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SIMULTANEOUS DISCLOSURE

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ARGENTINA

PROGRAM TO BOOST GROWTH

(AR-L1283)

LOAN PROPOSAL

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ABBREVIATIONS

BAPIN	Banco de Proyectos de Inversión Pública [Public Investment Project Bank]
BCRA	Banco Central de la República Argentina [Central Bank of the Argentine Republic]
DNIP	Dirección Nacional de Inversión Pública [National Public Investment Office]
FONDCE	Fondo Nacional de Capital Emprendedor [National Venture Capital Fund]
ICDB	Impuesto a los créditos y débitos bancarios [bank transactions tax]
IIBB	Impuesto a los ingresos brutos [tax on gross income]
IMF	International Monetary Fund
INDEC	Instituto Nacional de Estadística y Censos [National Statistics and Census Institute]
JGM	Jefatura de Gabinete de Ministros [Office of the Cabinet Chief]
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PBP	Programmatic policy-based loan
PCR	Project completion report
PPP	Public-private partnership
REPSAL	Registro Público de Empleadores con Sanciones Laborales [Public Registry of Employers with Labor Sanctions]
SAS	Sociedad de acciones simplificada [simplified stock corporation]
SIDIF	Sistema Integrado de Información Financiera [Integrated Financial Information System]
SNIP	Sistema Nacional de Inversión Pública [National Public Investment System]
WEF	World Economic Forum

PROJECT SUMMARY

ARGENTINA
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<table>
<tr><th colspan="5">Financial Terms and Conditions</th></tr>
<tr><td colspan="3" rowspan="2">Borrower: Argentine Republic</td><th colspan="2">Flexible Financing Facility[a]</th></tr>
<tr><td>Amortization period:</td><td>20 years</td></tr>
<tr><td colspan="3">Executing agency: The borrower through the Ministry of Finance, acting through the Office of Special Programs and Projects with a Sector-wide Approach</td><td>Disbursement period:</td><td>1 year</td></tr>
<tr><th rowspan="2">Source</th><th rowspan="2">Amount</th><th rowspan="2">%</th><td>Grace period:</td><td>5.5 years[b]</td></tr>
<tr><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td rowspan="2">IDB (Ordinary Capital):</td><td rowspan="2">300 million</td><td rowspan="2">100%</td><td>Credit fee:</td><td>[c]</td></tr>
<tr><td>Inspection and supervision fee:</td><td>[c]</td></tr>
<tr><td rowspan="2">Total:</td><td rowspan="2">300 million</td><td rowspan="2">100%</td><td>Weighted average life:</td><td>12.75 years</td></tr>
<tr><td>Currency of approval:</td><td>U.S. dollars</td></tr>
</table>

<table>
<tr><th colspan="7">Project at a Glance</th></tr>
<tr><td colspan="7">Project objective and description: The objective of this programmatic series is to strengthen private and public investment, in order to promote economic growth in Argentina. The specific objectives of this first operation are to (i) modernize the institutional framework for taxation, to increase private investment; and (ii) modernize the institutional framework for policy-making, to improve the efficiency of public investment.

This is the first of two contractually independent but technically linked operations under the programmatic policy-based loan (PBP) modality to address to Argentina’s main challenges to boosting growth through private and public investment, supporting the Argentine government in its ambitious agenda of reforms to reduce constraints on private investment, as well as strengthening public investment processes.</td></tr>
<tr><td colspan="7">Special contractual conditions precedent to the first and only disbursement: The first and only disbursement is contingent on fulfillment of the policy reform conditions established in the Policy Matrix (Annex II), the Policy Letter, and other conditions established in the Loan Contract (see paragraph 3.4).</td></tr>
<tr><td colspan="7">Exceptions to Bank policy: None.</td></tr>
<tr><th colspan="7">Strategic Alignment</th></tr>
<tr><td>Challenges:[d]</td><td>SI</td><td>☐</td><td>PI</td><td>☑</td><td>EI</td><td>☐</td></tr>
<tr><td>Crosscutting themes:[e]</td><td>GD</td><td>☐</td><td>CC</td><td>☐</td><td>IC</td><td>☑</td></tr>
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(a) Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.
(b) Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted, provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.
(c) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank’s lending charges, in accordance with applicable policies.
(d) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).
(e) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 **Recent economic performance.** After a recession in 2015-2016 with a cumulative 1.8% contraction in GDP, Argentina's economy returned to growth in 2017, expanding 2.9%, attributable to an 11.3% increase in total investment. Unemployment, as a result, declined from 8.5% to 8.1% between 2016 and 2018. Growth is expected to continue in 2018 and 2019 with mean growth rate projections of 3% for both years.[1] The main factor holding back growth may be the drought associated with the La Niña phenomenon, which could cost around 0.7% of GDP in reduced agricultural output. If a growth scenario is borne out in 2018, Argentina will have posted two consecutive years of economic expansion for the first time since 2011.[2]

1.2 Economic activity is expected to continue growing in 2018. On the demand side, investment should continue to boost growth through the lower cost of capital, pro-investment tax reform, and the infrastructure investment stimulus. The growth of total payroll should also continue driving private consumption, and exports should recover as economic growth picks up in Brazil. The market consensus expectation is for growth on the order of 3%, whereas the International Monetary Fund (IMF) projects a more modest gain of 2.5%.

1.3 Inflation, while still high (24.8% in 2017), has been on the decline since peaking at 47% in mid-2016. To reduce inflation, the Central Bank of the Argentine Republic (BCRA) has raised the ex ante real monetary policy rate to 11% from the negative pre-2016 levels. Inflation is projected at 22% in 2018, and 15% in 2019.[3]

1.4 On the fiscal front, the observed primary deficits have been around 4.2% of GDP in 2016 and 3.8% in 2017, while the federal debt-to-GDP ratio was 56.6% at year-end 2017.[4] To contain the deficit, the government is pursuing a four-year strategy of gradual fiscal consolidation aimed at substantially narrowing the primary deficit, while seeking to reduce tax distortions and promote infrastructure investment to boost long-term growth. The primary deficit is expected to decline gradually to 1.2% by 2020, which would help to stabilize debt at current levels.[5]

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1 Quarterly series on global supply and demand of the National Statistics and Census Institute (INDEC)

2 Based on INDEC's quarterly series on global supply and demand.

3 Market expectations survey (BCRA, April 2018).

4 Fiscal bulletin, Ministry of Finance.

5 Fiscal targets, Ministry of Finance.

Table 1. Selected economic indicators

	2012	2013	2014	2015	2016	2017
Real GDP growth (% change)		2.4	-2.5	2.7	-1.8	2.9
Job growth (%)[(a)]	1.3	0.9	0.1	2.2	-0.6	0.5
Inflation (end-of-period, %)	23.2	27.0	36.5	28.1	35.6	24.8
Tax revenues (% of GDP)[(b)]	30.6	31.2	31.1	32.0	31.3	30.8
Primary expenditure (% of GDP)[(c)]	36.6	38.3	39.3	42.2	42.2	40.4
National public sector primary deficit (% of GDP)	-1.1	-2.3	-3.4	-4.1	-4.2	-3.8
Public sector debt (% of GDP)	36.8	39.4	41.4	49.5	51.7	56.6

(a) Formal wage-based private employment (Argentine Social Security System (SIPA)).
(b) Net tax ratio of national and provincial government, excluding inflationary tax (Galiani and Afonso, 2018).
(c) Total primary expenditure including national, provincial, and municipal government (Galiani and Afonso, 2018).

Source: INDEC quarterly series on global supply and demand and consumer price index, Quarterly Fiscal Bulletin, Ministry of Finance.

1.5 In view of its considerable financing needs, as well as the capital outflow from emerging countries as monetary policy normalizes in the United States, Argentina has begun negotiating a stand-by arrangement with the IMF. This arrangement significantly reduces the risk of a sudden stop in financing and the risk of high volatility.

1.6 **The challenge of economic growth.** Argentina faces the structural challenge of accelerating its medium-term growth. Its GDP per capita grew about 1.1% between 1960 and 2014, well below the rate of other countries in the region.[6] This low growth rate is attributable to low levels of investment and low productivity growth (IDB, 2016).[7] Total factor productivity rose only 0.4% per year on average between 1961 and 2014, while capital per worker also grew only 0.4% per year on average over the same period (IDB, 2016).

1.7 The main obstacle to growth since 1999 has been capital per worker, which made a negative contribution (-1.6%) to economic growth, while human capital and total factor productivity made positive contributions of 13% and 60.5%, respectively.[8] In line with this, growth in capital per worker has been even lower in the past five years, with an average annual increase of 0.2%. This is attributable to low levels of investment, which declined from 19.5% of GDP in 2007 to 14.8% in 2016. This level of investment lags significantly behind that of other countries in the region, such as Brazil (18%), Mexico (22.7%), and Chile (22.7%).

1.8 Raising the level of capital per worker will require greater private investment and efficiency in public investment (IDB, 2016). The main constraints and disincentives for investment by firms are related to an unsuitable business climate (IDB, 2016),[9]

6 Average growth is even lower if taking into account the 1975-2014 period, when the growth rate was just 0.8%. Average growth over a similar period was 2.1% in Brazil, 4.6% in Chile, and 2.2% in Mexico (Country Development Challenges, Argentina).

7 Crecimiento en Argentina en el último siglo [Growth in Argentina in the last century] (Gabriel Sanchez, 2014).

8 Country Development Challenges, Argentina.

9 Four methodologies were used to identify the main development challenges: diagnostic assessment of growth, analysis of sector development gaps, analysis of priorities for productivity and revenues, and analysis of regional development gaps. For more information, see Country Development Challenges, Argentina.

partly as a result of: (i) distortionary fiscal policies, which reduce returns on investment; (ii) insufficient levels of financial intermediation and access to finance;[10] and (iii) transaction costs for existing firms and innovative startups.[11] Meanwhile, challenges at various stages of the public investment management process include: (i) low coverage of reporting and evaluation by the National Public Investment System (SNIP);[12] (ii) weaknesses in investment planning at public enterprises;[13] and (iii) lack of an effective framework for public-private partnerships (PPPs).

1.9 **Distortions of the tax system.** Argentina's tax system features a number of highly distortionary taxes that hamper business productivity, investment, and competitiveness (IDB, 2016 and Organization for Economic Cooperation and Development (OECD), 2017). These highly distortionary taxes include high marginal rates for the corporate income tax, the bank transactions tax (ICDB), and the provincial tax on gross income (IIBB).

1.10 Argentina's corporate income tax rate of 35% is high by international standards, even disregarding the impact of the IIBB (OCDE, 2017).[14] Steep rates for this tax tend to curtail private investment by reducing returns on capital, thus discouraging investment (Galiani and Afonso, 2018).[15] This leads to lower levels of investment, productivity, and economic growth (Schwellnus C. and Arnold J., 2008; Arnold, J., Brys, B., Heady, C., Johansson, A., Schwellnus, C.; and Vartia, L., 2011).

1.11 The bank transactions tax (ICDB), which was instituted as an emergency measure during the 2001 crisis, is a tax on banking transactions by individuals and entities. It has a negative impact on financial intermediation. Kirilenko and Summers (2004) showed that this type of tax leads to a 28% to 47% contraction in the bank transaction base, resulting in higher costs of financing and lower levels of productivity.[16]

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10 Argentina's ratio of lending to the private sector as a percentage of GDP is extremely low at 14.3%, (BCRA). See Country Development Challenges, Argentina.

11 The World Economic Forum (WEF) ranks Argentina 128th out of 137 countries on the specific indicator of cost of public regulations.

12 There was no centralized registry or evaluation of projects channeled through Capital Transfers and the Priority Investment Program (62% of projected expenditure on public works). Only partial registry is available for direct real investment (65%), while registry of transfers is virtually nonexistent (12%). Source: National Public Investment Office (DNIP).

13 Center for the Implementation of Public Policies Promoting Equity and Growth (CIPPEC), 2016.

14 The average in the region is 31.5%, while the OECD average is 31.1% (Galiani and Afonso, 2018).

15 The literature shows that corporate income taxes have the heaviest adverse impact on growth due to the sensitivity of investment by firms, including investment in research and development as well as fixed investment (Fiscal Policy and Management Sector Framework Document). The literature also shows that the effects tend to be sustainable over time when the tax cut is financed by reducing public expenditure and not through debt, which would eventually increase interest rates, reducing the impact of the tax cut on interest rates. For a review of the literature, see Auerbach and Smetters, *The Economics of Tax Policy*, 2017.

16 Aghion, Philippe, Peter Howitt, and David Mayer-Foulkes, 2005 showed that access to finance is one of the most important variables for economic convergence, as it impacts total factor productivity by encouraging innovation and research and development (Aghion, P.; Angeletos, G.-M.; Banerjee, A. & Manova, K. , 2010), efficient allocation of capital to projects with higher returns (Galindo, Arturo Jose; Micco, Alejandro, 2007), and access to new markets and segments with demand for greater added value (Beck, 2002; Minetti and Zhu, 2011; Manova, 2012; Muuls, 2015), as well as by reducing the impact of volatility and macroeconomic shocks (Cavallo, E. A.; Galindo, A.; Izquierdo, A. & León J.J., 2013.; Aghion et. al., 2005).

1.12 The provincial tax on gross income (IIBB) is a tax on sales, which makes investment less profitable and therefore less attractive. It also impacts productivity and exports (IDB, 2016) because it taxes intermediate sales, thereby triggering a cascade effect that encourages vertical integration and harms sectors whose intermediate stage is more significant (IDB, 2016). Moreover, it has a negative effect on interprovincial trade and encourages geographic concentration due the fact that the tax rate varies from one province to another. This is tantamount to the existence of internal customs duties, significantly increasing the cost of taxpayer compliance (Galiani and Afonso, 2018).

1.13 While these three taxes are highly distortionary, reducing or abolishing them has proven difficult due to the significant revenues that they represent. The revenue intake from these taxes was equivalent to 7.8% of GDP in 2017.[17] Fiscal space must be created to cut these taxes without undermining the sustainability of the public finances, whether by raising other, less distortionary taxes or by reining in growth in public expenditure.

1.14 **Financing challenges for existing firms and startups.** The conditions that increase the number innovative enterprises are related to the ability to create startups and the opportunities to secure financing for them and to help them grow quickly (IDB, 2017). While Argentina has shown that it has the capacity to produce dynamic startups, its entrepreneurial environment has major weaknesses in terms of financing. Argentina's overall challenges in financing are associated with, inter alia, low levels of financial intermediation related to the ICDB and macroeconomic volatility related to high inflation (IDB, 2016; Kirilenko and Summers, 2004; Sánchez, Gabriel; Butler, Inés; and Rozemberg, Ricardo, 2011). The persistence of these unfavorable conditions over a number of years resulted in Argentina's extremely low level of lending to the private sector as a percentage of GDP (14.3%) (BCRA), compared to the much higher levels of comparable countries, such as 112.1% in Chile, 62.2% in Brazil, and an average of 49% for Latin America and the Caribbean and 147.1% for OECD countries (IDB, 2016). Argentina's current administration has begun to change this situation. Measures thus far include the elimination of minimum interest rates on fixed-term deposits and maximum interest rates on consumer loans,[18] greater information on bank fees,[19] simplified procedures for opening accounts, and introduction of an inflation-indexed unit.[20] As a result, lending to firms increased by more than 20% in real terms in 2017, reaching its highest level in 16 years.[21]

1.15 Financing for innovation and startups faces special challenges, even in sound financial markets. Such financing is adversely affected by known market defects, such as information asymmetry, as well as by the special features of technology risk and the valuation of intangible assets in knowledge-based startups. This is why special structures are developed in countries promoting new, dynamic knowledge-

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[17] Fiscal Bulletin, Ministry of Finance.

[18] Decree 30/2018, Official Bulletin of the Argentine Republic.

[19] Memorandum A 5928, BCRA.

[20] "Purchase value units," created by Law 27,271.

[21] Source: BCRA, in its series of reports on lending and deposits of the nonfinancial private sector, disaggregated by type of account holder, end-of-month balances.

based enterprises, in addition to the usual offerings in financial markets, to ensure an effective flow of financing for such enterprises (IDB, 2017). In addition to the specific challenges described here, this type of innovative enterprise in Argentina faces the general challenges of shallow financial markets. Argentina placed 39th out of the 60 countries ranked in the Index of Systemic Conditions for Dynamic Enterprise (2016), and third among the 15 Latin American countries ranked in terms of quality of the entrepreneurial ecosystem. Of the 10 indicators measured, Argentina ranked lowest in access to finance, at 14th out of 15 countries in the region.

1.16 **Transaction costs for existing firms and innovative startups.** In a market economy, it is business owners and entrepreneurs who identify business opportunities and capitalize on them by investing in their companies or starting new ones. If high transaction costs make it difficult to capitalize on these opportunities, the pace at which new companies are started or new investments are made slows down, and growth and returns on productivity are undermined (IDB, 2016 and IDB, 2017). Up to 2015, Argentina accumulated a system of regulations and taxes that had an adverse effect on its business climate. The World Economic Forum (WEF) ranked Argentina's economy 92nd out of 137 in terms of general competitiveness, and 113th on the institutions pillar;[22] on this pillar, the WEF ranked Argentina 128th for the specific indicator of costs of public regulations,[23] due to the number of procedures and the amount of time it takes to start a business. The 92nd-place ranking in the 2017-2018 report reflects an improvement of 12 notches over the previous year, as a result of initial reforms undertaken by the current administration (WEF, 2018).

1.17 **Weaknesses in public investment and lack of a PPP framework.** Inefficiencies in public investment management processes lower the quality of public infrastructure (IMF, 2015) and tend to reduce economic growth (Gupta, S.; Kangur, A.; Papageorgiou, C.; and Wane, 2014). Argentina faces challenges at the various stages of the investment management process. At the project planning and selection stages up until 2016, less than half of public sector investment underwent an ex ante review process whereby investments were listed and evaluated by the SNIP.[24] This is associated with a lack of political support for the SNIP, which allowed much of public investment to bypass the system (Tamblay, 2018). Also in the planning and selection stages are weaknesses related to the lack of project evaluation methodologies and social pricing estimates (Tamblay, 2018). At the investment execution phase, in 2015 only about 40% of projects with a current budgetary allocation posted expenditures, which suggests significant delays in executing works. Linkage with other key systems of public administration, such as budgeting

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22 WEF, 2018.

23 To account for year-to-year changes, we will use the absolute values for these indicators: 4, 3.3, and 2.4, respectively.

24 There was no centralized registry or evaluation of projects channeled through Capital Transfers and the Priority Investment Program (62% of projected expenditure on public works). A partial registry (only 65%) is available for real direct investment, while the registry for transfers is nearly nonexistent (12%).

systems, is also weak (De Raco, 2017). No methodologies are in place for ex post evaluation of project outputs, outcomes, and impacts.[25]

1.18 Additionally, public enterprises are responsible for executing 70% of investment and have weaknesses in their oversight and corporate governance mechanisms.[26] Public enterprises lack formal corporate governance mechanisms to ensure quality and relevance in their investments.[27] Up until 2016, the lack of a central entity to oversee public enterprises impacted their returns and the effectiveness of their investments.[28] Moreover, the lack of a legal framework governing and providing legal certainty for PPPs, as well as the weakness of project execution units at individual ministries, were associated with contracts being broken in the wake of the 2002 crisis and the low level of utilization of PPPs.[29]

1.19 **Reform agenda to boost growth.** The Government of Argentina has made it a priority to reestablish the private sector as the engine of development and to build a more efficient and transparent State to support growth.[30] The government undertook an ambitious reform agenda in 2017 to lessen constraints on private investment and strengthen public investment processes. To such end, it has undertaken a tax reform process at both the federal and provincial levels to reduce distortionary taxes within a framework of fiscal responsibility. Reform processes are also under way to make public investment more efficient and encourage entrepreneurship. These reforms have been supported by the Bank and coincided with preparation of this operation.

1.20 **National tax reform.** In late 2017, the Argentine government undertook a national tax reform initiative[31] aimed primarily at encouraging investment and gradually reducing the tax burden. The main features of this initiative include the following:

a. Lowering the corporate income tax rate on undistributed earnings from 35% to 25% within four years. This will encourage companies to reinvest their earnings.

b. Making the ICDB tax-deductible. The government's reform initiative would, within five years, allow the ICDB to be fully deducted from earnings, eliminating the financial disintermediation effect.

1.21 **Provincial tax reform.** In late 2017 the provincial governments and the national government reached a "Fiscal Consensus"[32] aimed at harmonizing tax structures

[25] The empirical literature also underscores the importance of project design, selection, implementation, and evaluation in the final impact of investments (Esfahani and Ramirez, 2003; Haque and Kneller, 2008). Emerging countries could improve the quality of their infrastructure by an average of 40% without having to increase expenditure, compared to 27% for developed countries and 55% for the lowest-income countries (IMF, 2015; Gupta et al., 2014). In other words, the average emerging country squanders about 40% of its public investment due to weaknesses in the public investment process. Argentina could improve its infrastructure quality by more than 35% at the same level of public investment (IMF, 2015).

[26] Source: DNIP.

[27] OECD, 2017.

[28] The OECD (2017) estimates that improved governance of public enterprises could boost economic growth by as much as 0.9% of GDP.

[29] Auguste, 2012.

[30] Source: Government Objectives.

[31] Law 27,430.

[32] Law 27,429.

across provinces to promote investment, jobs, and economic growth. Reducing the provincial tax on gross income (IIBB) is one of the most significant tax-related commitments undertaken by the provinces in the Fiscal Consensus. Provinces have agreed to (i) reduce tax rates within five years, with an exemption for primary production sectors, in order to reduce cascade effects; (ii) eliminate differential treatment based on where a company is based or where an establishment is located, in order to eliminate the "internal customs" effect; and (iii) reduce taxes on exports.

1.22 **Fiscal responsibility.** Reducing these taxes will entail a loss of revenue equivalent to at least 1.5% of GDP for the various levels of government.[33] To prevent this from adversely impacting public finances, the national government and provincial governments are also pursuing reforms to strengthen current expenditure and increase revenues from less distortionary taxes. Below are some of the most significant measures to strengthen fiscal responsibility:

a. Amendment of the Fiscal Responsibility Law to prevent current primary expenditure of the national and provincial governments from increasing at a faster pace than inflation or population growth. This will allow economic growth to gradually reduce the weight of public expenditure in GDP while creating fiscal space to reduce the tax ratio and improve the tax system (Galiani and Afonso, 2018). Growth in public expenditure—which rose from 26% of GDP in 2006 to 42.2% in 2016—has been one of the most significant limiting factors in the effort to reduce distortionary taxes in Argentina.[34] [35]

b. Reduction of differential subsidies for the Buenos Aires Metropolitan Area in energy by 2019, and in transportation by 2021. These subsidies were equivalent to more than 3% of GDP in 2016.

c. Proposal for a federal tax revenue sharing initiative, based on each jurisdiction's areas of responsibility, services, and roles. This initiative will include objective criteria for distribution and achieve targets for an equivalent degree of development across provinces.[36]

d. Property tax. To partially replace revenues from the IIBB with revenues from less distortionary taxes, the provinces agree to (i) create a federal agency, with the participation of the provinces, which will issue market-based property

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[33] Source: Draft tax reform initiative.

[34] This increase is primarily due to (i) an increase of 4.8 percentage points of GDP in total payroll, especially at the provincial level; (ii) an increase of 4.7 percentage points of GDP in social security expenditure; and (iii) an increase of 5 percentage points of GDP in transfers to the private sector, primarily due to increased energy subsidies. By contrast, investment as a percentage of total expenditure by the national public sector declined from 12% in 2007 to 8% in 2016 (IDB, 2016; Galiani and Afonso, 2018).

[35] The increase in current expenditure is related to a weak fiscal responsibility framework that, despite rules on growth in primary expenditure and on balanced budgeting, disregarded expenditure related to promoting economic activity, sustaining employment levels, and covering health emergencies (Federal Council on Fiscal Responsibility, 2017).

[36] As demonstrated in the literature on fiscal federalism and decentralization, this high degree of dependence on transfers creates incentives that run contrary to fiscal responsibility and efficiency, since a government that receives a significant percentage of its revenues from outside its jurisdiction lacks the requisite level of contact between taxpayers and public expenditure and may pursue a more expansive approach than it would otherwise (Fretes and Ter-Minassian, 2015; Qian and Weingast, 1997; Oates, 1999).

appraisals for tax purposes; (ii) use the appraisals issued by the federal entity; and (iii) set tax rates within a range of 0.5% to 2% of the appraised value.

1.23 **Strengthening the public investment process.** The national government has demonstrated its commitment to strengthening the SNIP by pursuing reforms to restore the role of the National Public Investment Office (DNIP) in the budgeting process. Responsibilities related to public investment and the DNIP were transferred in late 2017 from the Ministry of Production to the Office of the Cabinet Chief (JGM), and the Office of the Undersecretary for Budget Evaluation and Public Investment was designated as the authority responsible for implementing the SNIP. This reform reestablishes the SNIP's role in Argentina's national budgeting process.

1.24 The Government of Argentina will also undertake a number of reforms in the medium term to strengthen the SNIP, including (i) allowing for monitoring of budgetary execution through the Public Investment Project Bank (BAPIN) and automating the process of charging capital expenditures to the budget by linking the systems of the BAPIN and the Integrated Financial Information System (SIDIF); and (ii) adjusting the SNIP regulatory framework to simplify the requirements for institutions in issuing decisions.[37]

1.25 The Government of Argentina has also undertaken a process aimed at making public investment in public enterprises more efficient through PPPs. The national government has made progress in creating a unit within the orbit of the JGM to centralize oversight and monitoring of public enterprises, as well as in establishing corporate governance guidelines for public enterprises. The national government has also made progress in passing a PPP law and issuing regulations under it in 2017, and the Office of the Undersecretary for Public-Private Partnerships was created within the Ministry of Finance in 2018.[38] A remaining challenge along these lines is to develop a framework of transparency and fiscal responsibility, to ensure that the impact of PPPs on public accounts is sustainable.[39]

1.26 **Strengthening entrepreneurship.** To enhance the business climate and foster the emergence of dynamic startups, the federal government passed Law 27,349 to Support Venture Capital, now being implemented. This law led to the following improvements: (i) simplification of procedures through establishment of a new category of enterprise, known as a "simplified stock corporation" (SAS), which can be created online in a single day by meeting simple requirements; (ii) creation of the National Venture Capital Fund (FONDCE) to finance projects with seed capital and cofinance 13 accelerators to provide technical support for dynamic startups and finance their growth; and (iii) creation of tax stimuli for venture capital investors and issuance of regulations for a framework of new crowdfunding mechanisms.

1.27 **Executive order to cut bureaucracy simplify procedures.** Argentina's executive branch issued Executive Order 27/2018 to amend various laws and regulations that imposed unnecessary regulatory costs on the private sector. The main areas benefiting from this executive order are (i) companies, by improving the process for starting companies and making SASs more compatible with other laws; (ii) financing

[37] Source: DNIP.

[38] Decree 174/2018.

[39] For a review of best practices for bringing transparency to the fiscal impact of PPPs, see Fiscal and accounting note: Public-private partnerships.

for small and medium-sized enterprises, by simplifying the process whereby they secure various forms of financing for development, including changes in the operation of a public guarantee fund and in the regulations governing "mutual guarantee associations;" (iii) metrology, through a comprehensive review of procedures related to approval of review instruments in order to shorten processes and simplify procedures; (iv) trademarks and patents, by simplifying and scaling back procedures for registering trademarks and securing patents, through the adoption of international best practices; (v) labor markets, by improving the operation of the Public Registry of Employers with Labor Sanctions (REPSAL); and (vi) industrial regulations, by eliminating a mandatory registry for industries and facilitating the investment process in the automotive industry.

1.28 **Sector knowledge.** There is an extensive body of literature on the impacts of various types of taxes on growth, along with recommended reforms (Myles, 2009a, 2009b, 2009c; OECD, 2010, Martínez-Vázquez, J., V. Vulovic, and G. Canavire-Bacarreza, 2013; Mirrlees, J., A. Stuart, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles, and J. Poterba, 2011; and Auerbach and Smetters, 2017). The most significant conclusions for this program are as follows:[40] (i) property taxes are least likely to have an adverse impact on growth and distort the allocation of resources for savings and investment; and (ii) corporate income taxes have the greatest adverse impact on growth, due to the sensitivity of investment by firms. The economic literature offers ample evidence on the effectiveness of the program's primary measures. Auerbach and Smetters (2017) and the IDB (2016) both reviewed the literature and concluded that lowering the corporate income tax rate, when financed with reduced spending, is associated with higher levels of investment and economic growth. A number of studies in the empirical literature have found that distortionary taxes have an adverse impact on economic growth. Noteworthy among this literature are the papers by Kneller et al. (1999) and Gemmell, N., Kneller, R. and Sanz, I. (2011) for developed countries and Acosta-Ormaechea and Yoo (2012) for developed and developing countries. Additionally, Arnold J. (2008) and Arnold, J. et al. (2011) found that corporate income taxes are the most harmful of all distortionary taxes. While these papers do not address the economic mechanisms that lead to lower growth rates, these mechanisms may be related to a decrease in private investment and productivity. Schwellnus, C. and Arnold, J.(2008) and Vartia (2008) found that corporate taxes reduce investment and productivity, and Vartia (2008) also found that tax incentives for research and development increase productivity. Artana (2015) demonstrated the distortionary effect of the IIBB, while Kirilenko and Summers (2004) showed that taxes such as the ICDB cause a 28% to 47% reduction in the rate at which people utilize banking services.

1.29 National government involvement in matters of fiscal responsibility is a good practice supported by the literature. Rodden and Eskeland (2003) found that subnational government debt is more effectively controlled in a context of strong monitoring by the central government or the marketplace. Martell (2008) and Kishore and Prasad (2007) found that restrictions on coordination arrangements in Brazil and India were effective in increasing fiscal discipline. Cabasés, Pascual, and Vallés (2007) found that institutional restrictions on debt in Spain bolstered financial discipline in the debt

[40] For a review of this literature, see the Fiscal Policy and Management Sector Framework Document.

policies of local governments. In Colombia, Chamorro Narváez and Urrea Bermúdez (2016) found that implementation of a warning system and borrowing oversight made subnational governments more fiscally sustainable.

1.30 The empirical literature indicates that public investment has varying impacts on economic growth. Specifically, economic and social returns on public investment depend partly on how efficiently it is executed: a shock of one percentage point of GDP from public expenditure on investment increases GDP by only 0.3% in countries with low levels of expenditure efficiency, but the same shock results in a 0.6% increase in countries with higher levels of expenditure efficiency. These levels of expenditure efficiency, in turn, are partly determined by the strength and quality of institutions that frame the project cycle: countries with higher-quality institutions for investment management tend to have higher levels of efficiency in investment expenditure. As a result, the evidence shows the importance of strengthening the institutional framework, in order to improve public investment outcomes in developing countries. This strengthening occurs alongside a set of measures that include interventions to improve investment-monitoring mechanisms. The empirical literature also underscores the importance of project design, selection, implementation, and evaluation in the final impact of investments (Esfahani and Ramirez, 2003; Haque and Kneller, 2008). For example, Flyvbjerg, B., Bruzeliua, N., and Rothengatter, W. (2003) found significant cost overruns, benefits that fell short of expectations, and low levels of efficiency in investment selection and monitoring processes. The IMF (2015), using the data envelopment analysis method, found significant room for improvement in investment expenditure efficiency in the region. Emerging countries could improve their infrastructure quality by 40% on average without the need to increase expenditure, compared to 27% for developed countries and 55% for lower income countries.

1.31 Barriers to entrepreneurship—particularly barriers to entry—can represent significant obstacles to the emergence of startups. In the absence of the disciplining effect of competition from new participants, enterprises tend to grow less and are smaller and less productive (Klapper, L., Laeven, L. and Rajan, R., 2006). Potential gains in aggregate total factor productivity from more efficient allocation of capital and labor may have totaled 60% nearly a decade ago (Neumeyer and Sandleris, 2010; Busso et al., 2013). Sánchez (2009) found that competitiveness in the form of less productive informal enterprises played a significant role in the dispersion of productivity, for example, in the retail sector. Artana et al. (2010) estimated the marginal productivity rate of formal labor to be 80% higher than that of informal labor (which accounts for one third of the economically active population).

1.32 **The Bank's added value and technical operational support.** The Bank has supported the reform initiatives of the current administration in terms of diagnostic assessment, design, and implementation. In 2016 the Bank supported the national government in the diagnostic assessment of the most significant distortions in the tax systems at the national and, especially, provincial levels as part of the preparation of the Country Development Challenges document for Argentina and the design of operation 3835/OC-AR, the objective of which is to strengthen provincial fiscal management. In 2017 the Bank provided advisory support to the national government during the various phases of drafting the reforms to the Fiscal Responsibility Law and the Fiscal Consensus. The Bank is currently supporting implementation of the provincial reform commitments related to expenditure and tax administration through operation 3835/OC-AR,[41] in addition to complementing the national reforms with the Program to Enhance the Management Capacity of the Federal Administration of Public Revenue (loan 4500/OC-AR).[42] Financing was provided through operations 1884/OC-AR[43] and 2923/OC-AR for development and implementation of policies to support entrepreneurship. This program is also complementary to programmatic operation AR-L1298,[44] which supports productivity and economic growth through policies aimed at narrowing gender gaps in workforce participation.

1.33 The Bank has also supported the national government in assessing weaknesses in the public investment process as part of operation ATN/OC-16374-RG and is supporting the implementation of reforms through operation AR-T1204 with the general objective of supporting the National Public Investment Office (DNIP) in its institution-strengthening efforts, to make public investment in Argentina more efficient. To strengthen governance of public enterprises, the Bank has provided support in the form of a diagnostic assessment of the fiscal impact and transparency of public enterprises as part of operation ATN/KR-14970-RG and is supporting the implementation of reforms through operation ATN/OC-16115-AR, as well as the sharing of best practices in the region through operation ATN/OC-16161-AR.

1.34 **Lessons learned.** This programmatic series will benefit from lessons learned from, inter alia: (i) programs that contribute to boost growth through fiscal measures aimed at improving subnational fiscal management, such as the Program to Improve Municipal Management (loan 1855/OC-AR) and the PROCONFIS programs to consolidate the fiscal stability of the Brazilian states, in terms of the importance of measures to make public expenditure more efficient; (ii) programs to make the national tax system more efficient (operations 3201/OC-ME and 3676/OC-ME) in terms of the importance of modernizing national tax policy; (iii) programs to strengthen the national and provincial fiscal responsibility framework by strengthening fiscal rules (loans 4072/OC-ME, 2341/OC-CO, and 2744/OC-CO); and (iv) programs to strengthen growth by making public investment systems more efficient (loan 4428/OC-PE). Additionally, this program incorporates the best practices recommended by the Bank's Office of Evaluation and Oversight (OVE)[45] by including, alongside this programmatic series, investment programs to support measures aimed at improving tax administration at the national level (loan 3835/OC-AR) and provincial level (loan 4500/OC-AR). The program is also aligned with the recommendations stemming from OVE's evaluation of the Bank's country strategy with Argentina 2009-2015, to prioritize the Bank's efforts to support policy dialogue in the main areas of reform, including improvement of the regulatory

[41] This operation reached eligibility on 20 April 2017 and has disbursed 13% of its resources, supporting the provinces of Salta, Neuquén, Mendoza, and Corrientes.

[42] This operation was approved by the Bank's Board of Executive Directors on 12 March 2018 and is in the eligibility process.

[43] This operation was completed in December 2016.

[44] This operation is in the process of consideration and approval by the Bank, with approval expected in September 2018.

[45] In its 2017 report, Comparative Evaluation: Review of Bank Support to Tax Policy and Administration, 2007-2016, OVE identified as a lesson learned that tax reforms should be supported by a set of instruments with policy-based loans supporting policy reform, complemented by investment loans supporting implementation of the necessary tax administration reforms.

framework for promoting private investment, the strengthening of provincial governments, and enhancement of the business climate.

1.35 **Coordination with other multilaterals.** The reform program described above is aligned with the recommendations of the OECD and the IMF. Specifically, the OECD (2017) underscores the importance of: (i) carrying out tax reforms to reduce the marginal rate of the corporate income tax and phasing out the ICDB and the IIBB; (ii) introducing an expenditure rule; (iii) phasing out energy subsidies; (iv) rationalizing public employment; (v) improving corporate governance of state-owned enterprises; and (vi) simplifying administrative procedures and licensing requirements to start a business. The IMF (2017) also notes that the proposed amendments to the Fiscal Responsibility Law encourage fiscal discipline by limiting the expansion of public expenditure in real terms and restricting the increase in the number of public employees to the rate of population growth. Additionally, the IMF (2017) notes that the tax reforms address a number of the distortions in the tax system by (i) reducing the tax burden on investments by lowering the marginal rate of the corporate income tax; and (ii) reducing the impact of cascading taxes with gradual reduction of the ICDB and the IIBB.

1.36 **Strategic alignment.** The program is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008), and strategically aligned with development challenge of productivity and innovation through the objective of enhancing the business climate. The program is also aligned with the crosscutting theme of institutional capacity and rule of law through the objective of modernizing the institutional and policy framework, to make public investment more efficient. The program will contribute to the Corporate Results Framework 2016-2019 (document GN-2727-6), especially the following indicators: (i) percent of GDP collected in taxes; (ii) government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery; and (iii) business environment reforms enacted. The program is also consistent with the Bank's country strategy with Argentina 2016-2019 (document GN-2870-1), especially the priority area of business climate improvement and the strategic objective of government institution-strengthening. It is included in the 2018 Operational Program Report (document GN-2915) and is consistent with the Sector Strategy: Institutions for Growth and Social Welfare (document GN-2587-2), especially the area of public expenditure management and financing through improvements in revenue and expenditure management, and with the Fiscal Policy and Management Sector Framework Document (document GN-2831-3) as it relates to improving fiscal equity and social inclusion. It is also consistent with the Innovation, Science, and Technology Sector Framework Document (document GN-2791-8) by promoting an enabling environment for business and entrepreneurship.

B. Objectives, components, cost

1.37 **Objective.** The objective of this programmatic series is to strengthen private and public investment, in order to promote economic growth in Argentina. The specific objectives of this first operation are to (i) modernize the institutional framework for taxation, to increase private investment; and (ii) modernize the institutional framework for policy-making, to improve the efficiency of public investment.

1.38 This is the first of two contractually independent but technically linked operations under the programmatic policy-based loan (PBP) modality to address to Argentina's main challenges to boosting growth through private and public investment, supporting the Argentine government in its ambitious agenda of reforms to reduce constraints on private investment, as well as strengthening public investment processes. To such end, this programmatic series supports a tax reform process at the federal and provincial levels to reduce distortionary taxes (see paragraphs 1.9 to 1.13) within a framework of fiscal responsibility. Reform processes are also under way to make public investment more efficient (see paragraphs 1.17 to 1.19 and encourage entrepreneurship (see paragraphs 1.14 to 1.16). These reforms have been supported by the Bank and coincided with preparation of this operation.

1.39 The programmatic series as a whole supports the establishment of the legal framework for fiscal, investment, and entrepreneurship reforms, as well as their governing regulations and implementation. This first programmatic operation is geared primarily toward laying the legal groundwork for fiscal, investment, and entrepreneurship reforms at the national level, as well as the agreements for reforms at the provincial level. The second operation in the programmatic series is geared primarily toward supporting implementation of the legal reforms envisaged in the first operation through their governing regulations. This program builds on the reforms to reduce inflation and achieve price stability in the stand-by arrangement with the IMF. The program has three components.

1.40 **Component I. Macroeconomic stability.** The objective of this component is to ensure that a macroeconomic climate conducive to the program objectives is maintained, as established in the Policy Matrix and the Policy Letter.

1.41 **Component II. Improving the investment climate.** The objective of this component is to improve the business climate for private innovation and investment through the following: (i) modernize the national and subnational tax systems to promote investment and quality jobs; (ii) strengthen the fiscal responsibility framework to help lessen the tax burden; and (iii) strengthen the institutional framework for policy-making to lower transaction and financing costs for new and existing firms.

1.42 To modernize the national tax system, the first operation supports the approval of a national tax reform aimed at promoting investment and quality jobs (see paragraph 1.20) with emphasis on (i) lowering the marginal tax rate on undistributed corporate earnings from 35% to 25% within four years;[46] and (ii) allowing the ICDB to be fully deductible from earnings within five years.[47]

1.43 The second operation of the programmatic series will continue supporting implementation of the national tax reform. The measures under the second operation include (i) issuance of implementing regulations under the Tax Reform Law with emphasis on lowering the marginal tax rate on corporate earnings; and

[46] The literature shows that lowering the corporate income tax rate is effective at increasing private investment as long as these tax cuts are financed by reduced current expenditure. For a review of the literature, see Auerbach and Smetters, *The Economics of Tax Policy*, 2017. Additionally, higher corporate income taxes have been associated with lower productivity in the empirical literature (Schwellnus C. and Arnold J., 2008).

[47] Kirilenko and Summers (2004) showed that this type of tax leads to a 28% to 47% contraction in the bank transaction base and efficiency losses of 30% to 45% in the revenues from this tax.

(ii) issuance of implementing regulations under the Tax Reform Law with emphasis on making the ICDB fully deductible from earnings.

1.44 To modernize the subnational tax system, the first operation supports the approval of an agreement between the national government and the provincial governments whereby the provincial governments make a commitment to modifying the IIBB, to promote local economic growth (see paragraph 1.21). Under this agreement, subnational governments will commit to (i) lower tax rates over a five-year period with an exemption for primary production sectors to reduce cascade effects;[48] (ii) end differential treatment based on taxpayer headquarters or facility location, to eliminate the internal customs effect; and (iii) end taxes on revenues from goods exporting activities, except for exports related to mining or oil/gas activities and associated services.

1.45 The second operation of the programmatic series will continue supporting implementation of the reforms related to the IIBB, particularly through the issuance of the adopted regulations modifying the IIBB in at least 16 provinces.

1.46 To strengthen the fiscal responsibility framework to help lessen the tax burden while promoting fiscal balance at the national and provincial levels, the first operation supports the approval of an agreement between the national government and provincial governments establishing strategic guidelines to strengthen fiscal space at the national and subnational levels, in order to promote fiscal balance and lessen the tax burden (see paragraph 1.22). This will include the national government's commitment to moderate differential subsidies in energy and transportation for the Buenos Aires Metropolitan Area. The first operation will also support modernization of the policy framework for public finance by establishing strategic guidelines for the introduction of fiscal rules, with emphasis on the sustainability and creation of fiscal space for public investment,[49] including limits on increasing the number of public employees at the provincial and national levels to prevent this number from outpacing population growth.

1.47 The second operation of the programmatic series will continue to support implementation of reforms to strengthen the fiscal responsibility framework, particularly through (i) development of guidelines for drafting a federal revenue sharing bill;[50] (ii) development of policies for working toward the commitments assumed in the Fiscal Consensus in relation to the draft Law on Modernization of

[48] The commitment is for all primary sectors (farming, ranching, forestry, fishing, mining, and quarry operations), as well as electricity, gas, water, and transportation, to be exempt by 2022. The exemption for the manufacturing industry will not include the paper industry, which will be subject to a maximum 2% tax rate. The maximum tax rate on all other tertiary-sector activities will be 5%.

[49] There is extensive evidence linking the strength of fiscal responsibility frameworks to fiscal performance. For a detailed discussion of the literature, see the Fiscal Policy and Management Sector Framework Document.

[50] As demonstrated in the literature on fiscal federalism and decentralization, this high degree of dependence on transfers creates incentives that run counter to fiscal responsibility and efficiency, since a government that receives a significant portion of its revenues from outside its district loses the requisite level of contact between taxpayers and public expenditure and may pursue more expansionary behavior than it would otherwise (Fretes and Ter-Minassian, 2015; Qian and Weingast, 1997; Oates, 1999). As such, a federal revenue shareout law incorporating these principles will be important for strengthening efficiency incentives at the provincial level, as established in the Fiscal Consensus.

the State promoting transparency and efficiency in public administration;[51] and (iii) endorsement of the commitments related to fiscal strengthening by at least 16 provinces.

1.48 To lower transaction and financing costs for new and existing firms, the first operation seeks to strengthen investment in entrepreneurship through the issuance of implementing regulations for the Law to Support Venture Capital, which allows for the creation of public, private, or mixed-ownership venture capital institutions to contribute resources to clusters of entrepreneurship (see paragraphs 1.26 and 1.27). It also supports bills submitted to the legislature for laws that would reduce regulatory hurdles and controls for the development of private enterprises by cutting red tape and simplifying procedures.

1.49 The second operation will continue to support implementation of key mechanisms created by the Entrepreneurship Law nationwide, where: (i) at least three jurisdictions allow the creation of simplified stock corporations (SAS); (ii) at least three technology-based accelerators supported by these policies are active with projects financed; and (iii) at least one science-based accelerator supported by these policies is active with projects financed. The second operation will also support key policy and regulatory changes already implemented: (i) planned transformations in metrology are in effect; (ii) changes in the operations of the National Industrial Property Institute related to trademarks and patents are in effect; and (iii) listings in the National Industrial Registry (RIN) are no longer mandatory.

1.50 **Component III. Improving the efficiency of public investment.** The objective of this component is to make public investment more efficient through the following: (i) modernize the institutional framework for management of investment projects; (ii) optimize the efficiency of public investment by public enterprises; and (iii) modernize the regulatory framework for PPPs (see paragraphs 1.24 and 1.25).

1.51 To improve the institutional framework for management of investment projects, the first operation supports (i) approval of the institutional transfer of the National Public Investment Office (DNIP) into the orbit of the Office of the Cabinet Chief (JGM), to help streamline investment project approvals and strengthen ex ante review;[52] and (ii) approval of guidelines to centralize management of projects with external financing and/or projects with public-private participation, to optimize execution.

1.52 The second operation will continue efforts to improve the policy framework through the following: (i) approval of a policy framework to boost efficiency in public investment, with emphasis on simplifying SNIP requirements for issuing opinions and coordinating the Public Investment Project Bank (BAPIN) and Integrated Financial Information System (SIDIF), to automate the workload;[53] and (ii) implementation of centralized management of projects with external financing and/or projects with public-private participation, to optimize execution.

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[51] The new Law on Modernization of the State will be instrumental in moderating increases in current expenditure and especially in personnel, as agreed in the Fiscal Consensus.

[52] This policy addresses weaknesses related to the lack of political support for the SNIP, allowing much of public investment to bypass the system (Tamblay, 2018).

[53] Additionally, weaknesses related to the absence of project evaluation methodologies and the lack of social pricing estimates were discovered during planning and selection (Tamblay, 2018).

1.53 To optimize the efficiency of investment by public enterprises, the first operation supports: (i) creation of a unit within the orbit of the JGM to centralize monitoring and supervision of public enterprises; and (ii) approval of the good governance guidelines for Argentina's majority State-owned enterprises.[54] The second operation will continue this support through the adoption of specific corporate governance criteria for at least 50% of total expenditure by public enterprises.

1.54 To help modernize the regulatory framework for PPPs, the first operation supports the allocation of roles and responsibilities of the Office of the Undersecretary for Public-Private Participation within the Ministry of Finance. The second operation will support implementation of the regulatory framework through the award of at least three PPP contracts, as well as development of strategic guidelines to ensure PPP fiscal sustainability and transparency.

C. Key results indicators

1.55 The expected impact indicators are: (i) increase in economic growth in terms of GDP; and (ii) increase in the level of total investment, measured through gross fixed capital formation as a percentage of GDP. The expected outcome indicators are: (i) decrease in tax revenue intake from distortionary taxes as a percentage of GDP; (ii) increase in the percentage of national annual public investment recorded in the BAPIN system as a percentage of national annual total public investment; and (iii) number of technology-based startups receiving financing from the National Venture Capital Fund (FONDCE). The program's expected outcomes and impacts are given in the results matrix.

1.56 **Economic analysis.** Based on OVE's recommendations in its 2011 Evaluability Review of Bank Projects[55] and the results of the Review of Good Practice Standards for the Evaluation of Policy-based Lending, prepared by the Evaluation Cooperation Group (ECG) comprised of the independent evaluation offices of multilateral development banks,[56] as described in paragraph 1.3 of the Review of the Development Effectiveness Matrix for Sovereign Guaranteed and Non-Sovereign Guaranteed Operations (document GN-2489-5), indicating, inter alia, that there is no need to include an analysis of efficiency in the use of financial resources,[57] it was decided not to perform an economic analysis for loans of this type, as reported to the Bank's Board of Executive Directors. Thus, this operation does not include an economic analysis and, consequently, the economic analysis is not considered for purposes of measuring the evaluability score in this program's Development Effectiveness Matrix (DEM).

[54] The guidelines must establish good practices for the organization and functioning of leadership boards and management of firms, including practices for performance evaluation, transparency, and integrity. They must also include components related to specific policies on audit and control, economic performance, purchasing and procurement, and sustainability.

[55] Document RE-397-1: "Currently, Economic Analysis section is computed as the maximum between the CBA (cost benefit analysis) and the CEA (cost effectiveness analysis). Yet neither a CBA nor a CEA is applicable to PBLs (policy-based loans) and PBPs (programmatic policy-based loans)."

[56] Good Practice Standards for the Evaluation of Public Sector Operations. Evaluation Cooperation Group, Working Group on Public Sector Evaluation, 2012 Revised Edition. February 2012.

[57] The Evaluation Cooperation Group calls for policy-based loans to be evaluated for relevance, effectiveness, and sustainability. Efficiency was not included as a criterion because policy-based loans are sized according to the country's financing gap, independent of project benefits.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 **Financing instrument.** This operation has been structured under the programmatic policy-based loan (PBP) modality and is the first in a programmatic series of two contractually independent but technically linked operations, in line with document CS-3633-1, "Policy-based loans: Guidelines for preparation and implementation. New version." The programmatic modality has been selected to (i) provide support in the medium term for the government's program of financial policy reforms; (ii) promote ongoing dialogue; and (iii) help monitor and refine the implementation strategy given the high degree of complexity of the reforms, which involve policy actions at multiple levels of government.

2.2 **Dimensioning**. The cost of this operation will be US$300 million, to be financed by the IDB from Ordinary Capital resources. This amount, to be disbursed in a single tranche, is justified by Argentina's broad fiscal resource needs, even if they are not directly related to the reform-associated costs to be borne by the borrower, as provided in paragraph 3.27 of document CS-3633-1. The public sector financing requirements for 2018 are estimated at approximately US$30 billion. This operation accounts for 0.7% of these requirements, and 2.2% of the expected external financing for the federal public sector.

B. Environmental and social safeguard risks

2.3 In accordance with Directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this program does not require classification. The operation will support the development of policies, standards, management instruments, and other institutional strengthening actions, and will not finance infrastructure investments or works. Consequently, no social or environmental risks are envisaged.

C. Fiduciary risks

2.4 No fiduciary risks have been identified for this operation. The resources for this operation will go directly into the treasury accounts, to cover the financing needs of the national government, for which the executing agency has the necessary financial management instruments and control systems.

D. Other project risks

2.5 **Fiscal sustainability.** The main macroeconomic risk, rated as high, is related to an adverse international environment with rising interest rates and currency devaluations that could hamper the growth of private-sector investment while making it difficult to reduce the financial deficit of the national government, stabilize the debt, and cover the high external financing requirements. Although this risk cannot be controlled, the national government has designed a strategy for fiscal sustainability and financial discipline to better enable the country to respond, if this macroeconomic risk becomes a reality. The national government is also negotiating a stand-by arrangement line of credit with the IMF to ensure macroeconomic stability and meet its external financing requirements.

2.6 **Development.** Two development risks were identified, both rated as medium: (i) Problems may arise in implementing the reforms related to fiscal responsibility and reduction of the tax on gross income at the subnational level due to institutional weaknesses in the provincial tax administrations and lack of political consensus. This risk is mitigated by support from operation 3835/OC-AR and loan AR-L1285, now in preparation, both of which include an objective of strengthening provincial tax administrations and cadastre agencies. Regarding the risk of lack of political consensus, the fiscal responsibility actions underwent a lengthy consensus-building process with the provinces, in which discussions were held, and agreement reached, on the need for these reforms and their scope. As a result, the proposed reforms submitted by the national government originated in the Fiscal Responsibility Council with the consensus of the provinces; and (ii) Delays may occur in implementing the reforms related to strengthening the National Public Investment System (SNIP), due to institutional weaknesses in the National Public Investment Office (DNIP). This risk is mitigated by the implementation of operation ATN/OC-16721-AR, which has a general objective of supporting the DNIP's institution-strengthening, to make public investment in Argentina more efficient.

2.7 **Public management and governance.** Another medium-level risk is the political uncertainty that may result from the 2019 presidential elections. This risk is mitigated by a Policy Matrix that calls for measures to be approved before the electoral period.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** The borrower will be the Argentine Republic, and the executing agency will be the Ministry of Finance, acting through its Office for Special Programs and Projects with a Sector-wide Approach or successor agency.

3.2 The executing agency will be responsible for (i) coordinating with the agencies responsible for the operation's activities in all respects; (ii) providing evidence that the policy commitments have been met, as well as any other program-related evidence needed by the Bank to approve the relevant disbursement; and (iii) once the program disbursement has been made, gathering information on performance indicators for evaluation of program results. The executing agency will use the institutional means at its disposal to ensure effective coordination among the relevant public agencies for policy measures covered by this operation. It will also work with the Bank for the necessary coordination with other entities in relation to measures included in this operation.

3.3 **Coordination mechanism.** The executing agency, as part of its institutional roles and responsibilities, periodically reviews existing operations with external financing throughout the national public sector and conducts supervision, evaluation, monitoring, and control. The objective in doing so is to coordinate and optimize the execution of existing programs, to ensure compliance with the sector-specific policies of the national government.

3.4 **Special contractual conditions precedent to the first and only disbursement: The first and only disbursement is contingent on fulfillment of the policy reform conditions established in the Policy Matrix (Annex II), the Policy Letter, and other conditions established in the Loan Contract.**

B. Summary of arrangements for monitoring results

3.5 **Monitoring system.** A monitoring and evaluation plan was prepared to monitor program results. This plan features the following instruments: (i) the Policy Matrix (Annex II), (ii) the means of verification matrix, and (iii) the results matrix. These are the key parameters for monitoring and evaluating program results. The Bank will monitor execution from the Country Office. The executing agency will be responsible for monitoring the results of the operation, in coordination with the Ministry of Finance.

3.6 **Evaluation.** A two-part evaluation strategy will be used. An analysis will be done of how the rate of economic growth and level of public and private investment changed following implementation of the measures included in the program. Another analysis will be done of the impact of the reduction in distortionary taxes on investment by firms (see monitoring and evaluation plan). A project completion report (PCR) will also be prepared. These analyses and the PCR will be prepared upon completion of the programmatic series. The analysis of how the rate of economic growth and level of private investment changed will employ a before-and-after analysis without attribution of results. Growth accounting models similar to Daude and Fernandez-Arias (2010) will be used to determine what percentage of growth is explained by the accumulation of physical capital. This analysis will be included in the PCR and will be completed by IDB staff, possibly with support from a consultant engaged for such purpose. Meanwhile, as part of the ex post evaluation of the operation, an analysis will be done of whether the reduction in distortionary taxes encouraged greater investment by firms. The program policy measures include a reduction in the marginal tax rate on corporate earnings and modification of the provincial tax on gross income. Although these tax cuts are expected to encourage investment in physical capital, their effect on investment is not currently known, and will be estimated on an ex post basis. This study, therefore, will contribute to the analysis of impact number 2 in the results matrix (gross fixed capital formation as a ratio of nominal GDP).

IV. POLICY LETTER

4.1 The Bank and the Government of Argentina have agreed on the policy commitments to be supported through this program. These commitments are set out in the Policy Matrix (Annex II), the means of verification matrix, and the results matrix. The Policy Letter, which the borrower will deliver to the Bank in due course, confirms the government's commitment to the objectives and actions of the programmatic operation as a whole.

Development Effectiveness Matrix		
Summary	**AR-L1283**	
I. Corporate and Country Priorities		
1. IDB Development Objectives	**Yes**	
Development Challenges & Cross-cutting Themes	-Productivity and Innovation -Institutional Capacity and the Rule of Law	
Country Development Results Indicators	-Percent of GDP collected in taxes (%) -Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Business environment reforms enacted (#)*	
2. Country Development Objectives	**Yes**	
Country Strategy Results Matrix	GN-2870-1	Institutional strengthening of government
Country Program Results Matrix	GN-2915	The intervention is included in the 2018 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	9.6	
3.1 Program Diagnosis	3.0	
3.2 Proposed Interventions or Solutions	3.6	
3.3 Results Matrix Quality	3.0	
4. Ex ante Economic Analysis	N/A	
5. Monitoring and Evaluation	7.0	
5.1 Monitoring Mechanisms	1.1	
5.2 Evaluation Plan	6.0	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	Medium	
Identified risks have been rated for magnitude and likelihood	Yes	
Mitigation measures have been identified for major risks	Yes	
Mitigation measures have indicators for tracking their implementation	Yes	
Environmental & social risk classification	B.13	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)		
Non-Fiduciary	Yes	Strategic Planning National System, Statistics National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	In terms of public investment, the Bank has supported the GN in diagnosing the weaknesses of the public investment process within the framework of ATN/OC-16374-RG and is supporting the implementation of reforms through the AR-T1204 . In terms of strengthening the governance of Public Enterprises (PS), the Bank has supported the implementation of a diagnosis of the fiscal impact and transparency of the PSs in the framework of the ATN/KR-14970-RG and is supporting the implementation of the reforms through the ATN/OC-16115-AR as well as the exchange of best practices in the region through the ATN/OC-16161-AR.

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

This is the first operation of the two that comprises this Programmatic Loan to Support Policy Reforms (PBP). This PBP consists of two contractually independent and technically linked loans.

The general objective is to strengthen private and public investment, to promote economic growth in Argentina. In this first operation, the specific objectives are: (i) to increase private investment, by modernizing the institutional-tax framework (component II) and (ii) to improve efficiency in public investment, by modernizing the regulatory-institutional framework (Component III).

The diagnosis identifies low levels of capital per worker as the main problem for economic growth. The specific problems identified are: (i) low level of private investment and (ii) low efficiency of public investment.

The main causes associated with low private investment are: (i) distortionary fiscal policies, (ii) insufficient levels of financial intermediation, (iii) low access to financing and (iii) high transaction costs for firms. Regarding the low efficiency of public investment, its main causes are: (i) low coverage in the registry and evaluation by the National System of Public Investment, (ii) weaknesses in the planning of investments in Public Firms and (iii) absence of an effective framework of Public-Private Partnerships.

The operation presents adequate evidence of internal (but not external) validity for the proposed solutions. The vertical logic of the project is clear and well specified. The results matrix, in general, is adequately constructed.

The PBP has an adequate monitoring and evaluation plan. The measurement of results on economic growth and business investment is made through an ex-post economic analysis, whose attribution is based on a theoretical level.

The general risk rating of the program is average. Mitigation measures have been identified and have adequate monitoring indicators.

POLICY MATRIX

Specific objectives	Policy actions, first operation	Indicative policy actions, second operation
Component I. Macroeconomic stability		
Ensure that a macroeconomic climate conducive to the program objectives is maintained, as established in the Policy Matrix and the Policy Letter.	1.1 The borrower's macroeconomic environment is conducive to the program objectives.	1.1 The borrower's macroeconomic environment is conducive to the program objectives.
Component II. Improving the investment climate		
Modernize the national and subnational tax systems to promote investment and quality jobs.	2.1 Approval of a national tax reform aimed at promoting investment, competitiveness, and quality jobs with emphasis on (i) lowering the marginal tax rate on corporate earnings, and (ii) allowing the bank transactions tax (ICDB) to be fully deductible from earnings.	2.1.1 Issuance of implementing regulations under the Tax Reform Law with emphasis on lowering the marginal tax rate on corporate earnings.
		2.1.2 Issuance of implementing regulations under the Tax Reform Law with emphasis on making the ICDB fully deductible from earnings.
	2.2 Approval of an agreement between the national government and the provincial governments whereby the provincial governments make a commitment to modifying the provincial tax on gross income (IIBB), to promote local economic growth. Under this agreement, the provincial governments will agree to (i) lower tax rates over a five-year period with an exemption for primary production sectors to reduce cascade effects; (ii) end differential treatment based on taxpayer headquarters or facility location, to eliminate the internal customs effect; and (iii) end taxes on revenues from goods exporting activities, except for exports related to mining or oil/gas activities and associated services.	2.2 Issuance of the adopted regulations modifying the IIBB in at least 16 provinces.

Specific objectives	Policy actions, first operation	Indicative policy actions, second operation
Strengthen the fiscal responsibility framework to help lessen the tax burden.	2.3 Approval of an agreement between the national government and provincial governments establishing strategic guidelines to strengthen fiscal space at the national and subnational levels, in order to promote fiscal balance and lessen the tax burden. This will include the national government's commitment to moderate differential subsidies for the Buenos Aires Metropolitan Area.	2.3.1 Development of guidelines for working toward the shared agreements assumed in the Fiscal Consensus, particularly in relation to a federal revenue sharing bill. 2.3.2 Development of policies for working toward the shared commitments assumed in the Fiscal Consensus in relation to the draft Law on Modernization of the State promoting transparency and efficiency in public administration.
	2.4 Modernization of the policy framework for public finance by establishing strategic guidelines for the introduction of fiscal rules, with emphasis on the sustainability and creation of fiscal space for public investment, including limits on increasing the number of public employees at the provincial and national levels to prevent this number from outpacing population growth.	2.4 Endorsement of the commitments related to fiscal strengthening by at least 16 provinces.
Strengthen the institutional framework for policy-making to lower transaction and financing costs for new and existing firms.	2.5 Strengthening of investment in entrepreneurship through the issuance of implementing regulations for the Law to Support Venture Capital, which allows for the creation of public, private, or mixed-ownership venture capital institutions to contribute resources to clusters of entrepreneurship.	2.5 Implementation of key mechanisms created by the Entrepreneurship Law nationwide, where: (i) at least three jurisdictions allow the creation of simplified stock corporations (SAS); (ii) at least three technology-based accelerators supported by these policies are active with projects financed; and (iii) at least one science-based accelerator supported by this policy is active with projects financed.
	2.6 Bills submitted to the legislature for laws that would reduce regulatory hurdles and controls for the development of private enterprises by cutting red tape and simplifying procedures.	2.6 Key regulatory and legal changes are in effect: (i) planned transformations in metrology are in effect; (ii) changes in the operations of the National Industrial Property Institute related to trademarks and patents are in effect; and (iii) listings in the National Industrial Registry (RIN) are no longer mandatory.

Specific objectives	Policy actions, first operation	Indicative policy actions, second operation
Component III. Improving the efficiency of public investment		
Modernize the institutional framework for investment projects, including public enterprises and PPPs.	3.1 Approval of the institutional transfer of the National Public Investment Office (DNIP) into the orbit of the Office of the Cabinet Chief (JGM), to help streamline investment project approvals and strengthen ex ante review.	3.1 Approval of a policy framework to boost efficiency in public investment, with emphasis on: (i) simplifying SNIP requirements for issuing opinions; and (ii) coordinating the Public Investment Project Bank (BAPIN) and Integrated Financial Information System (SIDIF), to automate the workload.
	3.2 Approval of guidelines to centralize management of projects with external financing and/or projects with public-private participation, to optimize execution.	3.2 Implementation of centralized management of projects with external financing and/or projects with public-private participation, to optimize execution.
	3.3 Creation of a unit within the orbit of the JGM to centralize monitoring and supervision of public enterprises.	3.3 Adoption of specific corporate governance criteria for at least 50% of total expenditure by public enterprises.
	3.4 Approval of the good governance guidelines for Argentina's majority State-owned enterprises.	
	3.5 Allocation of roles and responsibilities of the Office of the Undersecretary for Public-Private Participation within the Ministry of Finance.	3.5.1 Award of at least three PPP projects. 3.5.2 Development of strategic guidelines to ensure PPP fiscal sustainability and transparency.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/18

Argentina. Loan ____/OC-AR to the Argentine Republic
Program to Drive Growth

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 Argentine Republic, as borrower, for the purpose of granting it a financing to cooperate in the execution of the Program to Drive Growth. Such financing will be for an amount of up to US$300,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___ ____________ 2018)

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Pipeline No.: AR-L1283