrower, through the ANSeS, must have begun the process of selecting a specialized firm to conduct a census of beneficiaries and review benefits awarded.

2. The borrower must demonstrate that the fiscal deficits of provinces included in the previous tranche have been reduced by an amount equivalent to the fiscal relief provided through the transfer of the respective CPPs.

3. The aforesaid provinces must also have:

    a. Lowered the ratio of staff to net income (current revenue plus contributions less transfers to municipalities). The weighted average of the aforesaid ratio is to have been lowered prior to the next disbursement. Provinces with a ratio exceeding 85% in 1995 are to lower the ratio by at least 10% prior to release of the third tranche.

    b. Lowered or improved the provincial debt profile in the context of the August 12, 1992, agreement between the national and provincial governments.

c. Presented their budget projections for the next three years demonstrating a sustainable fiscal policy and the effect of transferring the CPPs.

D. **Special conditions precedent to release of the third tranche (US$80 million equivalent)**

1. The borrower must have engaged the specialized firm mentioned above, in accordance with the terms of reference agreed upon with the Bank.

2. The borrower must demonstrate that the budget deficits of the provinces included in the previous tranche have been reduced by an amount equivalent to the fiscal relief provided through the transfer of the respective CPPs.

3. The aforesaid provinces must also have:

   a. Lowered the ratio of staff to net income (current revenue plus contributions less transfers to municipalities).

   b. Lowered or improved the provincial debt profile in the context of the August 12, 1992, agreement between the national and provincial governments.

   c. Presented their budget projections for the following three years demonstrating a sustainable fiscal policy and the effect of transferring the CPPs.