Program Information Document (PID)

Appraisal Stage | Date Prepared: 06-Aug-2018 | Report No: PIDC25307

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Argentina	P167889	First Inclusive Growth DPF	---
Region	**Estimated Board Date**	**Practice Area (Lead)(s)**	**Financing Instrument**
Latin America and the Caribbean	September 20, 2018	GMTLC	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Argentina	Ministry of the Treasury (*Ministerio de Hacienda*)		

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Proposed Development Objective(s)

The objectives of the DPF series are to:

- Strengthen the Foundations for Private Sector-Led Growth
- Strengthen the Social Safety Net and Fiscal Equity

Financing (in US$, Millions)

SUMMARY

Total Financing	US$500 million

DETAILS

Source:
IBRD

Decision

The Decision Meeting authorized the appraisal and negotiations of the DPF.

B. Introduction and Context

Country Context

Argentina has been engaged in a reform agenda to transform its economy, while confronting the challenge of unwinding macroeconomic imbalances and mitigating the social costs of the transition. In December 2015, the Government faced the challenge of pervasive macroeconomic imbalances, large microeconomic distortions, and a weakened institutional framework: large fiscal deficits, financial repression, monetization of the deficit, high inflation, and low investment, were accompanied by price controls, large and regressive subsidies, trade restrictions, and the rationing of foreign currency. The Government eliminated foreign exchange controls and moved to a flexible exchange rate regime, put in place an inflation-targeting framework for monetary policy, initiated the process of realigning utility prices and reducing subsidies, and improved official statistics. The Government also initiated structural reforms to strengthen the competitiveness of the economy and remove distortions holding back private sector-led growth, including reducing export taxes and easing import controls.

Despite the important progress toward addressing the most pressing challenges and initiating structural reforms, the country remained vulnerable to market sentiment and changes in global financial conditions given macroeconomic imbalances. A more gradual pace of fiscal adjustment, aimed to prevent a deterioration in economic activity and to mitigate the adverse impacts on the most vulnerable, led to a slow decline in the primary fiscal deficit. Interest spending increased rapidly, as the Central Bank's (*Banco Central de la República Argentina,* BCRA) financing was replaced with public debt issuances. The slower than anticipated pace of disinflation has brought additional uncertainties. At the same time, the build-up of the BCRA short-term securities (LEBACs) brought additional uncertainties since a substantial share had to be rolled over every 28 days. The combination of these factors, together with the tightening of global financial conditions and the strengthening of the U.S. dollar, led in April 2018 to a generalized run on Argentine assets, further currency depreciation, a reduction in international reserves, and an increase in the country risk. The authorities' response included a large policy rate hike to ensure the successful rollover of the LEBACs and to ease the pressure on the exchange rate. With continued pressure on the peso and Argentine assets, the Government decided to seek the financial support of the IMF on May 8.

The Government reached an agreement with the IMF for a Stand-By Arrangement (SBA) and committed to accelerate key reforms. The agreement seeks to restore market confidence through a sound monetary and fiscal framework, while protecting the most vulnerable. The program supports strengthening the BCRA's independence and recapitalization to achieve its price stability objective, ceasing Central Bank financing of the Treasury and gradually repurchasing a large share of the non-marketable government securities held by the Central Bank. On the fiscal side, the Government intends to increase the pace of fiscal consolidation to reach a federal primary balance in 2020, with the aim of decreasing the country's financing needs and setting public debt on a sustainable path.

Relationship to CPF

The programmatic DPF series is fully aligned with the priorities identified in the Systematic Country Diagnostic and Country Partnership Strategy. The Performance and Learning Review dated January 13, 2017 (Report No. 110546-AR), confirmed the broader focus areas for the engagement identified under the World Bank's Country Partnership Strategy FY14-FY18. The first pillar, originally focused on sustaining employment at the firm and farm level, was widened to encompass long-term productivity growth and job creation, and fostering private investment and strengthening its enabling environment. The original Pillar II, focused on direct assistance to the poor at the household level, but under the PLR expanded to incorporate a specific urban approach toward poverty eradication, especially related to housing. The broader policy dialogue established with the new Administration translated into a substantial broadening of the analytical and advisory program on improving the quality of and access to public services for citizens and businesses; transparency and anti-corruption; capital markets development; trade, investment and competition, and analysis of public expenditures. The new Argentina Country Partnership Framework (CPF) FY19-FY22, is expected to build on the current Country Partnership Strategy 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. The DPF series supports policies and institutional reforms that aim to further the goals of both pillars of the Country Partnership Strategy, and is closely linked to the Systematic Country Diagnostic findings.

C. Proposed Development Objective(s)

The proposed Development Policy Financing is the first operation in a programmatic series of two, aimed at accompanying Argentina's efforts to strengthen the foundations for inclusive economic growth. The DPF series supports policy measures to strengthen: (i) the foundations for private sector-led growth (pillar one), and (ii) the social safety net and fiscal equity (pillar two). The operation is part of a package of coordinated financial assistance from international partners prepared in response to the recent financial markets turmoil and its policy content complements and is complemented by other international partners efforts, including the International Monetary Fund (IMF), the Inter-American Development Bank (IDB), and the Development Bank of Latin America (CAF).

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.
- *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

- *Improving targeting and coverage of social tariffs as subsidies are reduced:* The reforms of social tariff will result in a consistent, equitable, and efficient social tariff scheme, with increased coverage among the Bottom 40 percent of population, and lower inclusion and exclusion errors.
- *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.
- *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. Program Description

PILLAR 1: STRENGTHENING THE FOUNDATIONS FOR PRIVATE SECTOR-LED GROWTH: Reforms under Pillar 1 aim at supporting the Government in strengthening the foundations for private sector-led growth. The pillar focuses on measures that promote competition, trade, firm entry, access to finance and the reduction of corruption involving private companies. In particular, the reforms would reduce the barriers firms face due to the lack of competition in the economy, costly and restricted access to intermediate and capital imports, costly bureaucracy, limited access to credit, and corruption. Competition has become disproportionally restricted in Argentina and the lack of pro-competition regulation, particularly in enabling sectors, such as telecommunications and transport, holds back firm competitiveness. In addition, reforms are needed to decrease business costs by reducing the barriers to trade in capital and intermediate inputs, and the burden for firms of bureaucratic processes. Argentina’s extremely shallow capital markets restrict investment and do not allow sufficient capital to flow into the enterprise sector. Increased capital investment by firms and SMEs facilitated by deeper capital markets is needed to increase firm productivity, growth and employment. Finally, given the perception is that corruption is high, levelling the playing field involves reducing corruption in the enterprise sector.

PILLAR 2: STRENGTHENING SOCIAL SAFETY NETS AND FISCAL EQUITY: Actions under Pillar 2 aim at supporting reform measures that strengthen the social safety net and advance fiscal equity to complement the fiscal consolidation the Government is implementing. Overall public expenditures grew substantially over 2006-2016, with the national government accounting for over two-thirds of the rise. More than three-quarters of the increase in expenditure was driven by pensions, economic subsidies, and the public-sector wage bill, while capital expenditures remained flat. The DPF series supports measures that combine growth and equity considerations with fiscal sustainability aspects. Creating fiscal space for priority spending, while better designing and targeting social protection programs and expanding universal health coverage are central to effectively mitigate adverse economic impacts on vulnerable population in the short run and build economic resilience and fiscal sustainability in the long term. Part of this agenda involves addressing the fragmentation of the social protection and health systems to ensure effective and efficient access to the most vulnerable while reducing overlaps and costs. 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.

E. Implementation

Institutional and Implementation Arrangements: **The Ministry of the Treasury (*Ministerio de Hacienda*) will be the main coordinating agency for monitoring and evaluation among other participating ministries: Ministry of the Treasury, Ministry of Interior, Ministry of Production, Ministry of Health, Ministry of Transport, Ministry of Energy, ANSES, and the Office of the Presidency of Cabinet of Ministers.** The Ministry of the Treasury would coordinate with other ministries the monitoring of the results indicators, which are based on routinely published sector indicators. While the technical capacity of these institutions is adequate to perform regular monitoring of the indicators and outcome measures designed to assess the program's success, the World Bank will also provide assistance to the Ministry of the Treasury in terms of appropriate indicators for monitoring of the DPF implementation, including of social indicators.

F. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts: **The policy measures supported under this DPF series are expected to play a role in mitigating the short-term distributional impacts of the Government's reform program on the most vulnerable, while implementing structural reforms to reduce distortions and enhance growth**. The overall reform package supported is expected to protect the living standards of the poor, both directly through reforms to social safety net programs and indirectly through reforms that promote growth. By strengthening the foundations for private sector-led growth, the policy program under Pillar 1 is expected to bring positive distributional impacts, although these would only materialize in the medium term. Measures that support the strengthening of competition in domestic markets are expected to contribute to poverty reduction and welfare increases for the population in the bottom 40 percent of the income distribution, primarily through its effect on consumer savings due to lower prices. The reduction of barriers to trade on intermediate and capital goods, including IT, is expected to boost competitiveness. Additional measures to reduce the costs for firms and fight corruption would help strengthen economic growth, and benefit the bottom 40 percent. Policies supported under Pillar 2 are aimed at strengthening social safety nets and fiscal equity. The introduction of an integrated tariff system for metropolitan transport is expected to balance subsidy reduction toward cost-recovery, and moves to a system that benefits more low-income families that live in the outskirts and tend to travel longer distances through various means (railways and buses) and make more transfers. Future measures to enhance the social tariff system that increase coordination and reduce targeting errors will be crucial and expected to help to shield the more vulnerable families from the impact of further tariff increases. The reduction of regressive and distortive taxes and increase of progressive taxes, central elements of the Fiscal Pact, are expected to have a positive distributional impact. The introduction of Single Window is expected to improve the conditions of the most vulnerable by increasing access to social programs and national identification documents. Finally, implementing the UHC strategy is expected to increase effective access and quality of health care for the poorest and most vulnerable population.

Environmental Aspects: **The measures supported under the proposed DPF are not expected to have significant effects on the environment, forests or other natural resources.** The DPF does not entail direct risks to the environment, while the reforms of the energy and transport tariffs are expected to contribute to higher energy efficiency with positive impacts on the environment.

G. Risks and Mitigation

The overall risk rating of this operation is considered to be high. While there is a strong consensus around the 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. 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 risks. The key mitigating measures include: (i) the recent steps taken by the authorities to stabilize the economy, underpinned by a three-year SBA with the IMF, approved in June 2018; (ii) the flexibility of the DPF program to allow for adjustments in the second operation in case a more adverse scenario materializes; (iii) the Government's commitment and track-record to tackle important reform areas; (iv) the coordinated support by the international community, including continued technical assistance for the design and implementation of the reform program; and (v) automatic stabilizers as well as discretionary policies to protect vulnerable and poor from the impact of macroeconomic stabilization program, including the identification of additional spending on pre-specified high-impact social assistance programs if the economic situation deteriorates.

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Borrower/Client/Recipient

Republic of Argentina

Implementing Agencies

Ministry of the Treasury (*Ministerio de Hacienda*)

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APPROVAL

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