



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 08-Apr-2019 | Report No: PIDC26690



BASIC INFORMATION

A. Basic Project Data

Country Argentina	Project ID P168713	Project Name Second Inclusive Growth programmatic DPF (P168713)	Parent Project ID (if any) P167889
Region LATIN AMERICA AND CARIBBEAN	Estimated Board Date Jun 18, 2019	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Ministerio de Hacienda	Implementing Agency Ministerio de hacienda		

Proposed Development Objective(s)

The Development Objectives of the operation are (i) strengthening the foundation for private sector led growth, and (ii) strengthening the social safety net and enhance fiscal equity

Financing (in US\$, Millions)

SUMMARY

Total Financing	500.00
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DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **The programmatic DPF series accompanies Argentina’s efforts to strengthen the foundations for inclusive economic growth.** This proposed Development Policy Financing operation (DPF2), in the amount of US\$500 million, is the second in a series of two operations—. The DPF series supports policy measures to: (i) strengthen the foundations for private sector-led growth (Pillar 1), and (ii) strengthen the social safety net and enhance fiscal equity (Pillar 2). The



programmatic DPF series builds on strong policy dialogue and close collaboration with the authorities across the DPF-supported policy areas. The measures supported in this DPF series build directly on close collaboration with the Government across these priority areas. This operation also fits within the policy priorities to promote sustainable growth and shared prosperity identified in the 2018 Systematic Country Diagnostic. The DPF series has been prepared as part of the international efforts to support Argentina's program for economic stabilization, including the exceptional access Stand-By Arrangement (SBA) provided by the International Monetary Fund (IMF) with an overall financing envelope of US\$56.3 billion.

The DPF series complements the Government's macroeconomic stabilization plan by focusing on the agenda for medium-term growth and strengthening the safety net and enhancing fiscal equity. Achieving higher growth and job creation in the private sector is critical for Argentina, particularly in a period of increased consolidation in the public sector. The DPF series supports continued efforts to spur on private sector growth through measures that enhance competition, further decrease barriers to trade, reduce business costs, encourage capital markets development, and enhance anti-corruption efforts. Core to the World Bank's support is a focus on the protection of the most vulnerable from the effects of a deterioration in economic activity. In this context, the focus of the first DPF is on actions that facilitate access to government services for the most vulnerable population, create fiscal space, improve the impact of fiscal policy on equity and the effectiveness of health care provision for the less well-off.

This second operation in the DPF series has been prepared in a context of continued adherence to the IMF's SBA, but the risks associated with the proposed operation remain high. The Government implemented a strengthened fiscal and monetary policy framework under the IMF SBA takes in October 2018, which led to a stabilization of the peso and Argentine sovereign spreads started to decrease. However, early March has seen renewed volatility in part attributed to concerns on the political risk associated with the upcoming election and continued high inflation. While full adherence to the fiscal and monetary targets is paramount for a successful macroeconomic stabilization, macroeconomic risks are high as weakening external demand and/or a tightening of global financial conditions for emerging markets could dampen growth prospects and impact on the willingness of investors to rollover Argentine assets. In addition, political uncertainty ahead of the 2019 Presidential elections and potential social discontent add to these risks. While there is a strong consensus around the World Bank-supported reform agenda to strengthen the foundations of inclusive growth, there are downside risks that could delay or complicate the implementation of structural reforms.

Relationship to CPF

Support for the Government's reform program through DPFs is in line with the priorities identified in the World Bank Group's Argentina Country Partnership Framework (CPF) for FY19-FY22, which is under preparation. The new Argentina CPF for FY19-FY22, is expected to build on the current CPS program and focus on achieving the WBG twin goals through four interdependent focus areas closely linked to the priorities areas identified by the recent Argentina Systematic Country Diagnostic (SCD): (i) putting the macroeconomic and fiscal fundamentals in place; (ii) improving competitiveness and productivity; (iii) fostering an inclusive economy; and (iv) strengthening environmental sustainability and harnessing natural capital for growth.

C. Proposed Development Objective(s)

The Development Objectives of the operation are (i) strengthening the foundation for private sector led growth, and (ii) strengthening the social safety net and enhance fiscal equity

Key Results



PILLAR 1: STRENGTHENING THE FOUNDATIONS FOR PRIVATE SECTOR-LED GROWTH

- Fostering competition and access to efficient input goods and services: The implementation of pro-competition reforms is expected to increase the ability of firms to compete on a level playing field, while being able to access more efficient input markets.
- Supporting a more competitive tradable sector by reducing import barriers to input goods: The reforms are expected to benefit firms that import inputs as it has the potential to substantially reduce uncertainty and trade costs, increase efficiency, and boost firm competitiveness.
- Encourage entry and exit to facilitating formal entrepreneurship: The implementation of comprehensive business registration reforms is expected to lower bureaucratic barriers to entry and encourage formal registration of firms; it will also improve the quality and accessibility of data on registered firms.
- Deepening the financial sector: Capital market reforms will allow for a more flexible, varied and versatile capital market providing much better potential for growth in assets and increased financing instruments for enterprises.
- Greening the energy matrix. The reform will gradually help establish the renewable energy market for small-scale users, which has huge potential where all residential users represent 40 percent of the total electricity demand.
- Strengthening transparency and anti-corruption: The reforms are expected to strengthen the accountability framework and the ability to prevent and control corruption practices for private companies and public officials.

PILLAR 2: STRENGTHENING SOCIAL SAFETY NETS AND FISCAL EQUITY

- Protecting the poor and vulnerable while reducing costly, untargeted, and regressive subsidies. The reforms will result in a consistent, equitable, and efficient social protection, moving away from costly, untargeted, and regressive subsidies.
- Enhancing fiscal responsibility at the provincial level and equity of intergovernmental transfers: The proposed reforms should result in a gradual shift of sub-national tax structure from distortive and regressive composition toward a more efficient and progressive taxation. The Fiscal Responsibility Regime will also help reduce procyclicality of fiscal policy and create more space for public investment in infrastructure.
- Strengthening the social safety net system: The proposed reforms should result in expanded access of poor and vulnerable families to social support programs and lead to gradual increase in number of different programs that are included in the Single Window system. The proposed reform will also protect the benefits of effective social protection program in real terms from high inflation including due to the reduction of subsidies.
- Effective Universal Health Coverage (UHC): The UHC strategy will increase the effective and equitable coverage of key health services provided to the vulnerable population and increase the capacity of the national and provincial stakeholders to implement mechanisms for an integrated delivery system.

D. Concept Description

The DPF2 is the second in a series of two operations supporting reform measures to (i) strengthen the foundations for private sector-led growth, and (ii) strengthen the social safety net and enhance fiscal equity. The DPF series complements and reinforces the stabilization efforts by supporting measures that tackle distortions and level the playing field for private sector-led growth, which are important measures to help sustain and increase potential growth. Similarly, strengthening the social safety net system and enhancing fiscal equity are central to the operation to protect the most vulnerable and improve inclusion.

The Government is addressing policy distortions that act as barriers to private sector-led growth. This includes actions to promote competition, reduce the costs of intermediate inputs/capital goods and the red tape associated with doing business, while encouraging private investment in infrastructure, including the exploitation of renewable energy. Productivity growth in Argentina has been very low over recent decades in an economic setting marked by macroeconomic



and policy volatility.^{1,2} There are multiple factors holding back growth and productivity, such as the large barriers to competition and trade, as well as the high costs of doing business. As well as being one of the most closed economies in the world, what trade Argentina does is not integrated into global value chains (GVCs)—i.e. global trade in parts and components rather than end products. Limited competition prevents the reallocation of resources efficiently and effectively across sectors.³ Firms struggle with limited access to finance and the large costs of doing business⁴ related in part to low quality transport and logistics services.⁵ Capital markets are underdeveloped, leaving little opportunity for financial market intermediation and reflected in low investment: gross fixed capital formation was 14.8 percent of GDP in 2018,⁶ significantly below the average among upper-middle income countries (30 percent). Domestic credit to the private sector is extremely low at 15.1 percent of GDP, and most firms must finance expansion through own profits. Developing the country's rich renewable energy resources by attracting private investment is not just important for growth, but for meeting the country's ambitious climate change mitigation targets.

In a context of deteriorating economic conditions and high level of inflation, strengthening the efficiency, effectiveness and equity of fiscal policy is an essential element of the program. Creating fiscal space for priority spending to generate resource for growth and equity, while better reaching the poor with social protection programs and universal health coverage are central to effectively mitigate adverse economic impacts of shocks on vulnerable population in the short run and build economic resilience and fiscal sustainability in the long term. Given Argentina's federal system, it is also critical that actions at the federal level be accompanied by well-designed actions at the provincial level. Part of this agenda involves move away from costly untargeted subsidies towards more effective instruments for social protection. In this context, the operation has been strengthened to supports the recent measures to protect the real value of benefits of high-quality social programs under Asignaciones Universales para Proteccion Social"), which is efficiently administered, have reasonably wide coverage, and have been shown to improve socioeconomic outcomes in the target population. Part of this agenda involves addressing the fragmentation of the social protection and health systems to ensure effective and efficient access to most vulnerable while reducing overlaps and costs for managing agencies, hence acting as effective automatic stabilizers.

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

The policy measures supported by this DPF series are expected to play a role in mitigating the short-term distributional impacts of the broader Government's reform program on the most vulnerable, while implementing structural reforms to reduce distortions and enhance potential growth. By strengthening the foundations for private sector-led growth, the policy program under Pillar 1 is expected to bring positive distributional impacts and poverty reduction, although these would materialize in the medium term. Policies supported under Pillar 2, are aimed at strengthening the social safety net and enhancing fiscal equity. These measures are expected to increase the progressivity of fiscal policy in a sustainable

1 Since 1960, the contribution of TFP to growth has been erratic, decreasing in three of the last six decades for an average of zero growth, compared to a 0.6 percent average annual growth rate in OECD countries and new high-income countries (see Argentina SCD, 2018).

2 Argentina has spent roughly one-third of the years since 1950 in recession. This is more time in recession than any other country other than the Democratic Republic of the Congo (Argentina SCD, 2018).

3 Investors rank Argentina 137th out of 138 countries in openness to domestic and foreign competition. World Economic Forum's Global Competitiveness Index 2017/2018.

4 The country ranks 92nd out of 137 countries in the World Economic Forum's Global Competitiveness Index, and 117th out of 190 countries in the World Bank's Doing Business Survey.

5 Logistics costs in Argentina, at 27 percent of GDP, are the second highest in Latin-America and nearly three times higher than the average for OECD countries (see Fay, M., Andres, L. A., Fox, C., Narloch, U., and Slawson, M. 2017. Rethinking Infrastructure in Latin America and the Caribbean: Spending Better to Achieve More. Directions in Development. World Bank).

6 Gross Fixed Capital Formation figure for 2018 refers to the four-quarter moving average up to Q3-2018.



manner and increase access to programs and services for the most vulnerable. As such, the overall reform package supported is expected to contribute to protecting the living standards of the poor, both directly through strengthening the social safety net, and indirectly through reducing distortions and constraints to inclusive and sustainable growth. Overall, the long-run benefits of these reforms depend on how well they are implemented, and the efforts made by the Government to mitigate the negative pact associated with the current economic situation.

Environmental Impacts

The impacts of these reforms and the government's policies to reduce negative impacts and enhance positive ones, is being analyzed, as prior actions are being further refined. Some of the policy actions supported by this operation are expected to have significant positive environmental effects, with none of DPF-supported policies expected to generate significant adverse effect on Argentina's environment, natural resources and forests.

By supporting policy measures aimed at strengthening the foundations for private sector development, the reform program under Pillar 1 is expected to increase economic activity. Reducing market frictions such as costs of doing business does not imply a relaxation of environmental standards. Prior action #1 (Competition Law) is not likely to generate significant environmental effects. There may be a potential for positive impacts through more efficient rail freight services contributing to reduce emissions of air pollutants and greenhouse gases. Prior Actions #2 (Reduction of Import Barriers) and #4 (Productive Financing Law) are likely to generate positive indirect environmental effects by reducing the costs for investment in higher quality and more efficient intermediate inputs and capital goods, such as computers and industrial machinery. However, as prior actions #2, #3, and #4 are expected to increase overall economic activity over time, including industrial and agricultural production, they may also generate negative indirect effects in environmental quality and management of natural resources where respective environmental regulations and standards and/or their enforcement present gaps. Prior action #5 (Greening the Energy Matrix) is expected to contribute directly to fighting climate change by supporting the move to renewable energy generation. Prior Action #6 (Anti-corruption) is not likely to generate any type of significant environmental effects.

Under Pillar 2 "Strengthening the social safety net and enhancing fiscal equity", the reduction of government subsidies for gas and transport (Prior Action #7) is likely to generate significant positive environmental effects. Targeted assistance to the poor to compensate for related tariff increases through social tariffs will prevent potential negative effects like switching from gas to lower quality, higher emission residential fuels for heating and cooking. In addition, the gradual increase in tariffs is expected to send signals to firms and consumers for a more efficient and rationalized transportation system. For example, the decrease in transport subsidies should also incentivize bus operators to rationalize routes (and reduce operating costs). Prior Actions #8 (Fiscal Responsibility), #8 (Single Window for ANSES) and #10 (UHC) are not likely to generate any type of significant environmental effect.

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APPROVAL

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