OECD Economic Surveys

ARGENTINA

Multi-dimensional Economic Survey

July 2017

OVERVIEW

BETTER POLICIES FOR BETTER LIVES

This Overview is extracted from the 2017 Multi-dimensional Economic Survey of Argentina. The Survey was discussed at a meeting of the Economic and Development Review Committee on 17 May 2017 and at a meeting of the Governing Board of the Development Centre on 16 May 2017. It is published under the responsibility of the Secretary-General of the OECD.

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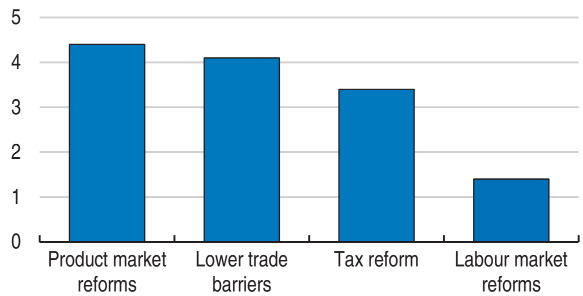
Executive summary

- *Further reforms will have significant pay-offs*
- *Raising investment and productivity is the basis for sustainable income gains*
- *Protecting the poor and ensuring that growth is inclusive and sustainable are key priorities*

Further reforms will have significant pay-offs

Expected GDP gains over ten years in percent



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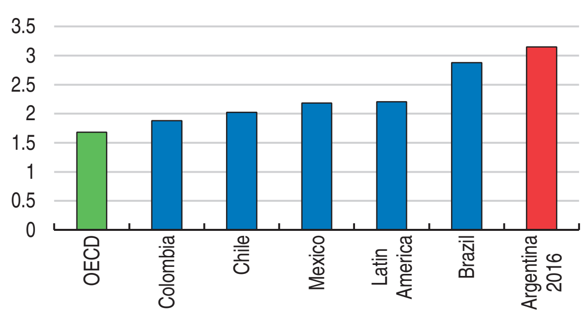
Following years of unsustainable economic policies, Argentina has recently undertaken bold reforms and a turnaround in policies that has helped to avoid another crisis and stabilise the economy. Reforms such as those already implemented and those currently planned should help lay the foundations to raise the material living standards and well-being of all Argentinians, including the most vulnerable. Continuing the structural reform agenda to deliver better material living standards for all Argentinians will be crucial. Aligning key policy settings with the OECD average could increase GDP per capita by 15% in 10 years. Bringing down inflation and the fiscal deficit is necessary for these pay-offs to materialise.

Raising investment and productivity is the basis for sustainable income gains

Barriers to entrepreneurship are high



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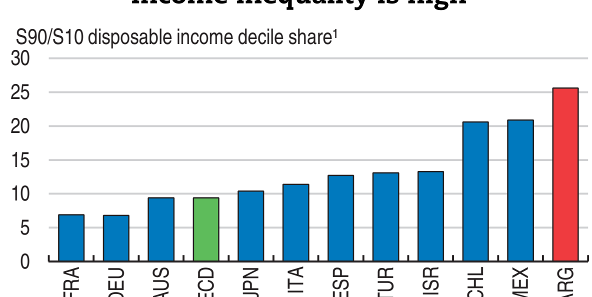
Structural and institutional reforms encompassing regulation on product markets, labour markets, competition, taxes, infrastructure, education, trade policy and financial markets can raise investment and productivity, which is the basis for sustainable income gains. Such reforms will involve adjustment costs as jobs will be lost in some firms and sectors and created in others. But well-designed policies can protect the poor and vulnerable from the burden of adjustment. A current focus on strengthening the social safety net and efforts to improve the quality of education are part of such policies, as is labour market support for affected workers.

Protecting the poor and ensuring that growth is inclusive and sustainable are key priorities

Income inequality is high



1. 2014 or latest year available, 2016Q2 for Argentina.

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The benefits of stronger growth will depend on improving the distribution of income, which is currently very unequal and leaves one third of the population in poverty, and one out of five Argentinians at risk of falling into poverty. Reforms and a recovery of growth are expected to provide better job and income opportunities, although some current jobs may be lost in the transition. Efforts are also underway to reduce inequalities in the access to quality education. Public transfers to reduce inequality and poverty will continue to play an important role, together with stronger efforts to curb labour market informality to improve productivity and job quality for all Argentinians.

MAIN FINDINGS	KEY RECOMMENDATIONS
Macroeconomic policies	
The fiscal deficit has increased substantially over the last years. Maintaining access to external finance and debt sustainability will require a credible plan to reduce the deficit.	Ensure fiscal sustainability by continuing to pursue planned fiscal targets but allow temporary deviations in either direction from the targets if growth disappoints or surprises on the upside.
Public expenditures have risen strongly over the years, but not all of this spending has contributed to stronger inclusiveness or growth. Spending efficiency could be improved by reallocating spending while ensuring a strong social safety net.	Phase out energy subsidies. Rationalise public employment, particularly in the provinces. Achieve further cost savings in state-owned enterprises and improve their governance. Undertake an expenditure review.
The tax system is complex and few people pay income taxes. It also contributes comparatively little to reducing inequalities and creates strong incentives for informality.	Undertake a revenue-neutral tax reform, including • Lowering the income threshold where taxpayers start paying personal income taxes. • Phasing out the provincial turnover tax and financial transaction tax. • Broadening the base of value added taxes. • Introducing progressivity into social security contributions. • Lowering social security contributions temporarily for low-paid workers whose jobs are brought into the formal sector.
Recent setting of multi-year deficit targets constitutes noticeable progress, but is not yet locked into legislation.	Introduce an expenditure rule and consider implementing a debt target over time. Use an independent fiscal council to assess compliance with the rules.
The central bank lacks formal independence and its mandate lacks clarity. This reduces monetary policy effectiveness.	Limit dismissal of the Central Bank governor to severe misconduct. Simplify the Central Bank's mandate, prioritising price stability.
The rule of law has been weakened in the past and corruption has affected the investment climate.	Strengthen the capacities and independence of bodies investigating corruption, reorganise and strengthen courts and enact the corporate liability bill to prosecute bribery.
Strengthening productivity and investment	
Barriers to entry and weak enforcement of rules weaken competition on product markets.	Simplify administrative procedures and licensing requirements to start an activity. Implement a one-stop-shop approach to business regulation.
	Ensure that the competition authority has autonomy and adequate resources.
The economy, shielded from international competition, has not been able to reap the full benefits of international trade and global value chains.	Lower import tariffs and further reduce the application of non-automatic import licenses. Expand labour market support for affected workers.
Rigid labour market regulations hamper job creation, raise labour costs and curb productivity growth.	Protect workers with unemployment insurance and training rather than strict labour regulations. Introduce out-of-court procedures for labour disputes.
Skill shortages are holding back productivity growth and the creation of high quality jobs.	Develop the vocational education system by increasing the involvement of employers and workplace education. Better align tertiary curriculums with jobs.
Making growth more inclusive	
Educational attainments are low. Grade repetition and drop-out rates are high.	Strengthen mechanisms to identify and support students at risk of dropping out through tutoring and individualised support.
The quality of education and in particular teacher quality is low, related to shortcomings in teacher training.	Merge teacher training institutions and strengthen their quality standards, governance, accounting requirements and transparency.
A lack of skills and incentives is reducing employment. A high share of youths is neither in training, employment nor education.	Scale up training, employment services, and incentives for small business development.
Female employment is low although women are on average better educated than men.	Expand early childhood education, promote flexible working time arrangements and extend paternity leave.
A third of the workforce is in informal employment, with low wages and no job protection.	Enforce formalisation and compliance with more labour inspections, in conjunction with other measures to strengthen incentives for formalisation mentioned above.
Pension spending is high and population aging threatens the long-term sustainability of the pension system.	Index pension benefits to consumer prices. Align retirement ages for women to those for men.
Social protection programmes reduce poverty and inequality, but are fragmented with substantial overlaps.	Integrate existing social protection programmes and allow them to share registries and targeting tools.

Assessment and recommendations

- *Wide-ranging structural reforms are the key to strong, sustainable and inclusive growth*
- *Comprehensive macroeconomic, structural and social reforms have been initiated*
- *Improving productivity and investment to raise well-being*
- *Making growth more inclusive*
- *Green growth challenges*

Wide-ranging structural reforms are the key to strong, sustainable and inclusive growth

The Argentinian economy has been through many ups and downs over the past 50 years, and has been affected by several severe economic crises (Box 1). As a result, Argentina lost substantial ground in incomes and wellbeing relative to Latin American and other countries over time (Figure 1).

Box 1. **A glance at Argentina's economic history**

Argentina's per capita incomes were among the top ten in the world a century ago, when they were 92% of the average of the 16 richest economies (Bolt and van Zanden, 2014). Today, per capita incomes are 43% of those same 16 rich economies. Food exports were initially the basis for Argentina's high incomes, but foreign demand plummeted during the Great Depression and the associated fall in customs revenues was at the root of the first in a long row of fiscal crises. The economy became more inward-focused as of 1930 when the country suffered the first of six military coups during the 20th century.

This inward focus continued after World War II, as policies featured import substitution to develop industry at the expense of agriculture, nationalisations and large state enterprises, the rising power of unions and tight regulation of the economy. The combination of trade protection and a significant state-owned sector lessened somewhat in the mid-1950s, in a succession of brief military and civilian governments.

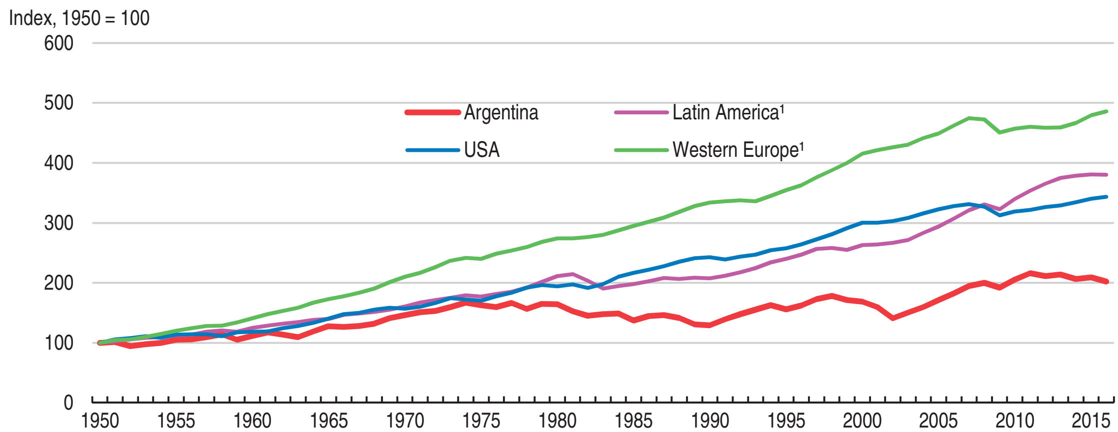
However, the weakness of both the external and fiscal balances continued into the 1960s and early 1970s, leading to an unstable growth performance and bouts of inflation, including a first hyperinflation in 1975. The military dictatorship of the 1970s and the democratic government of the 1980s continued to struggle with fiscal crises, resulting from spending ambitions exceeding revenues and exacerbated by the Latin American debt crisis starting in 1982, and the lack of a competitive export sector after decades of import-substituting industrialisation. The country fell into a fully-fledged hyperinflation in 1989-90. Between 1970 and 1990, real per capita incomes fell by over 20 percent.

While the economy returned to growth after 1990 in the context of lower import tariffs, foreign investment, a currency pegged to the US dollar and falling inflation, volatility did not recede. Export competitiveness faltered following the Asian crisis and the devaluation of the Brazilian Real and by the late 1990s the economy was facing a severe recession. Rising fiscal imbalances led to the 2001 debt default and the end of the currency peg. The impoverishing effect of the crisis was exacerbated by the subsequent devaluation which wiped out large amounts of household savings. Despite the recurrent crises, the growth performance of Argentina between 1990 and 2010 allowed it to begin a process of convergence with the developed world.

Argentina's traditionally more equal income distribution, with its fairly strong middle class, has also dissipated and inequalities across households and regions are now closer to the rest of Latin America. Since 2003, income inequality has fallen, as average income

Figure 1. **Argentina has lost ground relative to other countries**

GDP per capita



1. *Western Europe includes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and United Kingdom; Latin America includes: Brazil, Chile, Colombia, Mexico and Peru.*

Source: OECD calculations based on Bolt and Van Zanden (2014) (see *www.ggdc.net/maddison/maddison-project/data.htm*).

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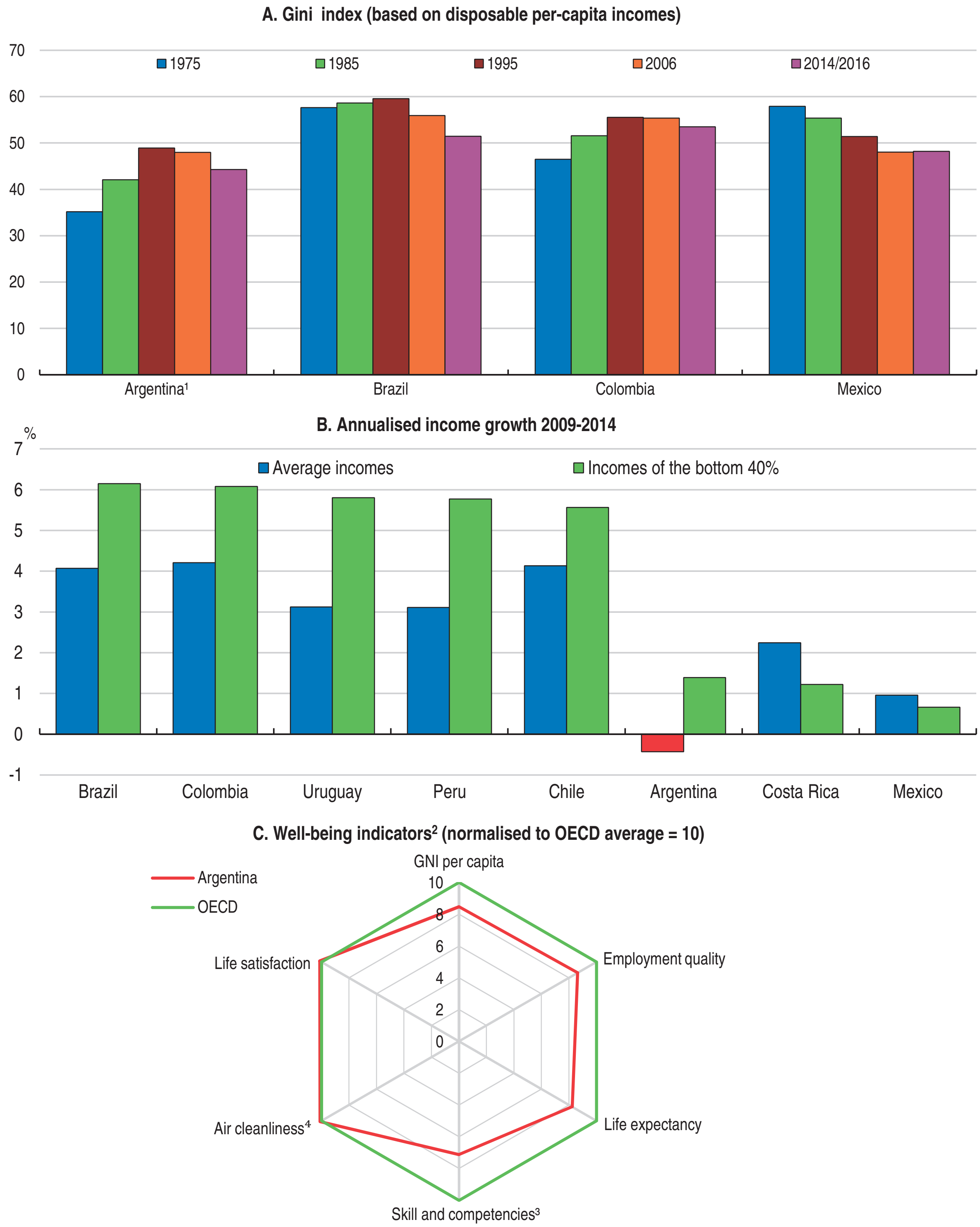
growth was negative during 2009-14 and that of the bottom of the distribution modestly positive (Figure 2). Poverty now affects close to a third of the population and a third of employment is informal. Indicators of well-being are below the OECD average, particularly with respect to skills, life expectancy, employment quality and incomes. This calls for improvements in education and health policies, but also for creating new and quality jobs.

The economy revived temporarily following the collapse of the currency board and debt default in 2001, initially supported by rising commodity prices, global liquidity conditions and subsequently by an unsustainable policy-led expansion of consumption. Income inequality and poverty declined following the crisis. However, important underlying issues of high fiscal deficits, high inflation, low productivity, declining competitiveness, low quality of education and weak institutions were not addressed and prevented growth from being sustainable (Figure 3). With imbalances building up, policy interventions were introduced in both real and financial markets, including capital and currency controls. These interventions, which intensified after 2007, created distortions and prevented the flow of resources to their most productive uses, thus dragging down productivity and growth.

Between 2011 and 2015, growth was virtually zero (Figure 4). The fiscal deficit widened to almost 6% of GDP by 2015, despite an unusually high tax burden for the region. As Argentina did not have access to international financial markets, deficits were financed increasingly through printing money, export taxes and seizures of private assets. Inflation rose to 40%. The overvalued fixed exchange rate vis-à-vis the US dollar, maintained through capital controls, import restrictions and foreign currency rationing, implied a substantial gap between the official and parallel exchange rates and the depletion of foreign exchange reserves. Investment fell to 16% of GDP by 2015, compared to 20.5% in the OECD, while supply-side bottlenecks and poor public services reduced growth. Institutions were weakened by political interference, a highly visible symptom of which was the loss of confidence in official statistics and the IMF declaration of censure against the national statistics institute (Box 2).

Figure 2. **Inequality has fallen but well-being is below the OECD average in some areas**



1. For Argentina, the latest estimate for the GINI coefficient is based on data from the third quarter of 2016.
2. Due to data limitations, not all components of well-being usually shown in OECD Economic Surveys could be reflected in this chart.
3. Skill and competencies are measured as the PISA combined mean score.
4. Air cleanliness is an inverted measure of the mean annual exposure to $PM_{2.5}$ (micrograms per cubic meter).

Source: World Bank World Development Indicators database, World Bank World Development database; OECD PISA database; *OECD Society at a Glance 2016*; and OECD calculations.

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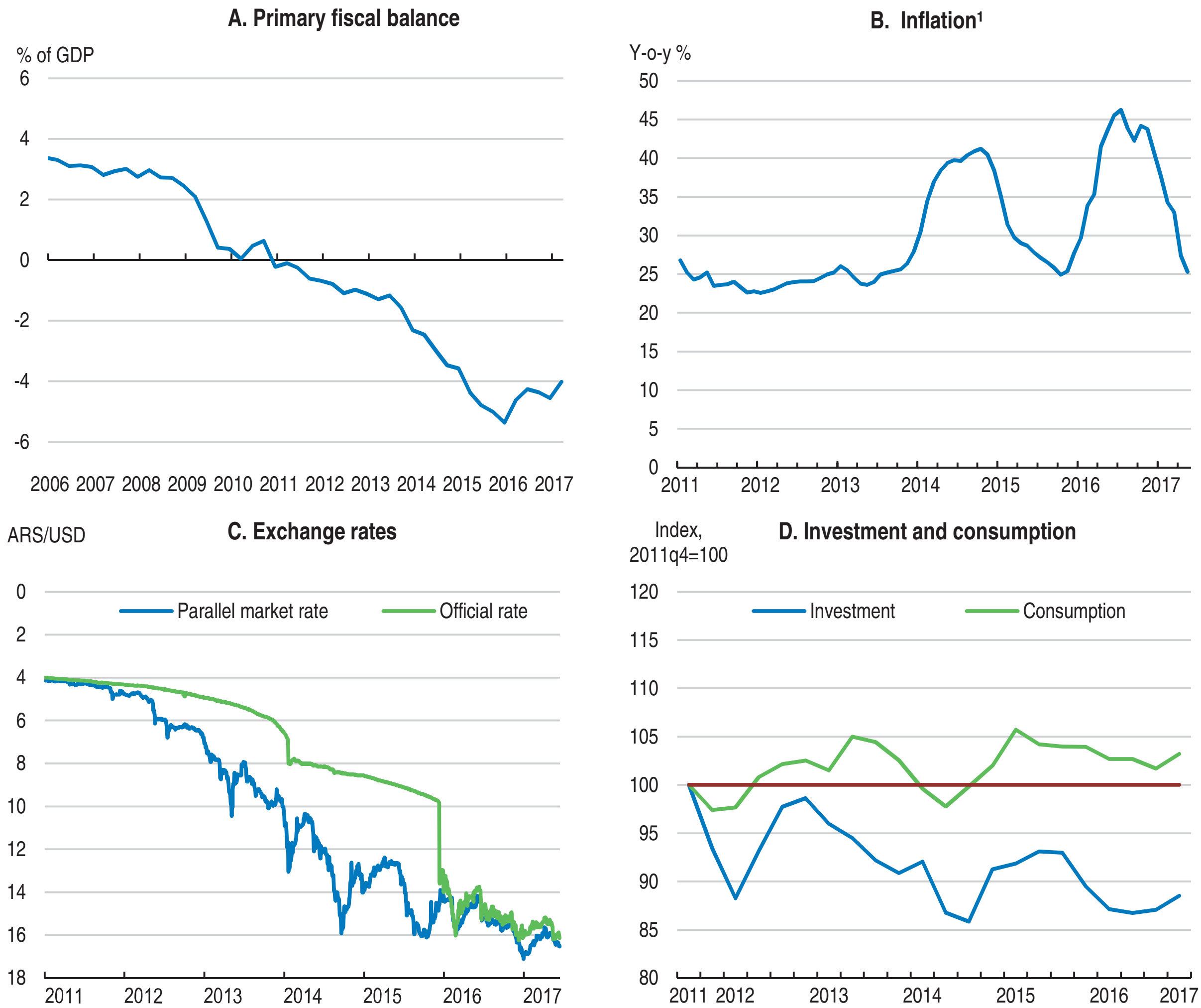
Figure 3. **Macroeconomic imbalances have built up**



1. Based on Congressional CPI index, Greater Buenos Aires area only.

Source: CEIC, Thomson Reuters, Ministerio de Hacienda, INDEC, Diputados del Congreso Nacional.Index.

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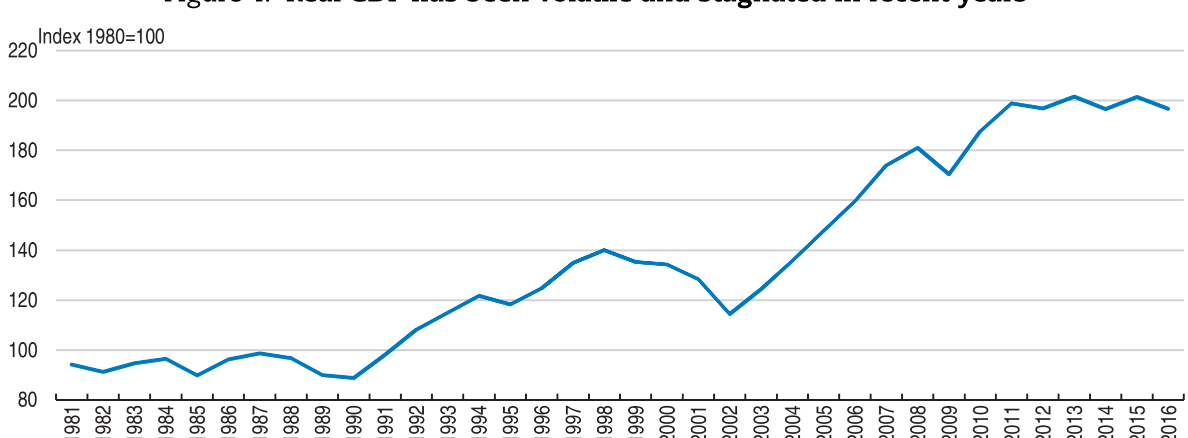
Figure 4. **Real GDP has been volatile and stagnated in recent years**



Source: INDEC.

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Box 2. The quality of official statistics in Argentina (see also Annex 1)

Argentina's statistics deteriorated over 2007-15 amid growing political pressures to show more "positive" data about the economy and society. The number and quality of underlying censuses, surveys and procedures declined and data on international trade, inflation, GDP and poverty levels became unreliable. In July 2011, the IMF found Argentina in breach of its minimum reporting requirements because of inaccurate provision of CPI and GDP data (IMF, 2013).

Since 2016, the national statistics institute INDEC has been completely overhauled and its leadership changed. Argentina is now working with the OECD to improve the quality of its statistics. A statistical emergency was declared at the end of 2015, putting the production of some indicators on hold until capacity was rebuilt, which limits the scope for drawing comparisons across time. For some series, the quality of historic data could not be improved and therefore remains subject to reservations. This is particularly the case for household data, which are considered unreliable for 2007 to 2015 as the sample composition may have been altered to obtain desired outcomes. For some series, reliable data are really only available as of mid-2016, preceded by a 6-months data gap due to the statistical emergency. For some variables, notably inflation, making recourse to non-official series for which a longer history is available is the only option. Moreover, poor statistics at the provincial level make comparisons across regions more difficult.

Comprehensive macroeconomic, structural and social reforms have been initiated

The new government elected in November 2015 inherited an economy at risk of suffering another severe crisis, but set out to correct the various imbalances. These reforms helped stabilise the economy and rekindle inclusive growth. The main structural reforms undertaken include:

- Currency controls were abolished.
- Export taxes were eliminated except for soy beans, for which they are being phased out.
- The scope of application of the cumbersome system of import licensing was significantly reduced.
- An agreement with holdout creditors from the 2001 debt default restored access to international capital markets in 2016.
- National statistics were completely overhauled.
- Multi-year fiscal targets were announced.
- Large and untargeted subsidies have been curtailed substantially and are being phased out.
- Social benefits, including child benefits, unemployment benefits and pensions, were expanded.
- A new capital markets law to develop financial markets and improve corporate governance was submitted to Congress.
- A large infrastructure investment plan with a focus on the Northern provinces was put in place.
- A tax amnesty programme led to the declaration of almost 20% of GDP in previously undeclared assets held by residents and raised extraordinary tax revenues of 1.6% of GDP.

- A new entrepreneurship law and a new SME law reduced entry restrictions and improved financing for entrepreneurs and SMEs.
- New programmes to promote PPPs and investment in renewable energy were launched.

After these bold initial measures, reforms have been more gradual, reflecting the need to support the recovery and build a broad consensus to pass legislative measures. Given the extent of remaining imbalances in the economy, a challenging reform agenda still lies ahead to deliver better material living standards for all Argentinians. This agenda encompasses a wide range of policy areas such as regulation on product and labour markets, taxes, infrastructure, education, innovation, trade policy and financial markets, all of which could have large pay-offs. Estimates based on the OECD Going for Growth framework of policy indicators suggest that policy reforms that would align Argentinian policy settings with the OECD average could increase GDP per capita by 15% in 10 years. Reforms to align Argentina with Chile, Colombia and Mexico, would raise per capita incomes by 8.5% over 10 years. These estimates represent a lower bound since some areas, such as improving education or access to finance, fall outside the scope of this quantification framework, but evidence suggests that they also have significant growth effects over time (Egert, 2017 and Melguizo et al., 2017).

Table 1. **Additional reforms are projected to pay off**[1]

If fully implemented, reforms would raise GDP per capita by 15% over a period of 10 years

Accumulated effect on GDP per capita over 10 years from:	Scenario 1: Convergence to selected Latin American peers[2]	Scenario 2: Convergence to OECD average
Product Market Reforms	**3.8**	**4.4**
Barriers to entrepreneurship	1.7	2.0
Governance of SOEs	0.9	0.9
Competition framework	1.2	1.5
Lower trade barriers	**3.2**	**4.1**
Labour market reform	**0.5**	**1.4**
Tax reform	**1.0**	**3.4**
R&D business expenditure	**0.0**	**1.9**
Total	**8.5**	**15.3**
Corresponding average annual growth increase:	*0.8%*	*1.5%*

1. Estimated impact on GDP per capita over a 10-year horizon, in percentage points. These estimates are subject to uncertainty with respect to their size and timing. See Annex to Chapter 1 for the methodology used to estimate the impact of reforms.
2. Peer Latin American countries include Chile, Colombia and Mexico.

Source: OECD calculations.

Making growth more inclusive is crucial. The recent expansion of social transfers will support vulnerable families during the adjustment period and help reduce inequalities and poverty. While transfers can go a long way in alleviating poverty, improvements in the provision of such public services as education and health, which have suffered from inefficient and sometimes corrupt governance in the past, will play a key role in improving income opportunities for poor people and those at risk of falling into poverty. In addition, structural and macroeconomic policies should be designed in ways that improve employment and job quality. Regional disparities, which have exacerbated since 2002, will also need to be reduced (World Bank, 2016b).

Meeting these challenges calls for a long-term vision with a strong focus on evidence-based policy design. Fortunately, in this respect Argentina is in a good position to benefit from international best practice and the experiences of other countries, both in Latin America and elsewhere. Finding the right sequencing and the appropriate pace of progress, while improving the well-being of all Argentinians, and especially the poor and the vulnerable, is an essential part of the current challenges.

Against this background, the main messages of the Survey are:

- Macroeconomic policies should foster sustainability, including bringing down inflation and reducing the fiscal deficit, while setting the basis for higher incomes and widespread improvements in well-being.
- Structural and institutional reforms should sustain rising incomes, with a specific focus on competition, product market regulations, trade policy, innovation and skills.
- Stronger efforts to reduce inequalities in the access to quality education and reduce labour market informality will extend the benefits of growth to all Argentinians.

The outlook has improved

Some of the reforms that were necessary to avoid a major crisis caused domestic demand to decline in 2016 (Table 2). Still, the short-lived recession bottomed out in the second quarter of 2016 and was less severe than what could have happened without these reforms. Quarterly growth, expressed in annual terms and with seasonal adjustment, rebounded to 2.8% during the fourth quarter of 2016 and to 4.2% in the first quarter of 2017.

Table 2. **Macroeconomic indicators and projections**

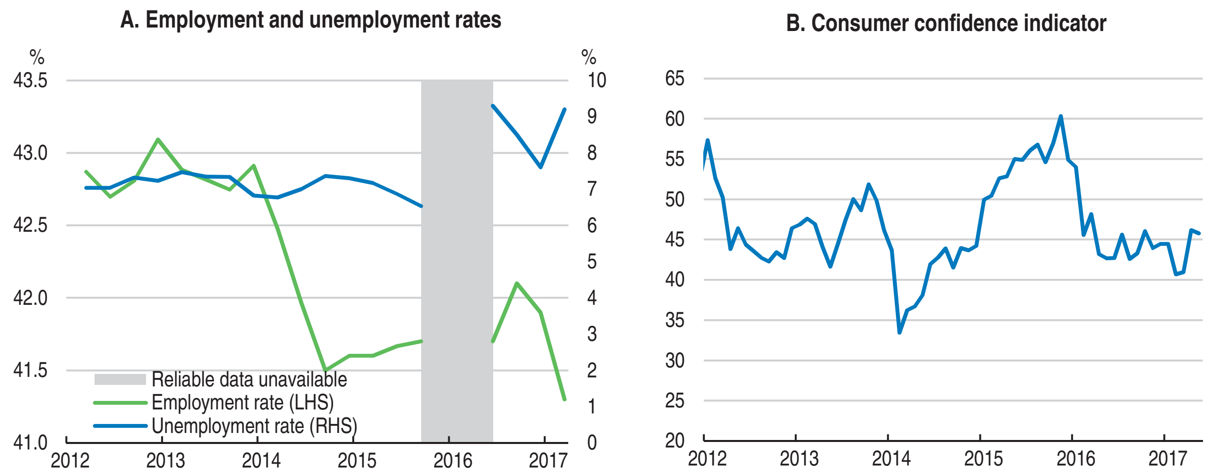
	2014	2015	2016	2017	2018
	Percentage changes, volume				
GDP at market prices	-2.5	2.6	-2.2	2.9	3.2
Private consumption	-4.4	3.5	-1.4	2.5	3.7
Government consumption	2.9	6.8	0.3	3.4	2.3
Gross fixed capital formation	-6.8	3.8	-5.1	4.5	5.8
Total domestic demand	-3.9	4.0	-1.6	3.6	3.9
Exports of goods and services	-7.0	-0.6	3.7	7.1	6.6
Imports of goods and services	-11.5	5.7	5.4	9.1	8.5
Net exports[1]	0.7	-0.9	-0.3	-0.3	-0.4
Memorandum items					
Current account balance[2]	-1.5	-2.7	-2.8	-3.0	-3.2
Central government primary fiscal balance[2]	...	...	-4.5	-4.2	-3.4
General government fiscal balance[2]	-4.0	-5.6	-5.8	-6.1	-4.9
Unemployment rate	...[3]	...	8.5	8.0	7.5
GDP deflator	41.7	23.6	41.0	22.3	14.7
CPI inflation[4]	38.4	27.7	40.7	21.8	14.3

1. Contributions to changes in real GDP.
2. As a percentage of GDP.
3. Not comparable with later data (see Figure 5A).
4. Greater Buenos Aires only. End-of-period. Year on year changes.

Source: OECD projections, *OECD Economic Outlook Database*, INDEC, Central Bank.

A substantial tightening of monetary policy to bring inflation under control was part of the initial measures taken. Household real disposable incomes contracted as a result of the initial spike in inflation and the partial withdrawal of utility subsidies, although rising social expenditures offset some of this. Employment has shown mixed signals, but has been falling since the second half of 2016. The projected recovery of growth should bring down the unemployment rate, which currently stands at 9.2% (Figure 5). The decline in real wages, which fell by approximately 5% during the first half of 2016, tapered off in the second half of that year. Consumer confidence is still showing mixed signals.

Figure 5. **The labour market and consumer confidence are showing mixed signals**



Note: Data on employment and unemployment between 2007 and 2015 are based on household surveys that are subject to methodological reservations.
Source: INDEC and Universidad Torcuato di Tella.

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As some of the forces that reduced growth in 2016 recede and the reforms begin to bear fruit, activity is projected to recover during 2017 and 2018 (Table 2). Investment, already strong in the first quarter of 2017, is projected to be a key driver of growth during 2017, supported by plans to raise infrastructure outlays, an improving business climate and rising inflows of foreign direct investment. In the energy sector, the removal of price distortions and improvements in the legal framework are likely to encourage the implementation of overdue investment plans. With import demand outpacing projected improvements in export performance in 2017 and rising debt service payments by the public sector, the current account is projected to remain in deficit.

Macroeconomic policies need to reduce the large imbalances built up in the past. This is particularly the case for monetary policy, which will need to remain restrictive with the objective of bringing down inflation. Fiscal policy will need to be moderately contractionary to reduce the large deficit, but in a gradual manner. This policy mix reflects the need to show determination in the fight against inflation, while low public debt levels allow the needed fiscal adjustment to be smoothed over the next few years.

Risks are related to the implementation of structural reforms and the external environment

Risks to this outlook exist both on the upside and the downside. On the upside, the reforms already undertaken could boost investment and lead to stronger-than-projected productivity improvements. Downside risks include political uncertainty, which could affect investment. This could affect the ability to implement structural reforms or meet fiscal targets. Difficulties in limiting nominal wage growth in collective bargaining agreements could lead to sustained inflationary pressures. In turn, higher inflation could require a tighter monetary policy that may in turn slow down investment growth. Moreover, sluggish world trade growth or a delayed recovery in Brazil could lead to lower export demand and a higher current account deficit.

Medium-term vulnerabilities are largely external (Table 3). Like many emerging market economies, Argentina is vulnerable to external shocks and currency mismatches, particularly as two thirds of the public-sector financing needs have been covered by external financing since the country regained access to international credit markets in 2016. Public finances would become more challenging in the event of sharp movements in foreign interest rates, rising risk premiums on international capital markets or a large depreciation of the domestic currency.

Table 3. **Key vulnerabilities**

Uncertainty	Possible outcome
Tighter external financing	Higher costs of financing the fiscal deficit and servicing debt, tighter fiscal and monetary policies. In the case of a sudden stop to capital flows to emerging markets, a significant fiscal adjustment would be necessary, given the limited domestic financing options.
Rise of protectionism and a slowdown in global trade	The benefits of integrating into the world economy will be lower if global protectionism were to rise. Export prospects would be lower.
Implementation of structural reform, including due to political divisions	If the reform agenda were derailed, growth outcomes would likely be much weaker. Unemployment could rise, capital inflows could slow down and the currency could depreciate.

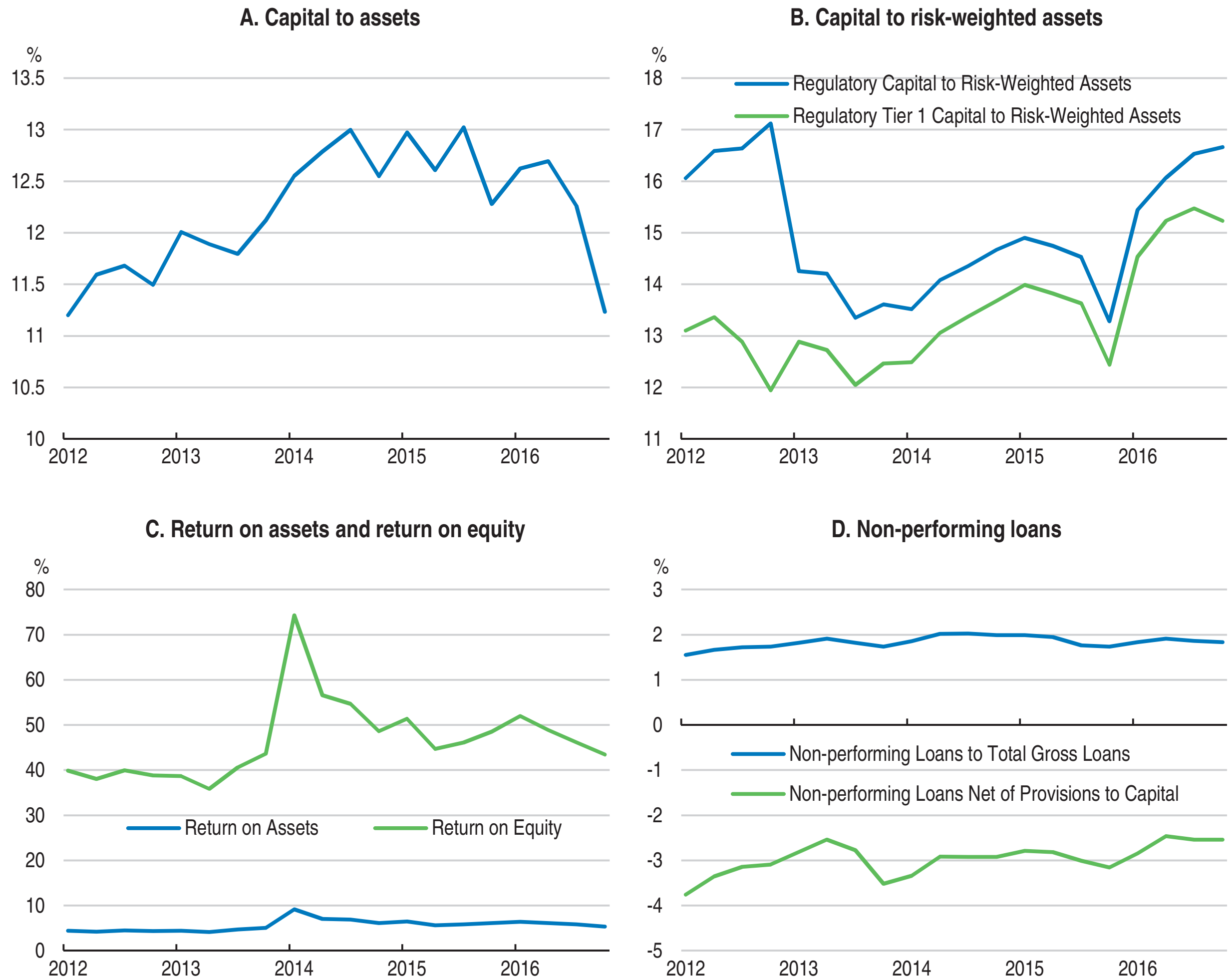
Due to past restrictions on accessing foreign capital markets, the stock of total external debt amounts to only around 25% of GDP, and corporate external debt is significantly below the Latin American average, at 13% of GDP. Foreign currency reserves have increased recently to USD 48 billion or 9% of GDP, which at 12 months of imports is above the regional average. In addition, the freely floating exchange rate provides another buffer against external shocks.

Most banks are in a position to withstand substantial levels of stress, reflecting large capital and liquidity buffers, as well as the quality of their assets (Figure 6; BCRA, 2017; BCRA, 2016; IMF, 2016a). Bank capitalisation is above international standards and less than 2% of loans are non-performing, with provisions far exceeding the volumes of these loans. Only 20% of bank liabilities are denominated in foreign currency. Even in the most adverse scenarios, the capital shortfall in the banking system would be small relative to the size of the economy.

This is partly a result of the small size of the financial sector (Figure 7). Overall credit to the private sector is below 12% of GDP and less than 70% of deposits. Maturity transformation is very limited as both deposits and lending are heavily focused on the short term. Household indebtedness is below 20% of incomes, reaching 23% for the lowest income decile, and debt service accounts for less than 12% of incomes. Corporate sector debt with the domestic financial system is around 7% of GDP, reaching up to 18% of sector-wide value added in the industrial sector (BCRA, 2016). The main challenge for financial stability will be to monitor and avoid vulnerabilities developing as the financial sector expands.

A precondition for deeper financial markets is continuous macroeconomic stability. Previous economic crisis resulted in freezes on bank deposits and, in the high inflation environment of the last years, real returns on private savings have consistently been negative. This has changed by now as declining inflation and positive real rates have already helped to attract more domestic savings into the banking sector, which can in turn

Figure 6. **Financial stability indicators do not point to significant vulnerabilities for now**



Source: IMF Financial Soundness Indicators, BCRA.

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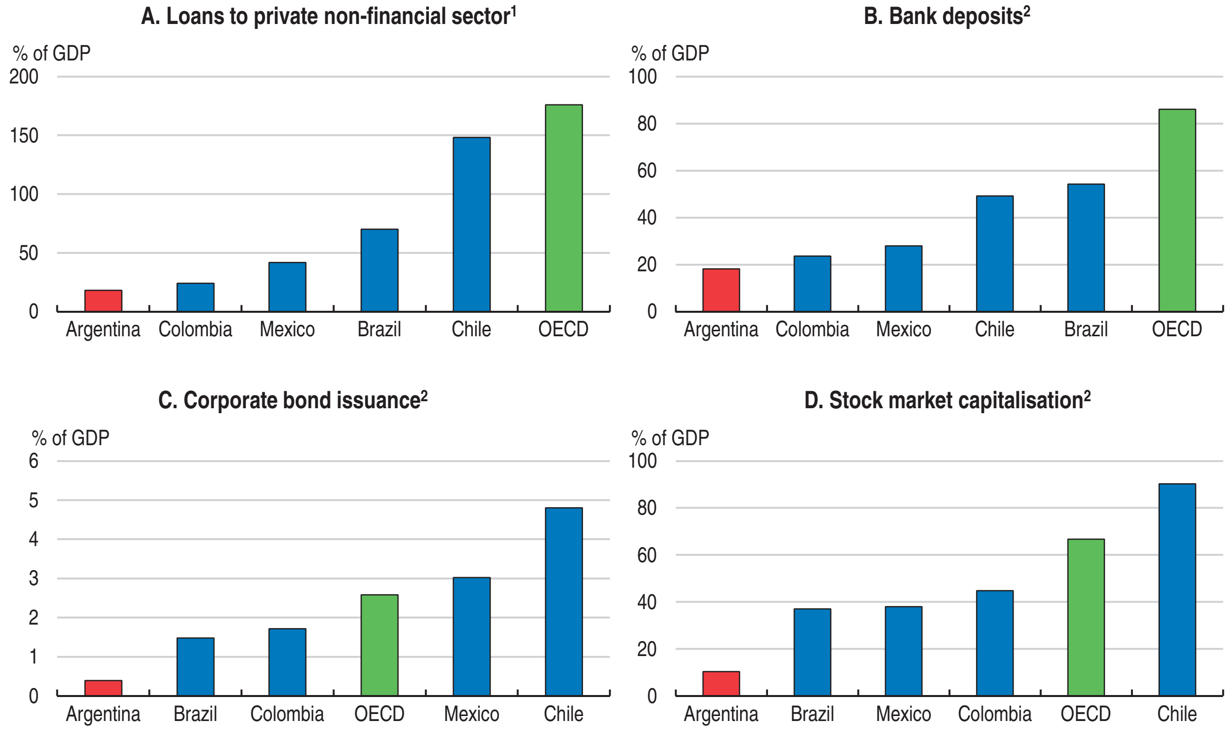
increase lending. However, building up the necessary confidence for savers to venture into longer maturity instruments, which would enable banks to lend more long-term, will probably take time. The additional resources flowing into the domestic financial system as a result of the tax amnesty are also likely to support the expansion of the financial sector.

The underdeveloped financial system reduces the efficiency of monetary policy transmission and makes access to finance very difficult for all but the largest companies, constraining investment and growth. Beyond the banking sector, the complete absence of domestic institutional investors, a legacy of the 2008 nationalisation of private pension funds, is a severe challenge.

A recent initiative by the Central Bank to create an inflation-indexed accounting unit for credit contracts, principally designed for building a mortgage market, can be a useful tool, as long as it is only used in the transition and in combination with a sunset date. Mortgages account for less than 1% of GDP, as most homes are purchased with cash, suggesting that there is significant unused potential to provide a boost to the mortgage market and housing investment (Figure 8). At the same time, however, indexed loans increase financial risk as they transfer risks to borrowers. The Central Bank, who is in

Figure 7. **The financial sector is less developed than in other countries**



1. Data refer to 2015 for Colombia and 2016q2 for all other countries.
2. Data refer to 2014.

Source: Bank of International Settlements; and World Bank Financial Development and Structure Dataset.

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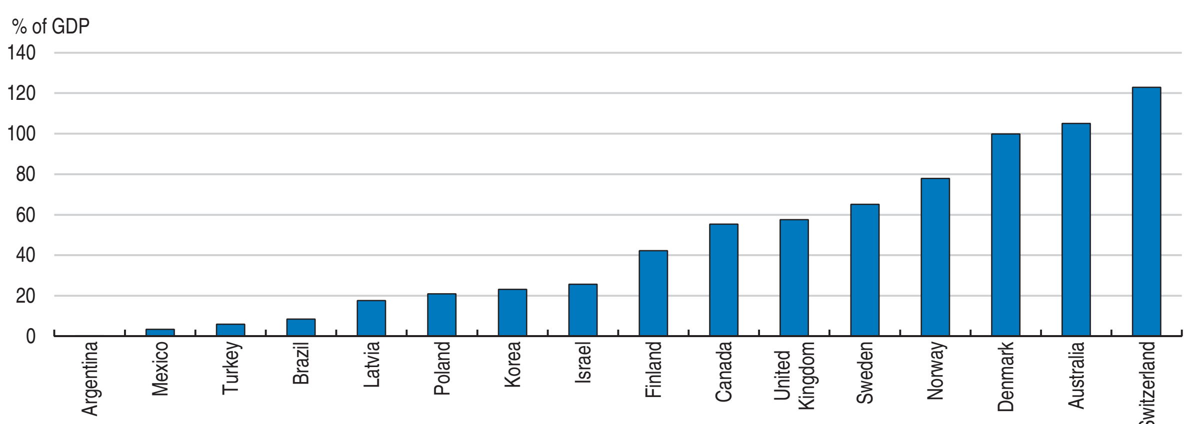
Figure 8. **Residential real estate loans are underdeveloped**

2016q3 or latest available year



Source: IMF Financial stability indicators database.

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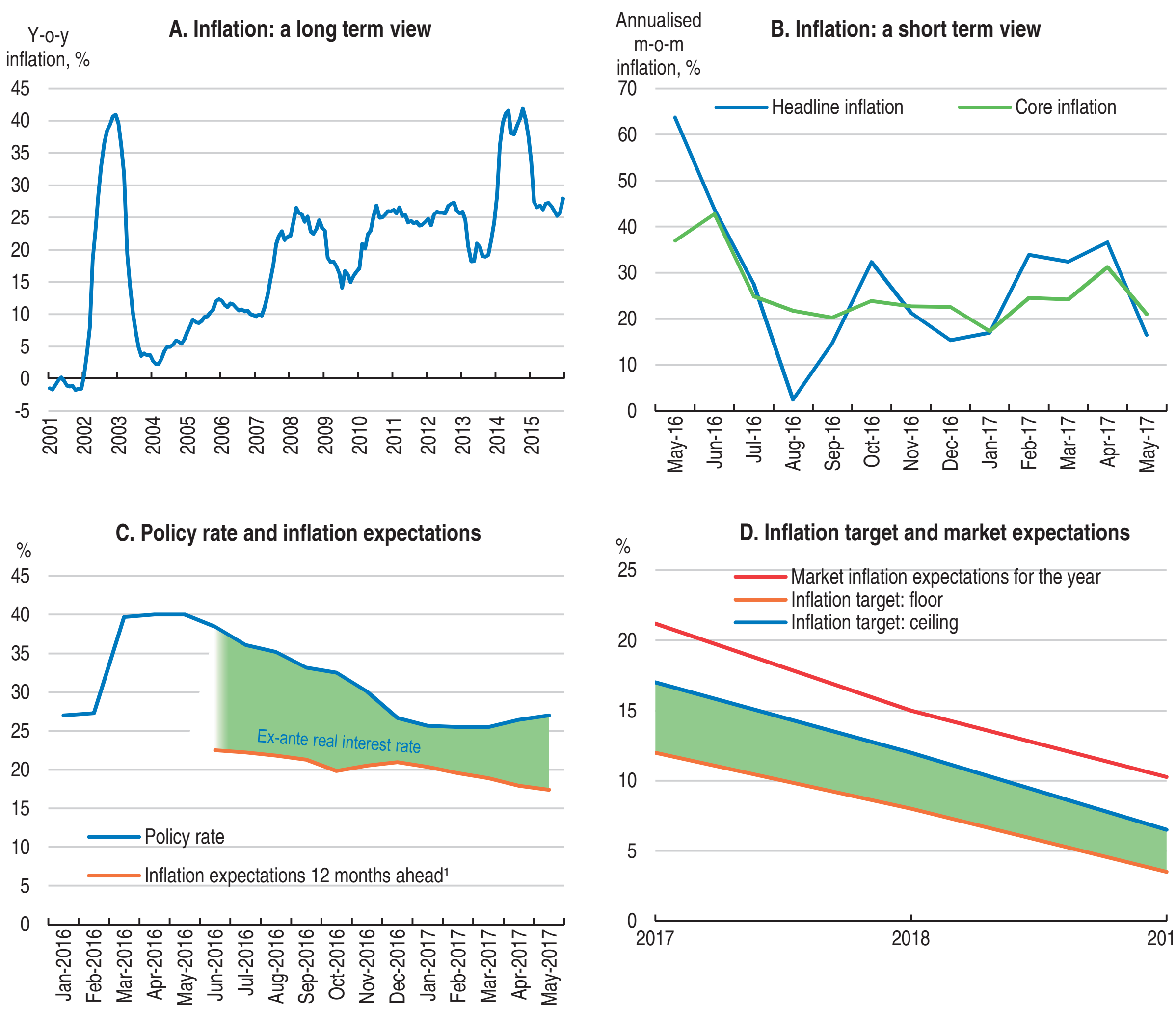
charge of financial stability, should stand ready to use macro-prudential tools, including limits on debt-service to income ratios, to ensure high asset quality as credit grows. Another initiative to develop the local mortgage market has been to use part of the public sector reserve fund endowment to create a trust which would securitise mortgages originated in banks.

Monetary policy will need to remain tight to bring down inflation

Inflation started to rise into double digits in 2007 and, as of 2011, the Central Bank increasingly printed money to finance the fiscal deficit. This raised revenues of up to 5% of GDP per year, but by 2014, annual inflation hovered around 40% (Figure 9). As of 2016, the gradual removal of subsidies for electricity, gas and transport and the depreciation that resulted from lifting currency controls had one-off effects on prices. As a result, inflation reached more than 40% during 2016, based on data from private sources, albeit with significant regional variation as the subsidies were concentrated in the Greater Buenos Aires area. The national statistics institute INDEC began to publish new inflation series as of April 2016, so far covering only the Greater Buenos Aires region. Its coverage will be expanded nationwide in July 2017.

Figure 9. **Bringing down inflation will be challenging**



1. No data on inflation expectations available prior to June 2016.

Source: Inflacionverdadera.com, BCRA, CEIC.

StatLink http://dx.doi.org/10.1787/888933541795

Inflation has started to be contained. The trajectory of monthly headline inflation throughout the year was volatile as a court decision caused a gas tariff hike to be initially undone in August 2016 and then reinstated in October. Core inflation has been on a smoother, declining trend since mid-2016. Monetary authorities first raised the policy rate by 685 basis points in March 2016. As inflation started to ease, the rate was cut gradually as of May 2016, but then raised again in April 2017 to 26.25% as inflation rose again.

In 2016, the Central Bank officially adopted inflation targets, with ranges of 12-17% for 2017, 8-12% in 2018 and 3.5-6.5% in 2019. Achieving these ambitious targets will require a tight monetary stance. The need for further electricity price hikes to achieve full coverage of costs will further increase consumer prices. In the absence of signs that this hike is feeding through into wage and price inflation more generally, the central bank can look through these one-off effects, and focus on the longer–term inflation targets. The publication of a nationwide consumer price index is expected for July 2017 and this index will be less affected by one-off effects from subsidy withdrawal as the subsidies were concentrated in the Greater Buenos Aires region.

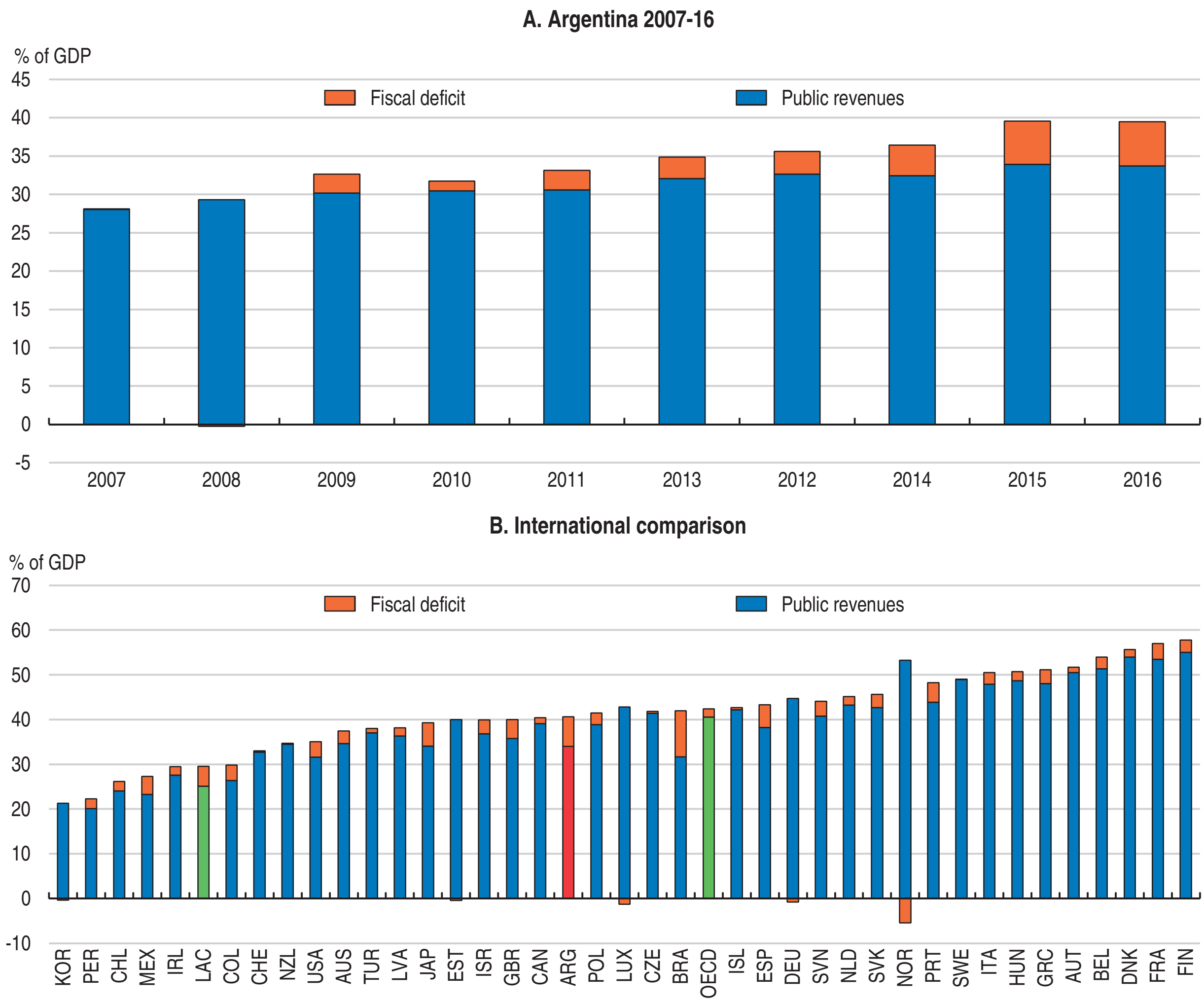
Current market expectations regarding inflation are falling. However, they are consistently above the inflation target ranges, by almost 5 percentage points, suggesting that more work is needed to strengthen central bank credibility and anchor inflation expectations. Institutional reforms would strengthen the effectiveness of monetary policy. The governor of the Central Bank can be replaced by the executive at any time. The only condition to replace the governor is to consult with Congress, but the resulting recommendation is not binding for the executive. To strengthen independence, many other inflation-targeting central banks have fixed-term mandates for the governor and the monetary policy committee members, during which they can only be removed in cases of serious misconduct according to clearly defined criteria and procedures.

Moreover, the law currently defines multiple objectives for monetary policy, including employment and equitable growth. These somewhat ill-defined objectives could lead to inconsistencies in monetary policy decisions, reduce the accountability of the central bank, and weaken the predictability and credibility of monetary policy making. Central banks need to consider the overall position of the economy and the effects its policies have on financial stability and well-being more broadly. But most countries with inflation targeting regimes have given more independence and a simpler mandate to their central bank (Schmidt-Hebbel and Carrasco, 2016; Mishkin and Schmidt-Hebbel, 2007). Explicit and verifiable goals, with the inflation target taking priority, would help reduce inflation by increasing the credibility of policy and of central bank decision making. Other policies can be used to deal with the other objectives.

Consolidating public finances by improving the structure of taxes and spending

Unsustainable fiscal policies have been at the root of almost all of the crises that Argentina has experienced in the past. Restoring the credibility of fiscal accounts is key for macroeconomic stability, without which the economy cannot grow in a sustainable and inclusive fashion, and for maintaining access to external financing. The fiscal balance deteriorated from almost zero in 2007 to a deficit of approximately 6% of GDP in 2015. Over that period, public expenditures rose from 28% of GDP to 40.5%, which is significantly above the average of Latin American economies and almost at the OECD average of 42.4% (Figure 10). This was largely accounted for by rising public wages, subsidies and social benefits. While some of this spending is worth preserving, particularly in the social area, large parts of previous spending probably brought little to no benefits to the economy and could be rolled back while still achieving current policy objectives.

Figure 10. **Public revenues and expenditures have reached high levels**



Source: IMF World Economic Outlook database, October 2016.

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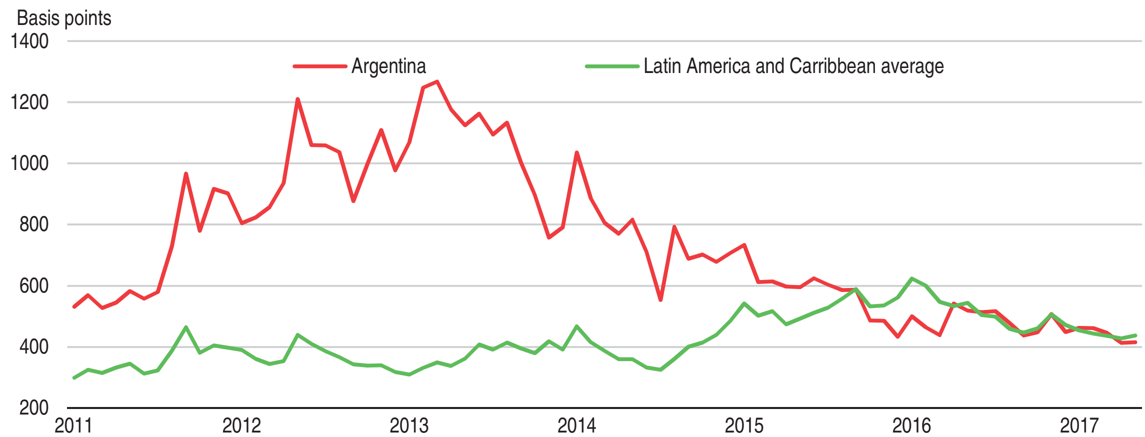
At 54% of GDP the level of gross public debt is moderate, which has allowed Argentina to tap into international capital markets on several occasions since the agreement with holdout creditors in April 2016, at reasonable cost as sovereign bond spreads have declined and converged towards the regional average (Figure 11). International rating agencies have recently upgraded their ratings for Argentina's sovereign debt. Around half of public debt is held by other public sector entities, predominantly the central bank and the social security fund (ANSES) and is hence not subject to rollover risk. This leaves debt held by private entities and international organisations at about 25% of GDP, which points to low debt-related vulnerabilities. It also provides space that can be used to reduce the deficit over a period of several years and support those who are set to bear the adjustment costs.

The authorities are pursuing deficit reduction with multi-year targets. The primary deficit targets are 4.2%, 3.2% and 2.2% of GDP for 2017, 2018 and 2019, respectively. With these plans and a continuation of the deficit reduction to reach zero in 2021, gross public debt is projected to stabilise at slightly above 60% of GDP (Figure 12). Debt held by private entities and international organisations, would also stabilise at about 36% of GDP.

Figure 11. **Bond spreads have converged with the regional average**

JP Morgan EMBI spreads



Source: Thomson Reuters.

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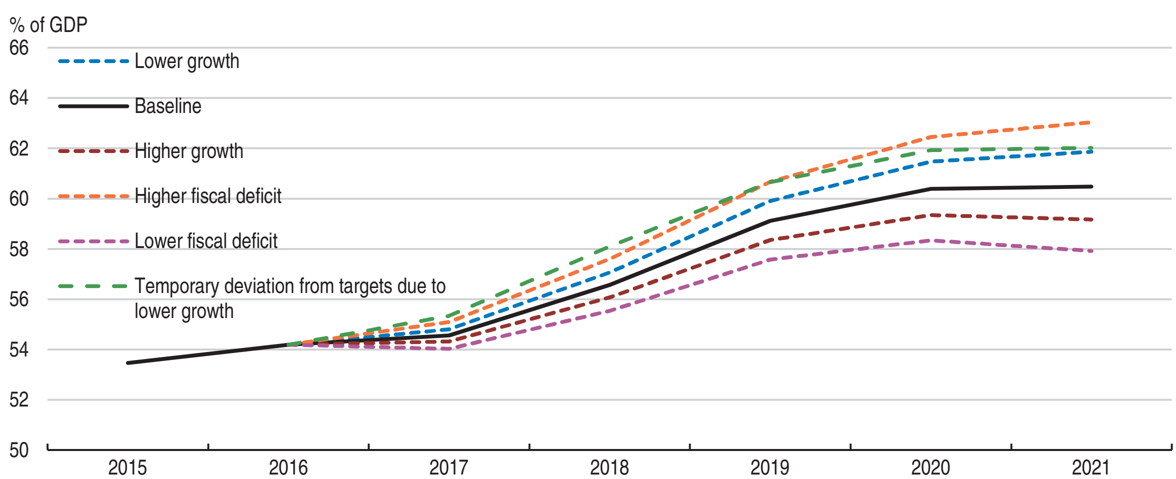
Figure 12. **Public debt is sustainable under several scenarios**



Note: In the baseline scenario, the primary deficit is as in table 2 until 2018, with an annual decline of 1 percentage point of GDP thereafter until it reaches zero in 2021. The interest rate for dollar-denominated debt is assumed at an average of 4.5% and the local currency rate at 8%. The real exchange rate is assumed to remain constant. GDP growth is assumed as in table 2 and constant at 3% after 2018. The lower/higher growth scenarios have growth lower/higher by 0.5 percentage point, the lower/higher fiscal deficit scenarios assume 0.5 percentage point lower/higher primary deficits. The temporary deviation scenario assumes lower growth and a higher fiscal deficit, both by 0.5 percentage points, in 2017 and 2018.
Source: OECD calculations.

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The current plans strike an appropriate balance between the need to ensure the sustainability of public debt and maintain access to financial markets at favourable conditions to ensure liquidity on one hand, and using the fiscal space afforded by comparatively low debt levels on the other. However, if growth were to turn out weaker than currently projected, the automatic stabilisers should be allowed to play, even if this implied a temporary deviation from the deficit targets. Such a temporary deviation from the target would merely stabilise debt at a slightly higher level without jeopardising sustainability. Given the significant share of foreign-currency debt, exchange rate fluctuations can affect public debt levels. Public debt management should navigate the trade-off between the currency denomination and the maturities of public debt as maturities are typically shorter for domestic-currency debt.

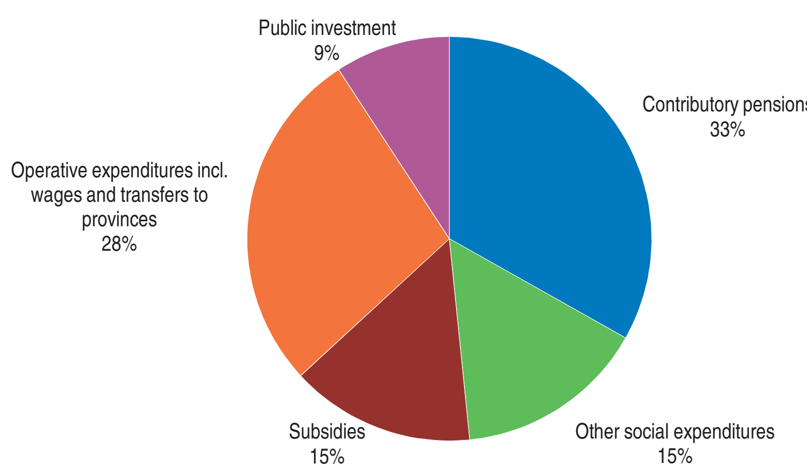
Making public spending more efficient

Reallocating spending towards more growth and equity-friendly measures will allow cutting the overall levels of expenditure without harming growth or adding to inequalities. International evidence suggests that the growth and equity effects of different public spending items vary substantially (Fournier and Johansson, 2016). An in-depth expenditure review could be useful to identify inefficiencies.

Social expenditures, currently at 29% of spending (Figure 13), remain a priority. During 2016, social spending rose by the equivalent of 1% of GDP, including through the establishment of non-contributory pensions for those above 65 without coverage, an expanded coverage of child benefits in the conditional cash transfer programme AUH, and a means-tested VAT rebate for basic staple items. Strengthening active labour market policies, and possibly unemployment benefits, may require further increases in social spending. Building on recent increases in public investment, particularly in infrastructure, would raise productivity and create jobs.

Figure 13. **Composition of primary expenditures**

2016



Source: OECD calculations, Ministerio de Hacienda.

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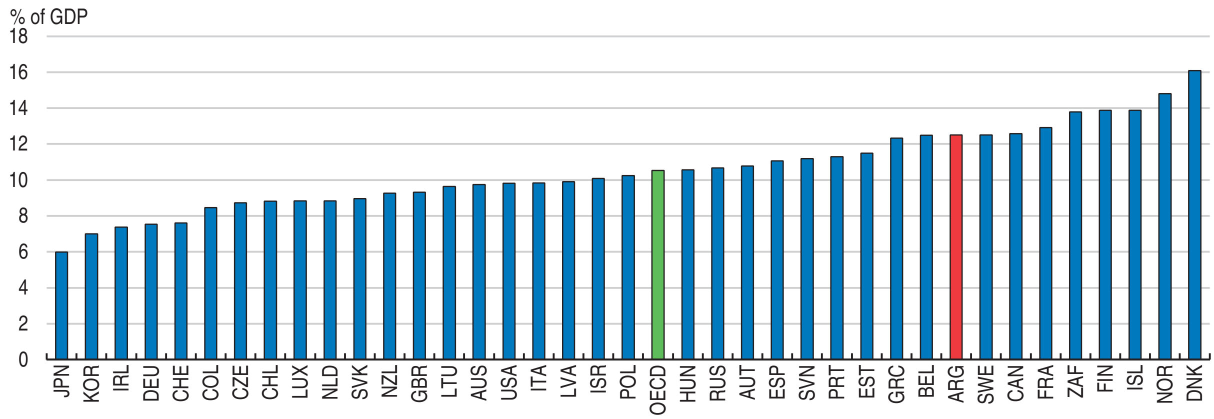
Subsidies for energy and transport still account for 2.2% of GDP, even after having been reduced by approximately 1.5% of GDP during 2016. Utility prices in the Greater Buenos Aires area still cover only around 50% of costs, up from around 25%. Current plans to phase out the subsidies should be pursued as they have clearly regressive distributional effects, besides discouraging energy efficiency (Castro and Barafani, 2015; World Bank, 2015). At the same time, it is important to protect those at risk of falling into poverty, for example through transfers.

Public employment increased by 70% between 2001 and 2014 and at 12.5% of GDP public sector payroll is above the average of OECD countries, many of which provide a higher level of public services (Figure 14). Much of this increase took place in provincial

Figure 14. **Public payroll expenditures are high**

Compensation of general government employees as a percentage of GDP, 2015 or latest available year



Source: OECD *Government at a glance* (2016).

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governments. During 2016, 10,000 contracts of irregularly hired public employees were cancelled and caps on future hirings are expected to be effective as of 2018. There is further scope for reductions in public employment, which accounts for 20% of the workforce.

Savings could also be achieved in many state-owned enterprises, including by defining more clearly the rationale for owning individual companies and through the definition of financial and non-financial targets. State-owned enterprises are active in areas such as oil and gas, electricity generation, air and rail transportation, paper production, banking, shipyards, among others and have 125,000 employees. Many have been financially underperforming. Transfers to these companies amount to approximately 1.1% of GDP and governance mechanisms suffer from a lack of separation of the roles of ownership, management and regulator, with no systematic performance evaluations being undertaken. Looking ahead, the state should define more clearly the rationale for owning individual SOEs and possibly review it, while establishing and monitoring the implementation of financial and non-financial targets. Levelling the playing field between SOEs and private enterprises would also enhance the scope for competition. A review of corporate governance of SOEs to align practices with OECD/G20 Guidelines on SOEs is currently underway (OECD, 2015d).

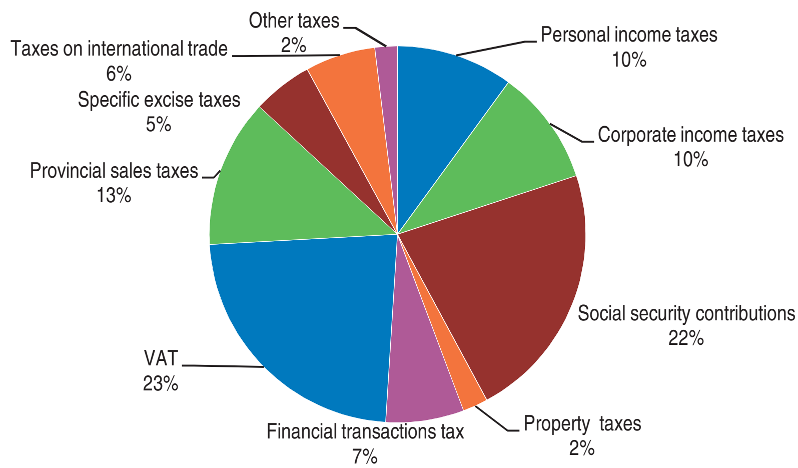
Tax reform is a key priority

The tax system is characterised by low tax bases and highly distortive tax design, with many exemptions and special treatments. This hurts productivity and the competitiveness of firms, but also leads to poor distributional outcomes. Income taxes and social security contributions currently account for 43% of revenues, which is close to the average of Latin American countries but significantly less than the OECD average of 61% (Figure 15).

Personal income taxes are levied at a progressive rate ranging between 9% and 35%. However, due to the high threshold of over 5 times the average income, below which income tax is not owed, only the top 10% of the income distribution pays income taxes (Figure 16). Lowering the thresholds while ensuring a progressive rate schedule would most likely raise more revenues in a more progressive way. Given how high the current threshold is, there is significant room for lowering it even without including workers with low incomes, who are

Figure 15. **Composition of tax revenues**

2015



Source: OECD/IDB/ECLAC/CIAT (2016), *OECD Revenue Statistics for Latin America and the Caribbean.*

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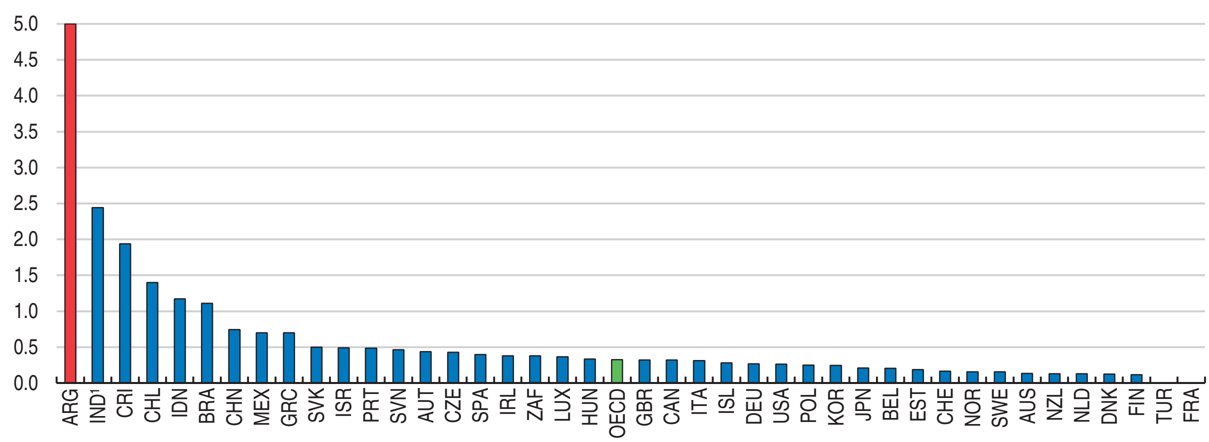
Figure 16. **Few people pay personal income tax**

Income threshold where single taxpayers start paying income tax, measured as a multiple of the average wage



1. For India, the average worker income is for the organised manufacturing sector as reported in the Annual Survey of Industries.

Source: OECD calculations for Argentina (based on 2016 data), Brazil, China, India, Indonesia and South Africa; and *OECD Taxing Wages 2016* for the rest of the countries.

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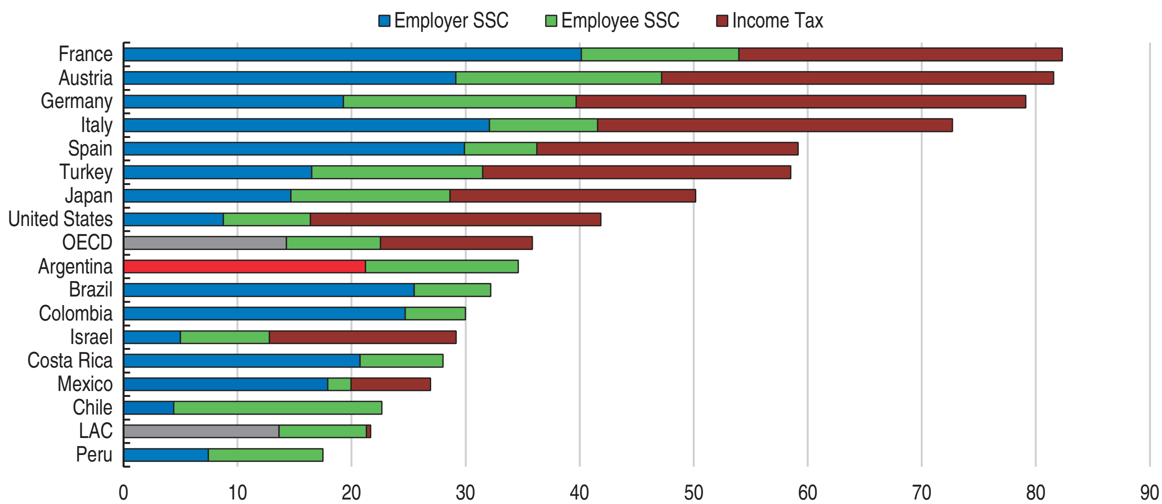
affected by informality. Bringing more people into the personal income tax system could also help to foster a culture of compliance.

Social security contributions of around 35% of wages, with hardly any progressivity, are high in international comparison and explain Argentina's high tax wedge on labour income (Figure 17). For those who pay the maximum PIT rate, the average labour tax wedge can reach a peak of 57%.

Labour informality, which affects a third of the active population, is both a cause and a consequence of the high tax wedge and breaking this vicious circle is challenging (OECD/IDB/CIAT, 2016). Temporary reductions to social security contributions for workers whose jobs have been informal before and are declared for the first time, can help foster formalisation, particularly when targeted at groups with low attachment to the formal labour market such

Figure 17. **The tax wedge on labour income is close to the OECD average**

2013, for workers earning an average wage



Source: OECD/IDB/CIAT (2016), *Taxing Wages and Taxing Wages in Latin America and the Caribbean*, OECD Publishing, Paris.

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as low-income earners. This could also benefit those at risk of falling into poverty. However, these kinds of measures are not a panacea. In Colombia, reducing payroll contributions paid by employers by 13.5 percentage points as a result of the 2013 tax reform is estimated to have led to the creation of 213 000 formal jobs in the short-run (Bernal, Eslava and Meléndez, 2015; Medina and Morales, 2016). The tax reform reduced the informality rate between 1.2 and 2.2 percentage points (Fernández and Villar, 2016).

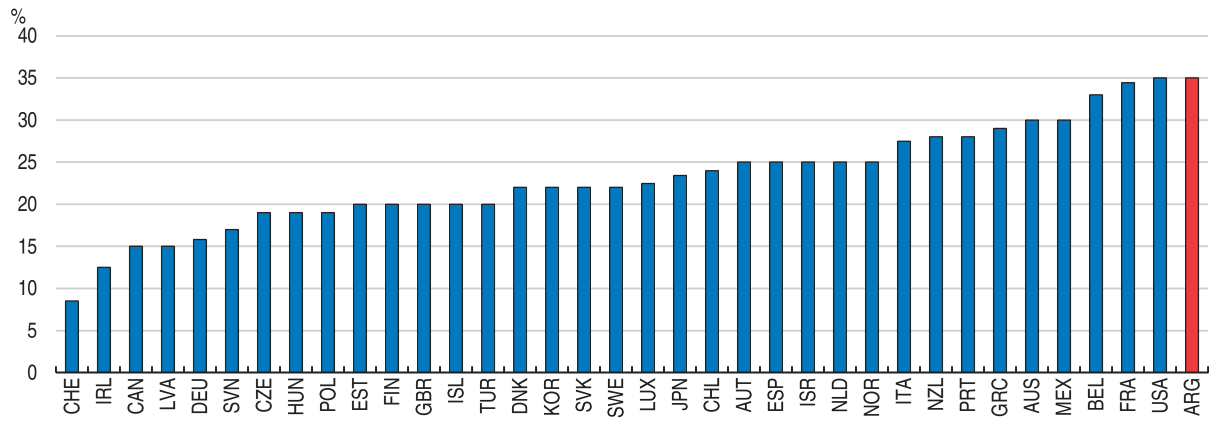
Such measures should go along with other efforts to raise formalisation, including easing formal labour market regulations, expanding training programmes to upgrade the skills of informal workers, enhancing enforcement through more labour inspections and promoting enterprise registration. Since 4 percentage points of social security contributions are currently used to finance union-operated health care schemes, making their governance structures more efficient could lead to cost reductions that would allow reducing this part of social security contributions.

Corporate income taxes have a high statutory rate of 35% (Figure 18), but the corporate tax burden is even higher because of a provincial turnover tax (see below). Even if other tax reforms may be more urgent at the current juncture, lowering the tax burden on enterprises, as recently done by Colombia (OECD, 2017b), would help to raise productivity and create high quality jobs by strengthening investment incentives (Arnold et al., 2011). There is also room to broaden the corporate tax base by eliminating some deductions and loopholes.

Argentina has two major indirect taxes. Firstly, a value-added tax (VAT) levied by the federal government allows for refunds for input VAT paid and applies a zero rate on exports. At the same time, non-compliance, reduced rates and exemptions create significant leakage. Argentina's VAT revenue ratio, which measures actual VAT revenues to potential revenues in the case where the standard rate were applied on all consumption, is only 46% while other countries, both in the OECD and in Latin America, have substantially broader VAT bases and better compliance (Figure 19). This suggests that more than half of potential VAT revenues, or around 3.5% of GDP, are foregone. Around two-thirds of these foregone revenues are due to non-collection or evasion, and the remaining third is due to

Figure 18. **Corporate income taxes are high**

Corporate income tax rate, 2016



Source: OECD Tax database.

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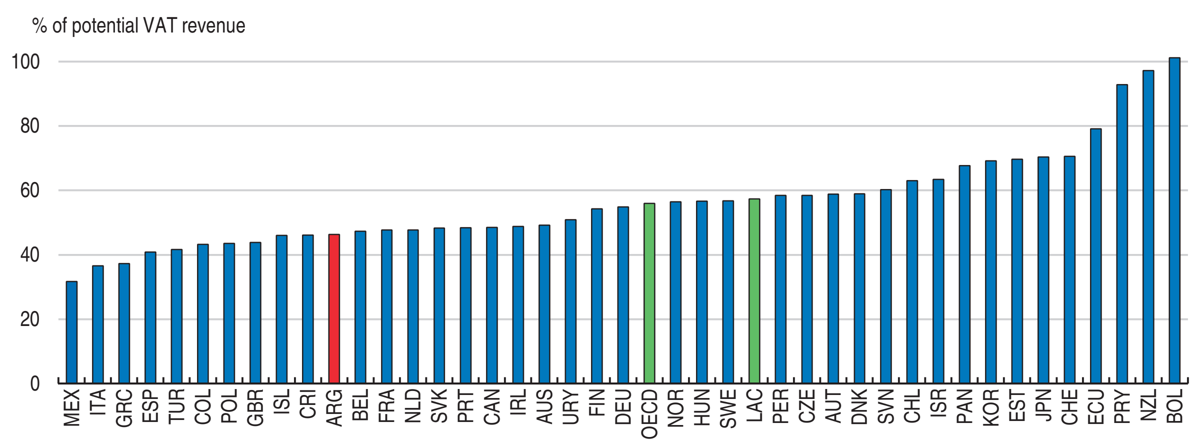
Figure 19. **VAT revenues could be higher with stronger compliance and less use of reduced rates**

VAT Revenue Ratio, 2014



1. The VAT revenue ratio (VRR) is defined as the ratio between the actual value-added tax (VAT) revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. The OECD aggregate is an unweighted average of data shown (excluding Latvia) and data for Canada cover federal VAT only.

Source: Calculations based on OECD (2016), OECD Tax Database, OECD Revenue Statistics and OECD National Accounts Statistics (databases), OECD Revenue Statistics for Latin American countries, 2016.

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exemptions and reduced rates (Artana et al., 2015). One way to fight VAT tax evasion could be by promoting electronic invoicing or even making it mandatory, as is currently being implemented in Chile (OECD, 2015e).

While the exemptions and reduced rates applied on food, medicines, education and transportation are likely to increase progressivity of the VAT to a small extent, they provide substantial support to better-off households and are therefore poorly targeted. In fact, only the lower rate on food brings larger benefits to low-income households than to high-income households (Artana et al., 2015). Simulations based on household data suggest that applying the current standard rate of 21% on all consumption would have small distributional effects, which could be compensated through transfers to low-income households with significantly less resources than the revenue losses resulting from reduced rates (Artana et al., 2015).

By contrast, the means-tested VAT rebates introduced in 2016, administered through specific debit cards, achieve a much better targeting and should be retained.

The second major indirect tax is a provincial turnover tax (*impuesto sobre los ingresos brutos*), which is levied on sales. This provincial tax, which accounts for 13% of tax revenues, is applied in a cascading manner at every stage in the supply chain, without any deduction for the tax paid at earlier stages, which reduces competitiveness and distorts the organisation of the value chain towards vertical integration. By contrast, global trends have been moving towards more fragmented value chains. With different tax rates depending on the origin and destination of goods, the turnover tax also acts as an interprovincial tariff barrier.

This turnover tax has increased sharply over the last years, partly because it is not very visible to consumers and voters. Integrating this turnover tax into the destination-based VAT, for example as a provincial surcharge on the same tax base as the VAT would significantly reduce distortions. However, such a move would lead to a redistribution of revenues across provinces and may require at least temporary compensation mechanisms among provinces, co-ordinated by the federal government, to become politically viable. India is a recent example of eliminating various state taxes and introducing a VAT on all transactions, part of which is then distributed to states (OECD, 2017d). At the same time, such a step would lead to very high VAT rates unless some tax revenue is shifted towards other taxes, for example by reducing the basic deduction in personal income taxes.

Another particularly distortive tax is the financial transaction tax, which is levied on transactions in checking and saving accounts. This tax should be phased out or at least reduced as it creates incentives to settle payments in cash, hindering formalisation. This tax currently raises revenue on the order of 1% of GDP and its rate of 0.6% on the volume of transactions is the highest among the countries that levy this type of tax (for example Colombia and Peru).

In contrast, recurrent taxes on immovable property could be used more as they have generally been found to be less harmful for economic growth than income taxes (Arnold et al., 2011). While the average OECD country raises 3.3% of tax revenues from these property taxes, they account for only 1.2% of revenues in Argentina. Updating property values on a regular basis will be crucial for raising more revenues from property taxes. Raising recurrent property taxes could be easier to achieve at the current juncture as the mortgage market is starting to develop. There is also room for collecting more revenues from environmentally related taxes, from which Argentina raises 1.2% of GDP, compared to an OECD average of 1.6% and 2.2% in Costa Rica. Finally, introducing inheritance taxes, which currently exist in some provinces but do not raise much revenues, could improve the equality of opportunities.

These recommended changes to taxes should be undertaken as part of a comprehensive tax reform, which can provide a boost to growth and investment, strengthen productivity and job creation and reduce labour informality and inequality. Protecting poor and vulnerable households is crucial in this context. Chile, Colombia and Mexico are examples of countries that recently implemented comprehensive tax reforms and are starting to reap the benefits (OECD, 2017a; OECD, 2017b).

Improving the fiscal framework

A stronger overall fiscal framework could also improve fiscal outcomes and make growth more inclusive. The transparent 2017 budget and the 2016-19 deficit targets constitute noticeable progress. The logical next step would be to lock in progress in the budgeting process into legislation. Fiscal rules would help enforce the framework and achieve medium-term targets. One possibility would be to establish an expenditure rule, in combination with defining a debt target in the medium term. An expenditure rule is attractive because compliance can be judged against a simple observable target, expenditure, which is easy to calculate and explain to voters and markets. Since automatic stabilisers operate predominantly through the revenue side, an expenditure rule would not be very pro-cyclical. The experience with such a rule has been positive in Peru and the Netherlands, for example (Ayuso-i-Casals, 2012; Carranza et al., 2014; Cordes et al., 2015). Brazil also established an expenditure rule in 2016.

Given that 40% of spending is at the subnational level, it would be important to include provincial budgets into the expenditure rule. Recent negotiations between the central government and provincial governors have led to an agreement for an expenditure rule that would keep expenditure constant in real terms until 2019. If approved by Congress, this expenditure cap would be useful, but should be amended by a longer-term commitment to rein in public expenditures. Some provinces have issued their own debt, including in foreign currency, currently amounting to around 4% of GDP. However, provinces require the authorisation of the central government for issuing debt.

Argentina should also establish an independent fiscal council whose remit includes both the central and provincial governments. This council should be granted sufficient independence and funding. Charged with *ex-ante* surveillance and publishing regular assessments of compliance with the medium-term plan and the fiscal rule, independent fiscal councils can enhance the credibility of complying with fiscal rules (Hagemann 2011). Almost all European Union countries have created such an institution by now. In Latin America, Brazil has recently created such an institution to improve the transparency of compliance with its new expenditure rule. Such an institution could also provide an independent view about the fiscal impact of legislative proposals and improve the transparency and reporting of fiscal results.

Strengthening institutions and safeguarding against corruption

Ensuring public sector integrity is crucial to maximise spending efficiency and citizens' trust in institutions and government (OECD, 2016a). Argentina ranks among the last ten of 140 countries in favouritism of government officials, ethics and corruption and executives view corruption as one of the five most problematic factors for doing business in Argentina (WEF, 2016a; WEF, 2017). Recent measures like the revamp of the anti-corruption agency are steps in the right direction and it will take time before they are reflected in opinion surveys. But there is significant scope to improve governance, for example through strengthening integrity rules and procedures in the three branches of power. Argentina could also conduct corruption risk mapping exercises and design tailored mitigation strategies in key agencies, such as those dealing with customs, tax and public procurement. Improvements in public procurement, including electronic procurement and reverse auctions, can reduce the risk of bid rigging or collusive tendering and raise spending efficiency.

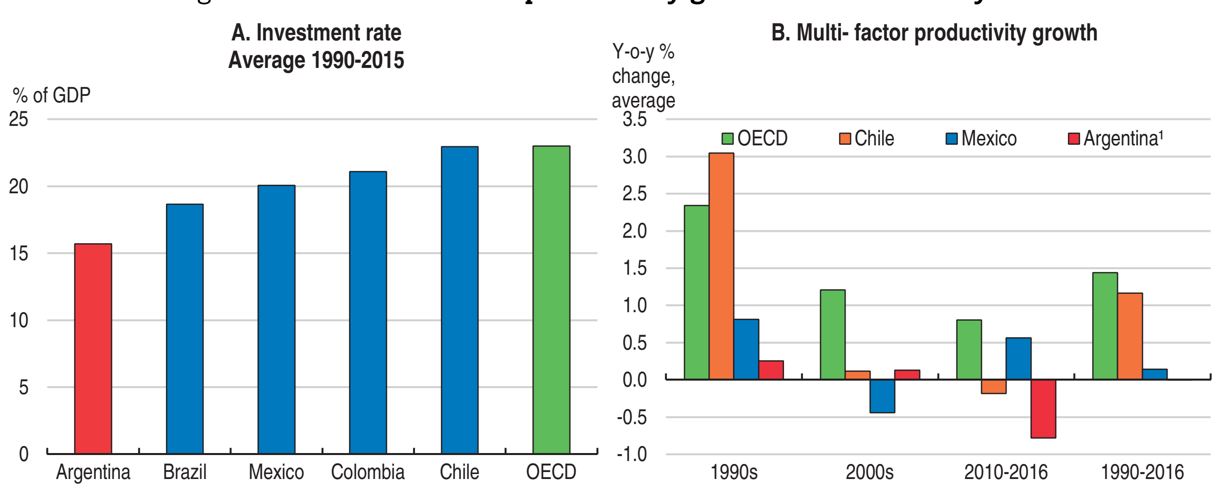
Separating the preventive and investigative powers of the recently revamped anti-corruption agency would be one way to enhance its effectiveness. At the same time, the capacities and de facto independence of the judiciary bodies responsible for the investigation of corruption should be strengthened, including by providing more resources to investigative judges and prosecutors, speeding up investigations and prosecutions and encouraging a more proactive enforcement. Such efforts should be complemented with the introduction of an effective and stronger whistle-blower protection scheme, as most corruption cases are unveiled through whistle-blowers (OECD, 2016d).

Success in fighting corruption, however, will depend greatly on Argentina's ability to improve its enforcement of criminal anti-corruption laws against both corrupt officials and those who corrupt them. In this respect, the OECD Working Group on Bribery recently expressed concerns about the lack of corporate liability for corruption; under-resourced investigative judges and prosecutors; significant delays in investigations and prosecutions; and the lack of enforcement proactivity. In response, legal changes are underway. Argentina must now ensure that the Corporate Liability Bill that was introduced into Congress in 2016 addresses these as well as other major deficiencies and then promptly enact the Bill. Moreover, Argentina has adhered to the OECD Council Recommendation on Public Integrity in 2017 and a comprehensive integrity review has been initiated.

Improving productivity and investment to raise well-being

Raising well-being will hinge critically on productivity growth, supported by stronger investment. On both accounts, Argentina has performed below par over the last 25 years and has unrealised potential for catching up (Figure 20). While the agriculture sector has performed relatively well, most other sectors, and particularly non-tradable services, have performed weakly (Coremberg, 2012). Unfortunately, a lack of comprehensive firm level data impedes a more detailed firm-level productivity analysis.

Figure 20. **Investment and productivity growth have been very low**



1. Data for Argentina end in 2015.
Source: OECD and CEP (Centro de Estudios de la Productividad).

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Weak productivity performance calls for a comprehensive and bold structural reform agenda that encompasses a wide range of policy areas. Getting the sequencing of reforms right is crucial. At the current juncture, Argentina should favour a swift implementation of key reforms that can stimulate medium-term productivity and at the same time support investment and job creation in the short-term. This is the case for product market reforms, which have a high growth-pay-off, facilitate the entry of new firms, and are likely to translate into job creation (OECD, 2016a). Given how closed the economy is, a swift removal of trade barriers in certain sectors, such as those providing key intermediate and capital inputs to other parts of the economy, could provide significant short-term and long-term benefits. Furthermore, estimates suggest that improvements in the tax structure and labour market reforms would also strengthen growth (see Table 1). But raising productivity is also about expanding the productive assets of an economy by investing in the skills of its people, allowing everyone to contribute to stronger productivity growth and ensuring that it benefits all part of society (OECD, 2016e). The potential benefits from reforms in individual policy areas will be discussed in more detail below.

Communicating clearly the direction, the sustainability and the expected benefits of reforms, with a special focus on who would benefit most from them, will boost confidence and create more ownership of the reform programme. Communicating the cost of not reforming is also useful, as this is large and accrues to vested interests.

Gains from structural reforms are large

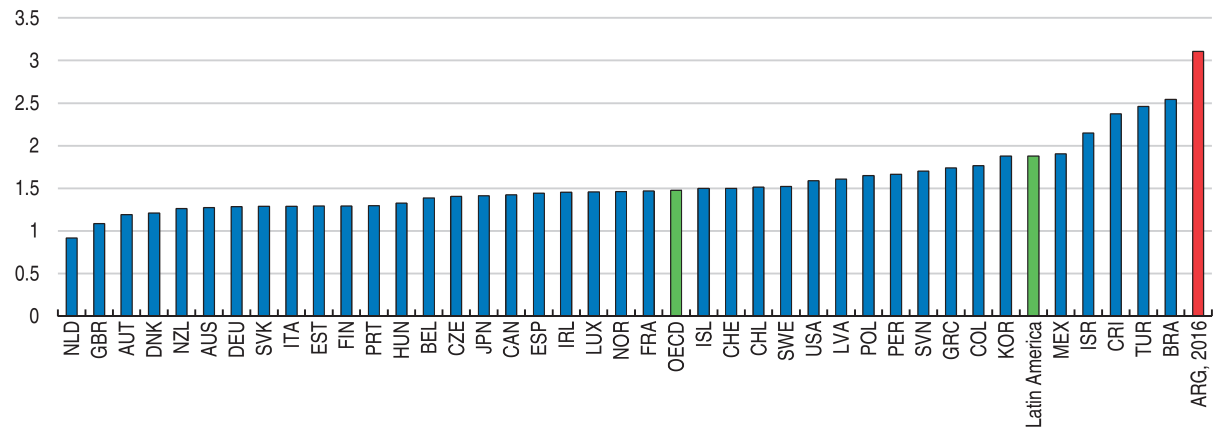
Regulations on product market serve a variety of legitimate objectives, but if ill-designed they can impose unnecessary restrictions on competition, and therefore on growth, living standards and ultimately well-being. Competition, which induces firms to become efficient or exit, has been traditionally weak and poor domestic policies have held back competitiveness of Argentinian producers, thus impeding them from exploiting their full productivity potential. The OECD Product Market Regulation Indicator and its sub-indicators measure the competition-restrictiveness of product market regulations across a wide range of countries. A recent update of the PMR indicator for Argentina, undertaken jointly with the World Bank, suggests that Argentina tops the list of countries with respect to the restrictiveness of product market regulations (Figure 21). OECD estimates suggest that GDP could be up to 4.4 percentage points higher after 10 years if Argentina were to align its product market regulations with international standards (Table 1). The largest benefits would accrue from reducing barriers to entrepreneurship, but also from improved governance of state-owned enterprises.

Argentina has one of the highest barriers to market entry of new firms in Latin America. Regulatory procedures are complex and long, especially those related to obtaining licences and permits (Figure 22). Procedures and regulations depend on the location of the firm and on the sector, with little co-ordination between different levels of government. Besides acting as a barrier to investment and entrepreneurship, this can also enhance the scope for corruption. The recently approved laws on entrepreneurship and SMEs aim at facilitating firms' start-up by creating a new type of firm, which can be set up in one day. This is a step in the right direction, but its success should be monitored and evaluated. It could be complemented by a wider application of "silence is consent" rules, whereby the licenses are issued automatically if the competent authority has not acted by the end of a statutory response period. Additionally, setting-up single contact points for issuing or accepting notifications or licences has been an effective way for reducing barriers to entrepreneurship across OECD countries.

In addition, the existing regulatory framework fragments the Argentinian domestic market as regional and local authorities often impose extra requirements on companies from other parts of the country. This lowers the intensity of local competition and, by reducing the scale of production, it also curbs productivity (Figure 23). Programmes to cut and eliminate administrative burdens imposed by different levels of government have been successful in Australia, Canada and Spain. In Spain, all regulations issued by the local,

Figure 21. **There is room to reduce the restrictiveness of product market regulations**

OECD Product Market Regulation Indicator

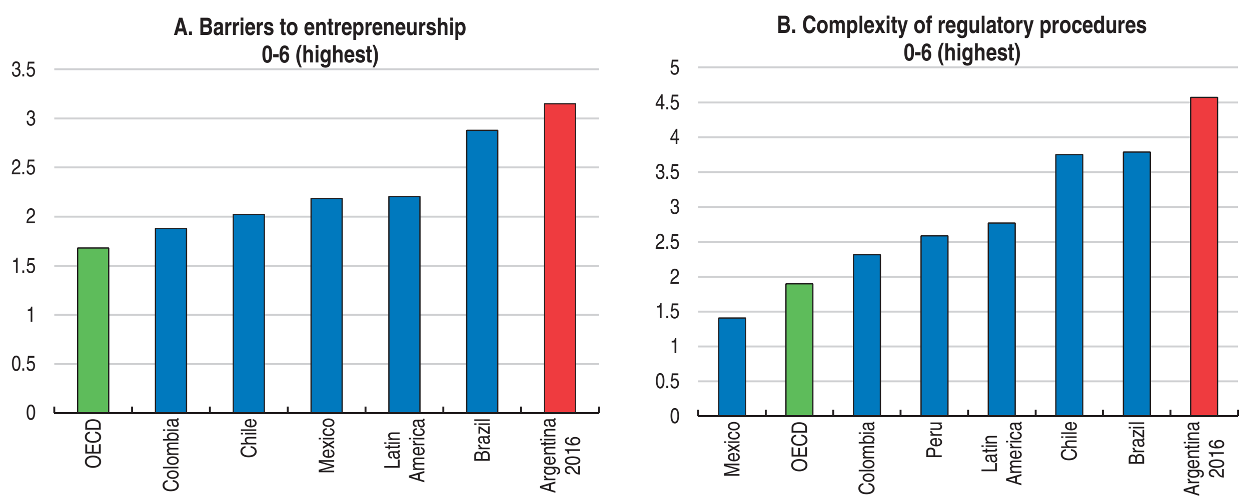


How to read this chart: The OECD indicators of product market regulation are synthetic indicators that summarise a wide array of different regulatory provisions on product markets across countries, with a focus on the degree to which these regulations restrict competition. They are expressed on a scale from 0 (least restrictive) to 6 (most restrictive). Data are for 2013 or last available year. Data for Argentina are preliminary and refer to 2016, based on an update undertaken jointly with the World Bank.

Source: OECD Product market regulation database.

StatLink http://dx.doi.org/10.1787/888933542289

Figure 22. **Barriers to entrepreneurship are high and regulatory procedures are complex**



Source: OECD Product market regulation database; and World Economic Forum Global Competitiveness Index Dataset. Data for Argentina are preliminary and refer to 2016, based on an update undertaken jointly with the World Bank.

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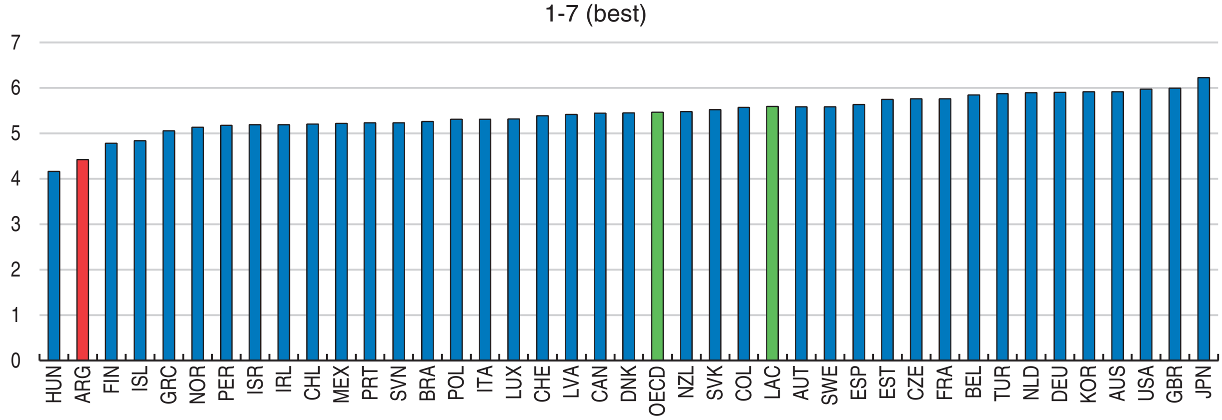
regional and central government that are found to effectively fragment the domestic market must be amended within six months and mutual recognition principles between regions are being established (González Pandiella, 2014). The Council of Australian Governments, established in 1992, has focused on in-depth harmonisation of legislation, standards and regulations among the states and territories. Canada put in place an intergovernmental agreement to prevent different levels of governments from establishing new internal trade barriers and to reduce existing ones (OECD, 2016b).

Figure 23. **Local competition could be stronger**

Intensity of local competition, 2016-17
1-7 (best)



Source: World Economic Forum Global Competitiveness Index Dataset.

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Strengthening competition policy

Aligning to OECD standards in competition policy could generate significant growth dividends (Table 1). Inefficient regulations, a weak anti-cartel framework, arbitrary government interventions and weak enforcement have reduced the enforcement of competition policies in the past. The national Competition Authority has recently been restructured and a law has been submitted to Congress that would strengthen its independence, give it a clearer mandate, more resources to conduct investigations and the power to impose higher fines. The law also establishes a leniency program and a specialised competition court, which would be a crucial ingredient for giving more teeth to the Authority. Establishing a legal separation from the Executive by moving the Authority out of the Ministry of Production would strengthen its autonomy, as would multi-annual budgeting mechanisms to provide greater financial security and insulate it better from political interference. In addition, higher threshold levels for mandatory examinations of merger and acquisition cases, which are currently set at USD 12.5 million of joint annual turnover, would allow a better focus on investigating cases of anti-competitive conduct rather than minor concentration cases.

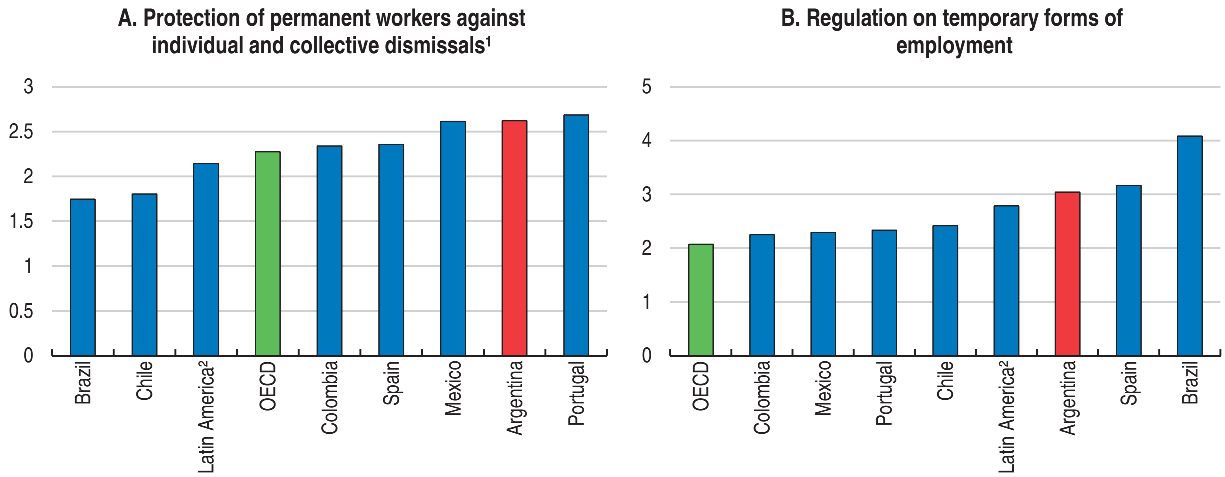
Evaluating whether planned or existing regulations can restrain competition should also form a more substantial part of the work of the Authority. Introducing a legal obligation for the executive to systematically submit all new laws with a potential to affect competition to a regulatory impact assessment has proven effective in many OECD and LAC countries, including Mexico (OECD, 2014). To take stock of the potential anticompetitive effect of existing rules, the OECD's Competition Assessment toolkit has been effective in many countries in screening regulations in specific sectors and for identifying and developing alternative, less restrictive measures that still achieve government policy objectives.

Improving labour market regulations

Excessively rigid employment protection legislation impairs the functioning of the labour market, with disproportionate negative effects on some categories of workers with weak attachment to the labour market, including women and youths. According to OECD indicators, labour market regulations are more inflexible in Argentina than in other Latin America countries and in the OECD on average (Figure 24). At the same time, there is

Figure 24. **Labour market regulations are relatively rigid**

2014 or last available year



How to read this chart: The OECD indicators of employment protection are synthetic indicators of the strictness of regulation on dismissals and the use of temporary contracts, expressed on a scale from 0 (least restrictive) to 6 (most restrictive). They are compiled from 21 items covering different aspects of employment protection regulations as they were in force on January 1st of each year.

1. Reflects an average of severance pay requirements after 4 and 20 years of tenure.
2. Latin America includes: Brazil, Chile, Colombia, Mexico and Peru.

Source: OECD/IAB Employment Protection Database, 2013 update.

StatLink http://dx.doi.org/10.1787/888933542441

significant scope for improving active labour market policies, such as training and job counselling, and making them more effective in helping Argentinians to gain employment. Easing labour market regulations and, in tandem, improving training and job-counselling would improve labour-market fluidity and strengthen both productivity and inclusiveness. This can also help to attract more foreign investment, for example by reducing the uncertainty related to labour costs including severance payments.

Argentina has a strong tradition of sector-specific collective wage bargaining covering more than 70% of workers (Lamarche, 2015). Evidence suggests that sector-specific collective bargaining systems with such a wide coverage, yet without the co-ordination inherent in wage bargaining at the level of the whole economy, may curb labour demand (Gal and Theising, 2015, Calmfors and Driffill, 1988). They may also impede wage adjustments in firms that are going through difficult times, thus causing the firm to fire workers or to fail (De Serres and Murtin, 2013). Empirical evidence both from Argentina and OECD countries suggests that more decentralised wage negotiations, including at the firm level, could increase productivity and preserve jobs as they are more flexible to respond to market changes than collective bargaining at the national level or at the level of broad industries (Lamarche, 2013, 2015, OECD, 2015c). Avoiding the extension of wage bargaining agreements beyond its signatories and a wider use of opt-out clauses could also ensure a better alignment between wage increases and the productivity growth of firms. The economic literature suggests that centralised wage bargaining at the national level can perform equally well (Aidt and Tzannatos, 2008; Calmfors and Driffill, 1988). However, in the context of emerging market economies with highly dispersed productivity levels across sectors and firms and large informal sectors, and given the rapid structural transformation that the economy is going through, this avenue may perhaps not bring the same benefits as in advanced economies.

Labour agreements have also regularly resulted in other rules that led to higher labour costs, including a high dispersion of overtime, commuting or regional supplements. A recent strategy by the authorities has been to promote project- or sector-specific agreements between unions and the corporate sector to attract new investment. These agreements rein in future wage costs and reduce investor uncertainty, which has helped to make several investment projects viable. There is also scope for reducing non-wage costs, for example, by making the costly insurance system against work risks more efficient. Mandatory contributions to this scheme can reach up to 20% wage costs, despite a significant fall in the number of accidents. Moreover, establishing administrative out-of-court procedures could reduce high levels of labour litigation, which create high costs and uncertainty for employers.

Reaping the benefits of international trade and global value chains

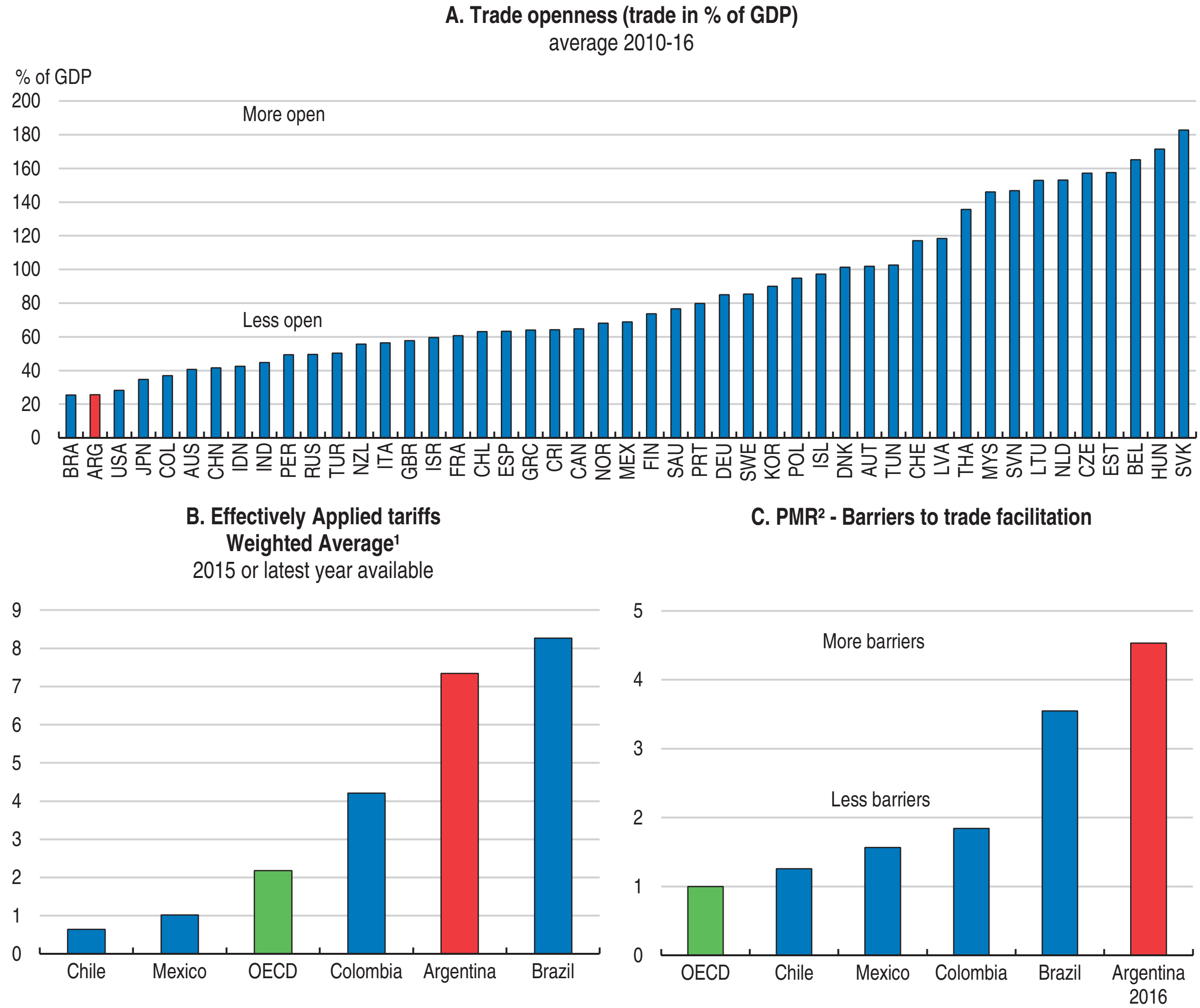
Rising trade barriers have isolated Argentina's economy more and more from the global economy in recent years. Imports plus exports amount to less than 30% of GDP, a low degree of openness for a country of the size of Argentina (Figure 25). The largest export items are food and agriculture products, which covered about 40% of total exports in 2015. Argentina is also a strong exporter of knowledge-based services, which account for almost 9% of exports and include mostly business, professional and technical services as well as software and computer services. Motor vehicles account for 9% of total exports, with 80% of this category going to Brazil.

Tariff protection and other barriers to trade, including non-automatic import licenses, are high in international comparison, which suggests strong potential gains from a better integration into the world economy. Surges in import protection over the last decade have led to the emergence of entire industries, including toys and electronics, based on import substitution strategies. However, these have proven highly inefficient and none of them have been able to become internationally competitive. While this has created employment, it has come at a high price for consumers and taxpayers. By contrast, other Latin American countries like Chile, Colombia, Mexico and Peru have actively promoted integration with large markets such as Japan, China and the United States through bilateral and regional trade agreements.

High trade protection reduces competitive pressures that would spur firms to reach global best practice, and it hurts downstream sectors that could use imports as intermediate inputs or capital goods, both of which can be crucial for productivity growth (Grossman and Helpman, 1991; Amiti and Konings, 2007). Countries that have managed to move from being a middle-income country to a high-income country on the basis of the industrial sector (Korea, Israel, Hong Kong, Singapore) have invariably done so by eventually integrating fully into the world economy (World Bank, 1993, Amsden, 1989). In Latin America, Mexico and Chile exemplify how trade and the integration in global value chains can contribute to economic growth and resilience (OECD, 2017a, OECD, 2015g). By contrast, Argentina is poorly integrated into global value chains (Figure 26).

The authorities are planning to open up the economy gradually. While the pace can be adapted to the circumstances in individual industries, what matters most is to establish a clear and credible time line for phasing out trade barriers. This encourages firms to invest in upgrading their technologies and otherwise to prepare for foreign competition. Progress on some of the domestic policies that currently curb competitiveness, including taxes and infrastructure, should precede a large-scale trade liberalisation.

Figure 25. **The economy is fairly closed and barriers to trade are high**



1. The average of tariffs weighted by their corresponding trade value.
2. The numerical PMR indicators represent the stringency of regulatory policy in specific areas on a scale of 0 to 6 with a higher number indicating a policy stance that is deemed less conducive to competition. PMR data for Argentina are preliminary and refer to 2016, based on an update undertaken jointly with the World Bank.

Source: IMF International Financial Statistics; OECD Economic Outlook database; and World Bank World Integrated Trade Solution, OECD Product market regulation database.

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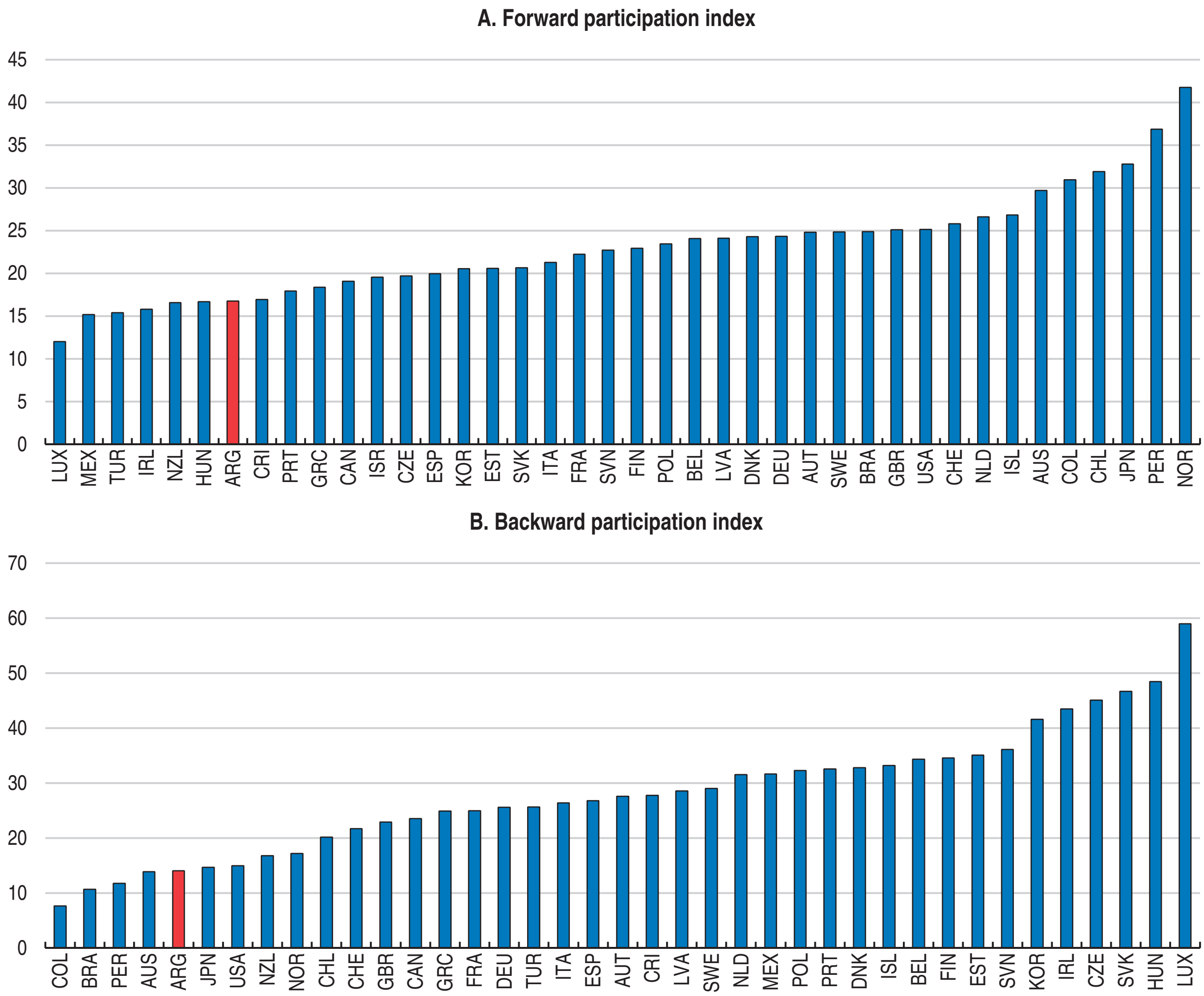
It is important to acknowledge that trade opening combines strong medium-term benefits such as more and better jobs with short-run adjustment costs. Jobs will be lost in some firms and sectors and created in others. But it is precisely this reallocation process that will allow capital and labour to flow to more productive sectors or firms that are likely to expand and create new jobs. Evidence suggests that the productivity gains from reducing resource misallocations could have been as high as 60% almost a decade ago (Neumeyer and Sandleris, 2010; Busso et al., 2013). Given the increase in economic distortions since then, it is likely to be even higher now. In the transition process, policies can go a long way to reduce the burden of adjustment for poor and vulnerable households. Scaling up active labour market policies, including training and job search assistance, and ensuring a strong social safety net to protect incomes during unemployment spells are key

Figure 26. **Participation in global value chains is low**



Source: OECD-WTO Trade in Value Added Database.

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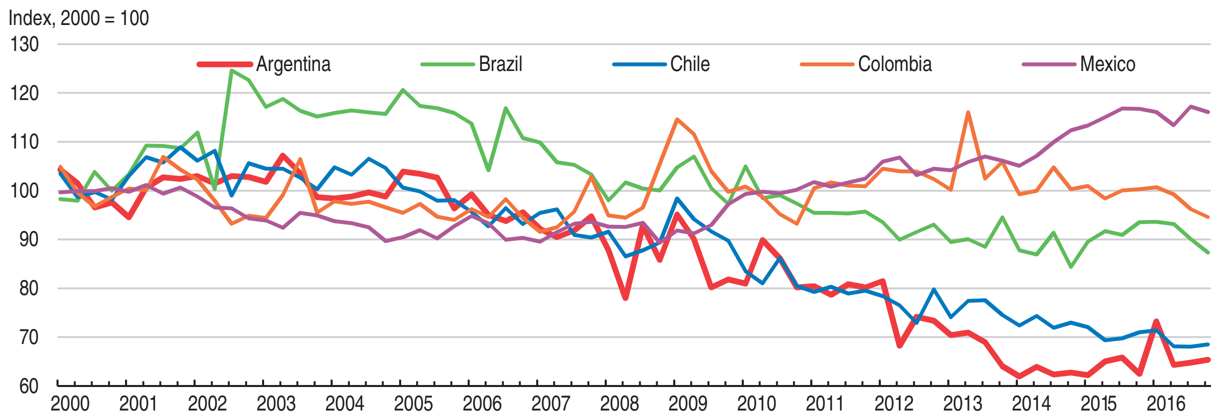
policy levers in this context. The focus of such accompanying policies, however, should be on protecting workers rather than on protecting jobs, economic sectors or firms (World Bank, 2013; Flanagan and Khor, 2012).

The pace of opening up vis-à-vis different trading partners can be leveraged to improve market access, thus raising exports and facilitating the integration into global value chains. Export performance has declined steadily, particularly in recent years in the context of export taxes and high administrative burdens related to international trade (Figure 27). Boosting exports would create opportunities for better-paid jobs, since Argentinian exporters pay 31% higher wages than non-exporters (Brambilla et al., 2016). Argentina is a member of the MERCOSUR customs union, which has traditionally not pursued an active strategy of seeking trade agreements. MERCOSUR has bilateral agreements covering about 10% of world GDP, but Peru and Chile have trade agreements covering about 70-80% of world GDP. Given a recent change in the orientation of trade policies in Brazil towards opening up, new opportunities are likely to become available to seek more bilateral trade agreements. In particular, strengthening the links with the Pacific Alliance and moving forward on

Figure 27. **Export performance has declined strongly**



Note: Export performance is measured as actual growth in exports relative to the growth of the country's export market, which represents the potential export growth for a country assuming that its market shares remain unchanged.
Source: OECD Economic Outlook database.

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negotiations with the European Union/EFTA are important initiatives in which Argentina should play a leading role. Lower trade barriers in advanced economies, particularly on agricultural imports, could provide a significant boost to Argentina's exports.

Attracting more and better foreign direct investment

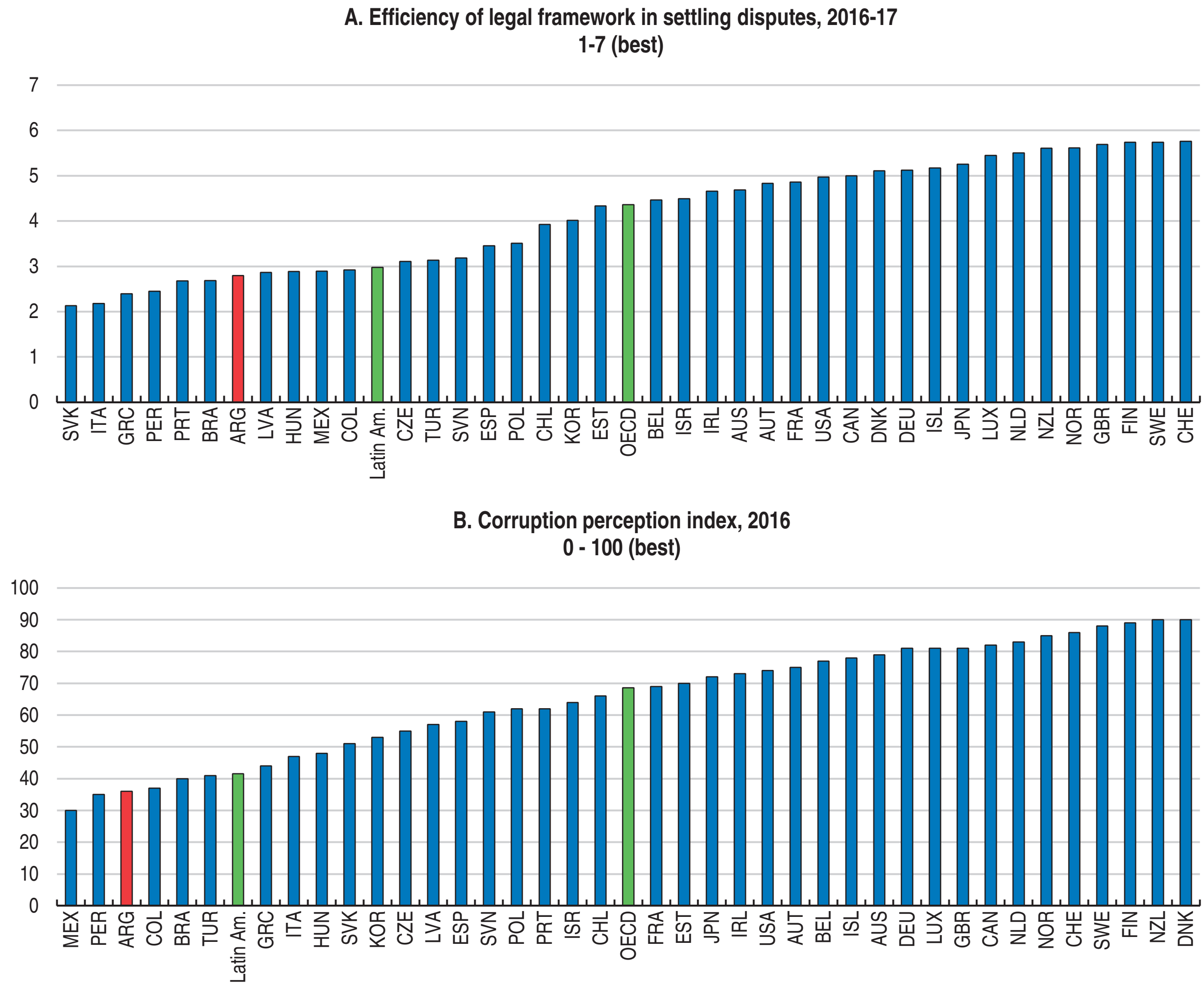
In the past, Argentina has attracted far less foreign direct investment (FDI) inflows than other Latin American countries such as Mexico or Brazil, and far less than regional top performers such as Costa Rica. Besides opening up new sources of investment financing that go beyond domestic savings, FDI is associated with productivity benefits as multinational enterprises are typically among the most productive firms and generate knowledge spill-overs (Arnold and Javorcik, 2009; Blalock and Gertler, 2008; Javorcik, 2004; Keller and Yeaple, 2009). The nature of FDI also matters. Given its fairly closed economy in the past, Argentina almost exclusively attracted market-seeking FDI as opposed to efficiency-seeking FDI, under which firms enter a country to benefit from factors that enable it to compete in international markets. The latter is often associated with stronger gains for productivity, employment and trade (Barrientos et al., 2011).

The important steps already taken to increase macroeconomic stability, along with the recommended reform of the tax system, would help to attract more and better FDI. A strong and decisive commitment to strengthen the rule of law would also help as Argentina lags behind in this area (Figure 28). Moreover, this is often singled out by investors as an important impediment to doing business in Argentina (World Bank, 2016a). Reorganising courts, implementing electronic judicial files and promoting out-of-court solutions to conflicts are avenues followed by OECD countries to enhance the efficiency of legal and judicial systems and should also be pursued by Argentina. Specific restrictions to FDI are lower than in many other countries (Thomsen and Mistura, 2017).

Improving infrastructure

Survey data on the perceived quality of infrastructure rank Argentina 109rd worldwide. Infrastructure quality has declined steadily over the past years, primarily due to low public and private investment (World Bank, 2016a). The deteriorating quality of roads, for example,

Figure 28. **Argentina ranks low on the rule of law and corruption perceptions**



Note: Latin America includes: Brazil, Chile, Colombia, Mexico and Peru.
Source: World Economic Forum Global Competitiveness Index Dataset; and Transparency international.

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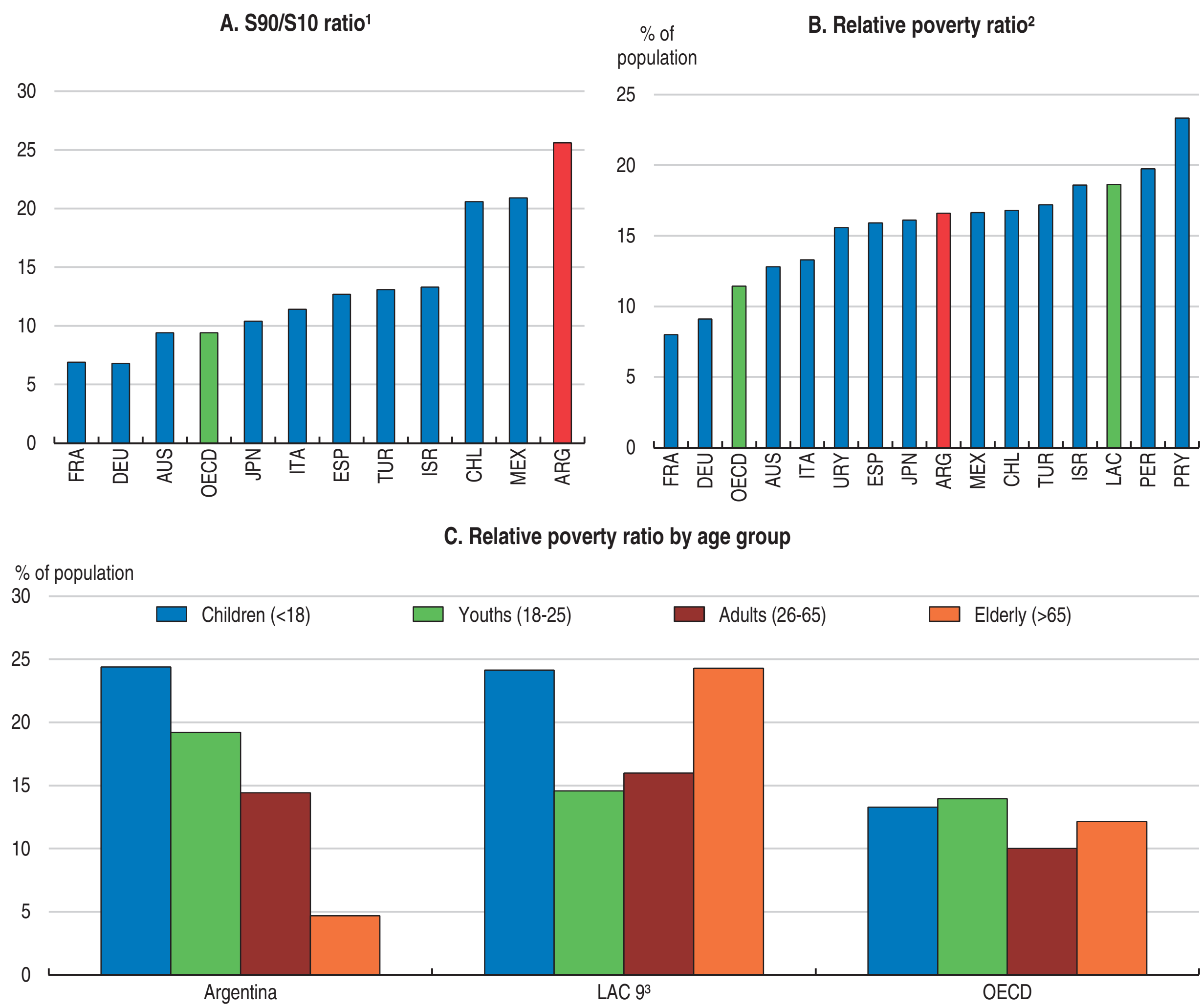
contributes to high logistic costs, especially in the Northern provinces without alternatives to road transport, and it also makes it more difficult low-income people in remote and isolated areas to get access to jobs and leads to higher carbon emissions.

The authorities have started an ambitious programme of public works. In addition, many infrastructure projects lend themselves to private sector participation in financing and execution, but getting the institutional and legal framework right is key. Both concessions, with which Argentina has experience, and public-private partnerships (PPPs), for which a new framework law has been passed recently, can be useful models. However, in some countries such as Spain and Portugal, PPPs have been attractive in the past because the associated future liabilities were not properly recorded in the budget. As a lesson from these experiences, the full budget implications of PPPs over their whole life-cycle should be incorporated into the medium-term budget framework. Furthermore, good project selection, strong institutional frameworks, technical capacities of the public sector and fair sharing of risk between private and public sectors are important.

Making growth more inclusive

Building the foundations for a period of growth without any major crisis is a precondition for raising average living standards. Productivity improvements will play a key role in this context. But raising productivity in an inclusive way also requires ensuring that growth benefits all parts of society, in terms of improved living standards and opportunities, while empowering everyone to contribute to these improvements. The current level of inequalities is high, with several indicators above OECD averages and around average in the region (Figure 29). One quarter of households and one third of the population are poor (INDEC, 2016a).

Figure 29. **Inequality and poverty are high**



1. The S90/S10 ratio is the ratio of disposable income of the 10% of people with highest disposable income to that of the poorest 10%.
2. Relative poverty rates after taxes and transfers (threshold of 50% of the median income). Data for Argentina are from the third quarter of 2016 and are representative of urban centres of more than 100.000 inhabitants. Data for all other countries refer to 2014 or latest available year.
3. LAC 9: Bolivia, Chile, Dominican Republic, Ecuador, Mexico, Peru, Paraguay, Panama and Uruguay.

Source: CEDLAS (2017a), Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC), OECD Income Distribution Database (2016), and OECD estimates based on CEDLAS country micro data.

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Inequalities appear to have a significant intergenerational component. Poverty rates are almost 50% higher among children. This shows the difficulty of breaking the intergenerational transmission of poverty. Inequalities also have a regional dimension, as Poverty rates exceed 40% in the Northern provinces. Poverty stems from many problems, such as a lack of quality jobs, low skills, high informality rates and poor public service provision in water, sanitation, electricity and health care facilities in many regions. For example, in the Northern provinces Misiones and Chaco, only 19% and 26% of households, respectively, have access to improved sanitation facilities, compared to 98% in the city of Buenos Aires (INDEC, 2016a). The performance of the City of Buenos Aires on the Human Development Index is far above the national average, while provinces like San Juan, Catamarca, Chaco, Corrientes, Santiago del Estero and Formosa perform much less well (UNDP, 2013).

Improving the distribution of market incomes by creating better jobs and tackling informality

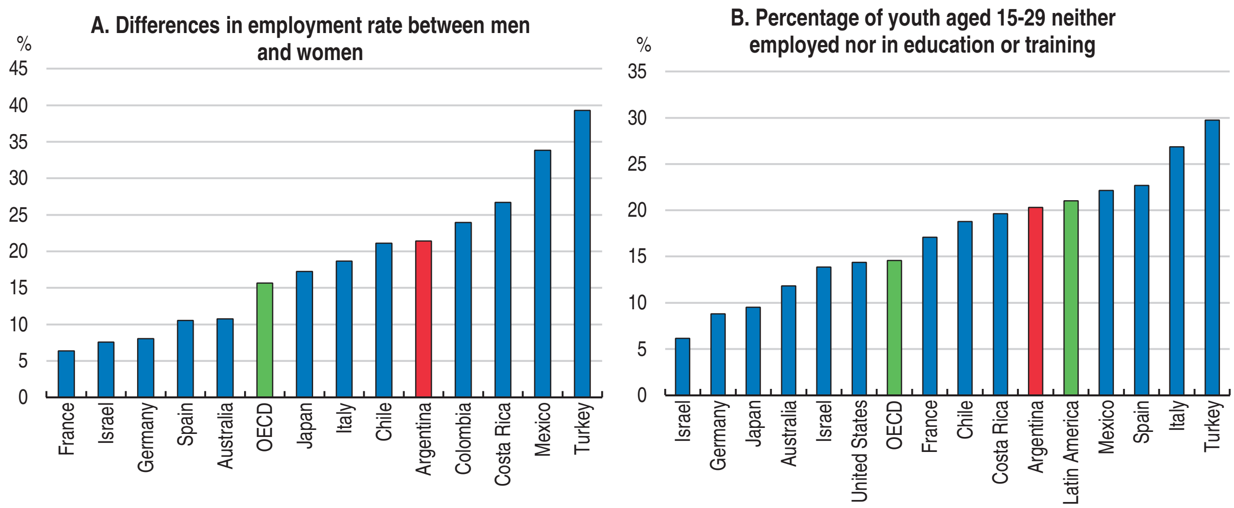
Creating quality jobs with good pay is the most effective and sustainable way to reduce poverty and provide opportunities for everybody. The role of market incomes in reducing poverty decreased substantially in Argentina between 2008 and 2015, in contrast to many other countries in the region where poverty reduction was closely linked to labour market developments (World Bank, 2015). However, this may change soon. After 5 years of hardly any job creation in the private sector, employment has been rising since mid-2016 and is expected to improve further as some of the recent reforms bear fruit.

Getting a job has been difficult for people with lower skills. These difficulties could even be exacerbated by the increasing digitalisation of production technologies, which is not only transforming the nature of jobs but also the set of skills that are and will be demanded (WEF, 2016b). More than half of the unemployed have not completed secondary education, compared to 35% of the working population as a whole, affecting their ability to find jobs (CEDLAS, 2016). The unemployment rate is almost four times higher among the young and one-fifth of those aged 15 to 29 are not engaged in employment, education or training (Figure 30). Two thirds of these are women, 80% of whom come from poor or otherwise vulnerable households.

More could be done to address constraints for women to participate in the labour market. More women than men have completed secondary education and attained a tertiary degree, but still, the difference in employment rates between men and women is over 20 percentage points, visibly larger than in OECD countries. Women also get substantially lower pay. OECD analysis based on recent household data suggests that women are paid 24% less, all other relevant personal and employment characteristics being equal. Improving childcare arrangements, for example through an expansion of early childhood education, as discussed below, would be one way forward. This should be complemented with measures to promote flexible working time arrangements and longer paternity leave.

When they manage to find employment, low-skilled workers, women and youths are disproportionally employed informally (Figure 31). There is a stark contrast between the stringent employment protection for permanent formal jobs and a complete lack of protection among those holding informal jobs (Canavire-Bacarrezao et al., 2009). OECD analysis based on a recent 2016 household survey suggest that informal workers earn about 36% less than formal workers, after accounting for other relevant personal and employment characteristics. In international comparison, Argentina is among the emerging economies with the largest wage gap between formal and informal workers (OECD, 2015c).

Figure 30. **Labour market participation is lower among women and the young**



Note: Data for Argentina refer to 2016, for all other countries to 2015.
Source: OECDstat, INDEC.

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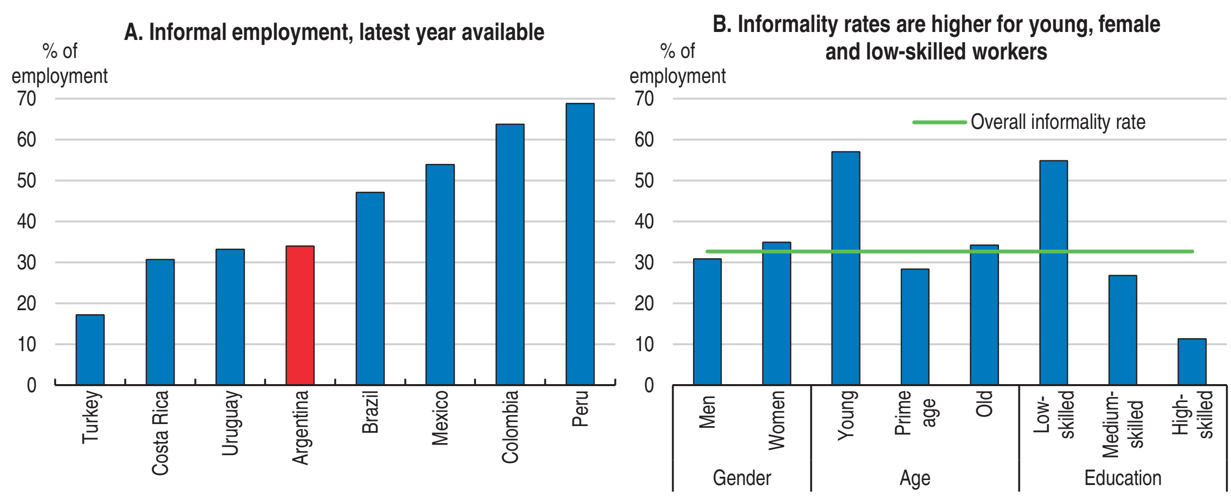
Figure 31. **Informality is high**



Note: A worker is considered informal if not contributing to the pension system. Data refer to 2016.
Source: World Bank; and Ministry of Labour of Argentina Based on INDEC (2016a).

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Tackling informality will require a comprehensive strategy, including a combination of better incentives to be formal and stronger enforcement of existing requirements to declare workers and firms. High social security contributions of 35% are a key impediment to operate in the formal sector. One way to strengthen the incentives for formalisation would be to introduce a progressive schedule for social security contributions and allow – at least temporarily – lower rates for newly formalised jobs for low-paid workers, among which informal labour relations are more frequent. This could benefit the poor and those at risk of falling into poverty. In Colombia, informality declined considerably after non-wage labour cost were lowered in 2012 (OECD 2017). Easier procedures also help: part of Brazil's recent progress in reducing labour informality is related to simplified and less costly procedures for small enterprises to get registered and declare their workers (OECD, 2015b). Reducing labour market rigidities, in particular the cost of adjusting formal employment, would also help to generate more formal sector jobs. This would likely be progressive, given that informal workers have both the lowest salaries and the lowest levels of protection.

Active labour market policies (ALMPs) focused on those individuals who face the strongest challenges on the labour market can help reduce earnings inequality. In many OECD countries, training, employment and counselling services and incentives to small business development have helped to improve the employability of job-seekers in a cost-effective manner (OECD, 2015c). Given that better training also raises the odds of getting a formal job, ALMPs can help to reduce informality and to close existing gender gaps, as women tend to benefit most from them (Bergemann and Van der Berg, 2008).

In Argentina, ALMPs have targeted the disadvantaged, especially women, youth and workers with incomplete secondary education. However, the coverage of these programmes has typically been low. They could be scaled up and expanded as many of those who could benefit the most from such programmes, including informal workers and many jobseekers, are currently not eligible. A stronger focus on women would also be warranted as the entry of women into the labour market has decelerated in the past decade (Gasparini and Marchionni, 2017).

The administration of the ALMP system is fragmented and lacks systematic evaluations to ensure a focus on the most effective programmes and maximise the alignment of training with labour market needs (OECD/ECLAC/CAF, 2016). Encouraging private firms to provide better and more on-the-job training could further contribute to improving the skills of the labour force at low cost.

The potential role of disincentives for cash transactions, as opposed to transactions through banks, could be worth exploring to bring more workers and firms into the formal sector (Rogoff, 2016). Policy options include banning cash for transactions above a certain threshold, as done recently by Spain and Italy, or taxing them more than transactions through banks or electronic platforms. South Korea introduced a tax incentive for electronically traceable payments, which succeeded in reducing cash transactions, increased tax revenues and reduced income inequality (Sung et al., 2017).

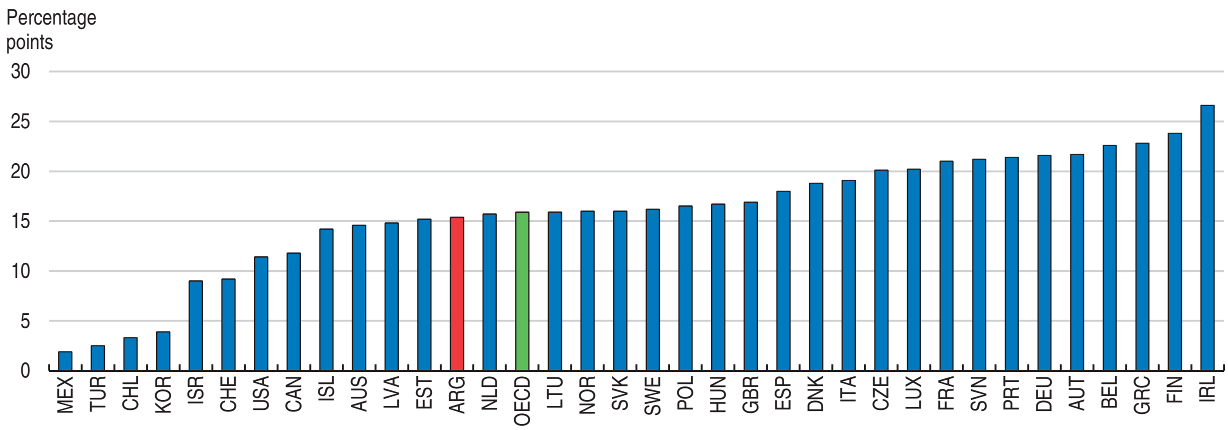
The role of taxes and transfers

Taxes and transfers play a significant role in shaping the income distribution, particularly at the bottom, and both inequality and poverty would be higher without redistribution through taxes and transfers. Argentina achieves a significantly larger reduction of inequality than Chile and Mexico, but less than the majority of OECD countries (Figure 32). Almost 80% of that reduction can be attributed to direct transfers such as family allowances and pensions. Subsidies on transportation, electricity, water and gas, which have already been reduced substantially and are being phased out completely by 2019, give the greatest benefits to the most affluent households as these spend much more on these services (Puig and Salinardi, 2015).

Among transfers, pensions play a significant role in alleviating inequality and poverty. Argentina has an integrated public pension system for both public and private employees, following the seizure of private pension funds in 2008. Given the substantial policy changes and high labour informality, formal contributions to the system fall short of many people's actual work history. Since 2005, a *Social Security Moratorium* has allowed workers with

Figure 32. **Transfers and taxes alleviate inequalities**

Reduction in GINI coefficient through taxes and transfers, latest available year



Source: OECD Income Distribution Database, OECD calculations for Argentina, based on 2016 household data.

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insufficient years of contributions to declare their work history in the informal sector *ex-post* by accepting a 20% penalty, deducted from pension benefits. The programme ended up constituting de facto a non-contributory pension. The new administration institutionalised this situation by creating a universal non-contributory pension (PUAM) for all people aged 65 and above, rather than relying on one-off measures like the moratorium. PUAM benefits are set at 80% of the minimum contributory pension benefit. At present, Argentina's pension system has almost universal coverage from age 65.

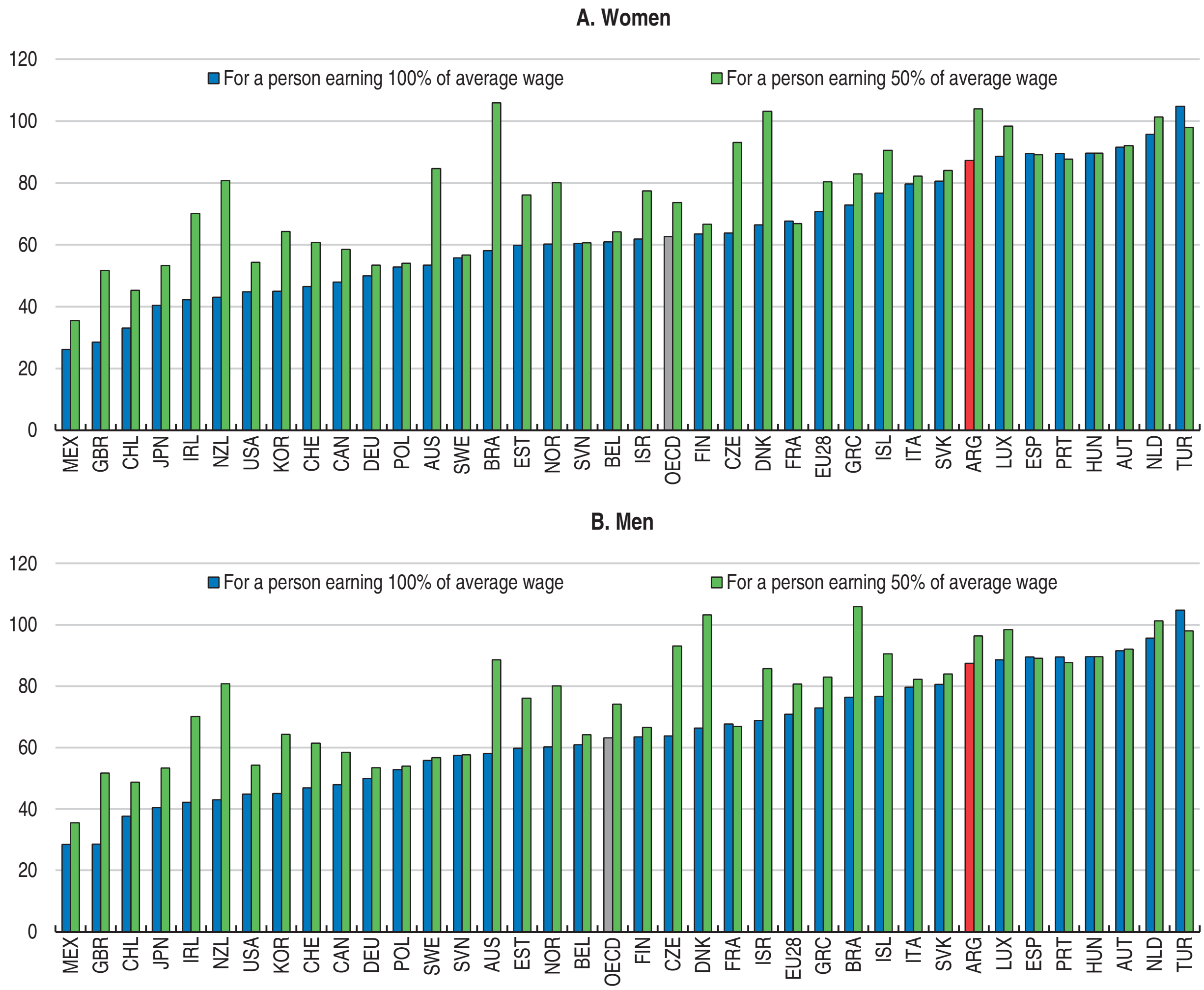
In the contributory system, 70% of beneficiaries get the minimum pension of approximately 80% of the minimum wage, equivalent to 54% of the average wage. Benefits are capped at around 6 times the minimum wage. Replacement rates, which link benefits to the last wage, are about 72% for an average wage, compared to an OECD average of 53%. The effective retirement age is 66 years for men and 63 years for women, which is broadly in line with current practice in OECD countries. Pension expenditures amounted to around 11.3% of GDP in 2015, which is high for a country with Argentina's age profile. They are expected to rise to around 12% of GDP by 2050 (OECD, 2016c).

The pension system, with its combination of contributory and non-contributory elements, contributes significantly to reducing inequality and poverty. Even before the introduction of the PUAM in 2016, the pension system was effective in reducing old-age poverty by around 35 percentage points, to a level of 5% (Rofman and Apella, 2014). Demographic developments will raise long-term sustainability issues for the pension system. Without adjustments, Argentina's pension system is not sustainable.

Pension benefits are comparatively high relative to working age earnings (Figure 33). Adjustments to the highly complex formula by which pension benefits are calculated (called *movilidad*) will be necessary to ensure the sustainability of the system in the longer run, as the current formula effectively passes on all productivity gains of current working generations to retirees (IMF, 2016). Going forward, productivity catch-up should yield substantial real wage increases, which would further raise pension payouts. OECD countries typically adjust pension benefits by consumer prices, wages, or a mixture of the two, but in light of demographic developments and high replacement rates, a prudent choice for Argentina would be to adjust pension benefits by consumer prices, preserving

Figure 33. **Pension benefits are high relative to working-age earnings**

Net pension replacement rates, latest available year



Source: OECD *Pensions at a glance*, 2016.

StatLink http://dx.doi.org/10.1787/888933542061

the real purchasing power of pensioners. Aligning the retirement age of women, currently at 60, with that of men, at 65, would also lead to savings and is in line with current trends among OECD countries. Estimates suggest that a combination of indexing to consumer prices and raising women's retirement age to 65 would be sufficient to close the actuarial deficit of 40% of GDP expected over the next 50 years (IMF, 2016c).

Potential for cost savings without parametric changes to the system as a whole could be found in a set of special pension regimes (*cajas especiales*). These regimes cover pensions for around 10-30% of beneficiaries, including the justice system, some public banks and provincial health services and they accord lower retirement ages and higher benefits. For those beneficiaries of the special regimes that are still sufficiently far away from retirement, the conditions could be brought in line with the general system.

Beyond pensions, social protection in Argentina takes the form of a large number of policies and programmes offered both at national and provincial level by different institutions and Ministries. Integrating and co-ordinating the delivery of these programmes has significant potential to increase the effectiveness of the social protection and efficiency of social spending (World Bank 2015). The creation of shared targeting instruments for multiple programs such as a unique social registry and of one-stop attention centres could make Argentina's social protection system more efficient by avoiding duplicate programmes, lowering administrative costs and simplifying the bureaucracy burden and payments.

Family allowances benefit around two-thirds of children under 18, at a cost of approximately 1.3% of GDP. For formal sector workers, they have traditionally been part of Argentina's social security system. Since 2009, the *Asignación Universal por Hijo* (AUH) has been providing targeted conditional cash transfers to informal workers with children, mimicking the family allowances under the social security system, but with a stronger incidence on the lower deciles of the income distribution. The conditionalities include attending school and regular health check-ups. In 2016, coverage of the AUH, which pays up to 70 USD per child and month, was expanded to reduce remaining gaps in the coverage of family allowances, particularly among independent and seasonal workers. This was a step in the right direction and has also helped to reduce some of the disincentives to formal sector employment that resulted from its previous design. Child poverty, which is almost 80% more frequent than among adults, would be about 13 percentage points higher without family allowances (World Bank, 2015). Building on this progress will require maintaining these family benefits.

Benefits other than old-age pensions or family allowances have traditionally played a minor role in Argentina. Unemployment benefits have a very limited coverage due to stringent eligibility conditions, with only approximately one in ten unemployed persons getting unemployment benefits. Informal sector workers are not covered at all. Flat unemployment benefit levels were raised from around USD 25 to USD 190 per month in 2016 and are paid for up to 12 months, or 18 months for those aged above 45. While unemployment benefits, available only to formal workers, are not reaching the most vulnerable segments of the population, they will become more important going forward to cushion the job turnover that is likely to occur as the economy adapts to the new circumstances. At around one third of the minimum wage, the current benefit level seems low and should be raised to the extent that fiscal space is available.

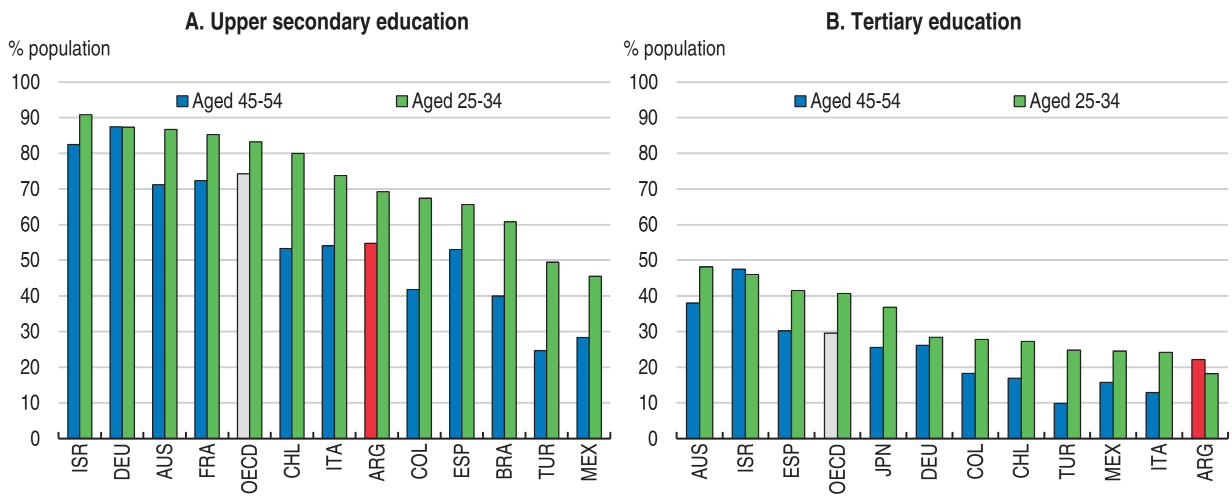
Education policies

Better education is a key vehicle for people to move out of poverty and earn better incomes. Argentina's education system has made substantial progress in improving access, particularly with respect to pre-primary, primary and secondary education. Public financing of education has also improved and education expenditures now amount to 6% of GDP. Nonetheless, important challenges remain especially in quality and attendance. Providing education is the responsibility of provinces, which gives rise to specific challenges concerning co-ordination and enforcement.

Expanding early childhood education could improve the equality of opportunities, as it allows children from disadvantaged backgrounds that are at risk of receiving less attention than others during their early childhood years to "catch up", at least partly, with their peers (IDB, 2015). In Argentina, 2016 household surveys suggest that 73% of children aged 3 to 5 were enrolled (INDEC, 2016b), compared to 86% in OECD countries and almost universal coverage in several OECD countries, including Mexico (OECD, 2017a). Recent policy plans aim at expanding the coverage of early childhood education. Secondary-school performance can improve by the equivalent of almost a full school year among those who had pre-primary education (OECD/CAF/ECLAC, 2014). Evidence from the United States suggests that the marginal returns on spending are higher than in any other segment of the education system. Boosting early education would offer a double dividend, as it would also facilitate greater female participation in the labour market.

Educational attainment is low in international comparison and has improved less than in other countries, including in the region (Figure 34). Half of students enrolling for an upper secondary degree leave school without finishing the degree, which calls for better mechanisms to identify and support students at risk of dropping out through individualised support. With respect to tertiary education, Argentina is not only far behind other countries, but has actually failed to make progress as the cohort aged 45-54 today has a higher share of tertiary graduates than those aged 25-34. Less than two fifths of Argentinians of age 25-34 have received some education at college, university or a higher level technical school, and only one fifth have obtained a tertiary degree. The authorities are currently designing strategies to reduce drop-out rates, including through more flexible school trajectories.

Figure 34. **Educational attainment is low and has not improved much**



Source: OECD, *Education at a Glance 2015: OECD Indicators*. INDEC (2016e) for Argentina.

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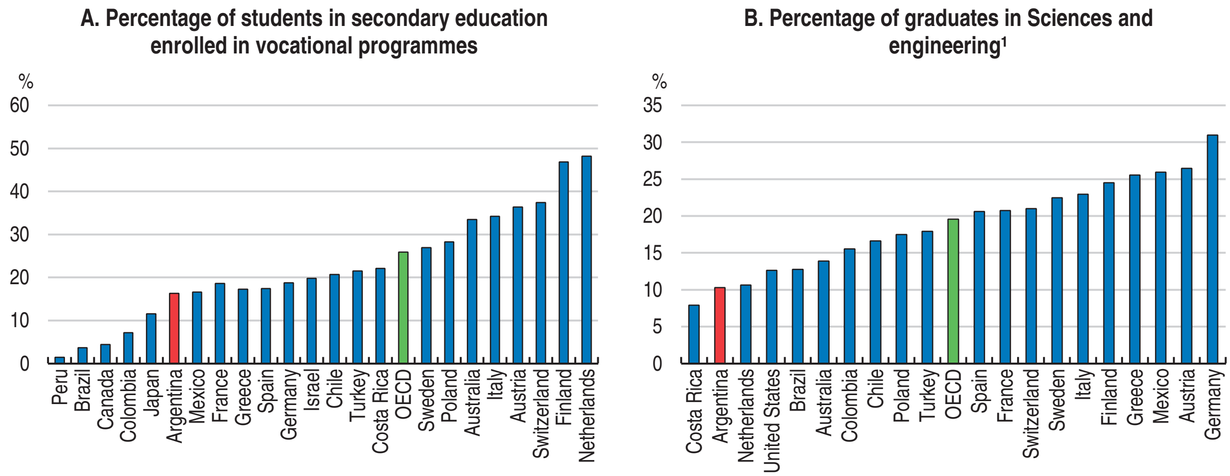
Besides lost opportunities for workers, this also generates shortages for some skills, especially for technicians, skilled trades and engineers (INET, 2016). Vocational education and training, which is attended by fewer students than in other countries, could be expanded (Figure 35, Panel A). This would also improve equity as it could provide labour-market relevant training opportunities to less academically-inclined students who are at risk of dropping out of the school system. International experience with workplace training and the engagement of employers in the design and delivery of the training has been promising. Giving employers a more central role, both in the design of courses and in the delivery of workplace training, would be a useful strategy. Tertiary education is also biased towards social science and humanities, producing few graduates in science, technology, engineering or mathematics (Figure 35, Panel B).

Secondary education graduates could also be better prepared for the transition into adult life as they leave school with lower skills than in other countries (Figure 36). Results from the OECD PISA study are only available for the capital city of Buenos Aires, and results

Figure 35. **Few students follow technical courses and careers**

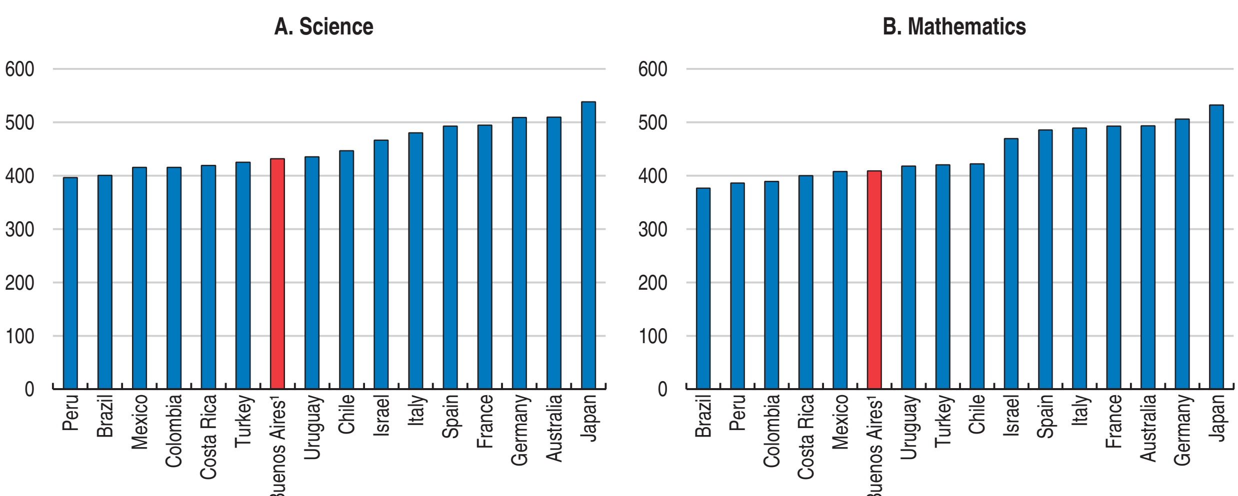


1. This includes all the tertiary graduates in the fields of Engineering, Manufacturing, Construction, Natural Sciences, Mathematics and Statistics. Data refer to the latest available year.

Source: World Bank World Development Indicators database; OECD Education at a Glance database; and UNESCO Education database.

StatLink http://dx.doi.org/10.1787/888933542099

Figure 36. **Learning outcomes show room for improvement even in the capital of Buenos Aires**



1. Data for Argentina refer to capital city of Buenos Aires only due to methodological shortcomings in the way the underlying tests were conducted in other provinces. They may therefore overestimate the national average.

Source: OECD, PISA 2015 Database.

StatLink http://dx.doi.org/10.1787/888933542118

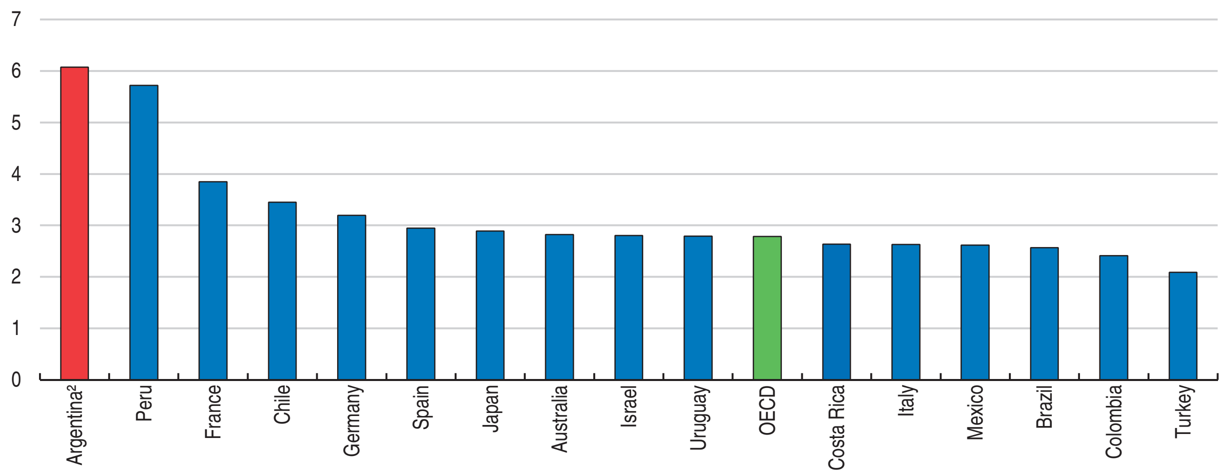
in major urban centres generally tend to be above the national average. Two-thirds of 15 year old students in the city of Buenos Aires do not have basic-level proficiency in reading, mathematics and science facing significant disadvantages in their transition into higher education and the labour force (OECD, 2016f).

Student performance depends strongly on family background (OECD/CAF/ECLAC, 2014). The socio-economic status of the student and the school can explain 27% of the performance variation in Argentina in PISA 2012 and 25% of the performance variation in the capital city of Buenos Aires in PISA 2015. Students from weak socio-economic background are more than 6 times more likely to have low educational attainment in science, relative to other students

(Figure 37). Empirical evidence from Argentina suggests that more instruction time can also improve learning outcomes, especially for disadvantaged students (Avendano et al., 2016). On average, high-performing students in mathematics have on average enjoyed more than one additional hour of mathematics classes per week than their low performing peers. Argentina also stands out for its gender performance gap. At present, the education system actually exacerbates inequalities rather than alleviating them (Figure 37).

Figure 37. **Student performance is strongly linked to socio-economic background**

Increased likelihood of socio-economically disadvantaged students to attain a low PISA science score[1]



1. A socio-economically disadvantaged student is a student in the bottom quarter of the distribution of the PISA index of economic, social and cultural status (ESCS) within his or her each country/economy.A low PISA score is defined as scoring below Level 2 in science.
2. For Argentina, data refer to the city of Buenos Aires only.

Source: OECD, PISA 2015 Database.

StatLink http://dx.doi.org/10.1787/888933542137

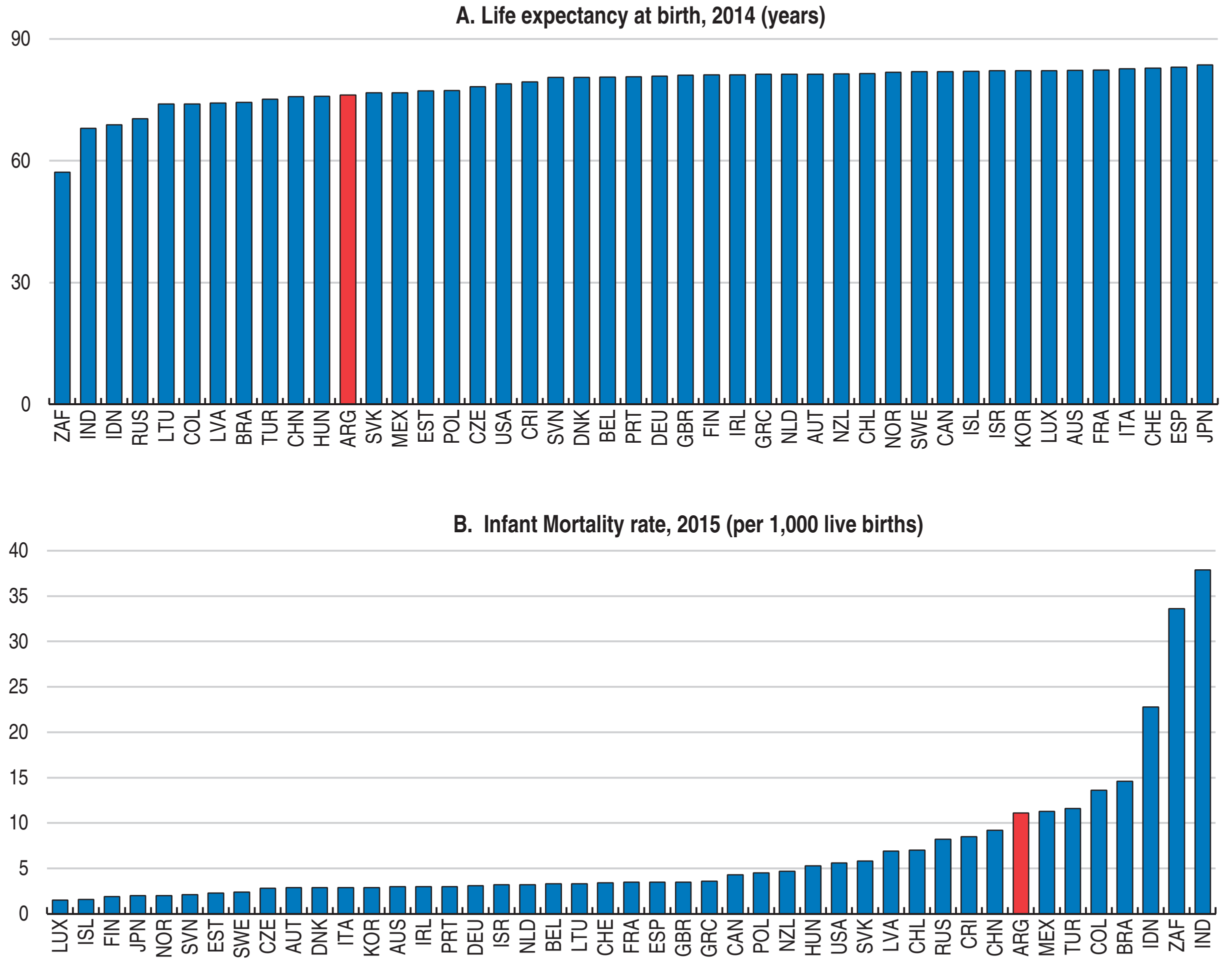
Improving teacher quality through better teacher training is a key challenge (World Bank, 2015). Argentina has 1296 teacher training institutions, with a generalised lack of quality standards and evaluations. Part of these are administered by teachers' unions and suffer from weak governance, insufficient accounting requirements and low transparency in the use of public funds. Separating the representation of workers interests from the administration of training institutions would reduce conflicts of interest and allow a more professional management of these institutions, including a better use of scale economies. Plans to improve teacher training are currently underway.

Health policies

Health outcomes could be improved further. With a life expectancy at birth of 76 years, Argentina is in the middle of the range of Latin American countries, above Colombia and Brazil, but below Mexico, Costa Rica and in particular Chile, where life expectancy is 5 years higher than in Argentina (Figure 38). Infant mortality is also lower than in other countries in the region, but almost 60% higher than in Chile and significantly above most OECD countries.

Argentina provides universal health care to its population, with provincial governments responsible for the delivery of healthcare services, and health outcomes are characterised by significant regional disparities. For example, infant mortality in the provinces of Corrientes and Formosa is almost twice as high as in city of Buenos Aires, while maternal

Figure 38. **Health outcomes can be improved**



Source: OECD Health Statistics 2016.

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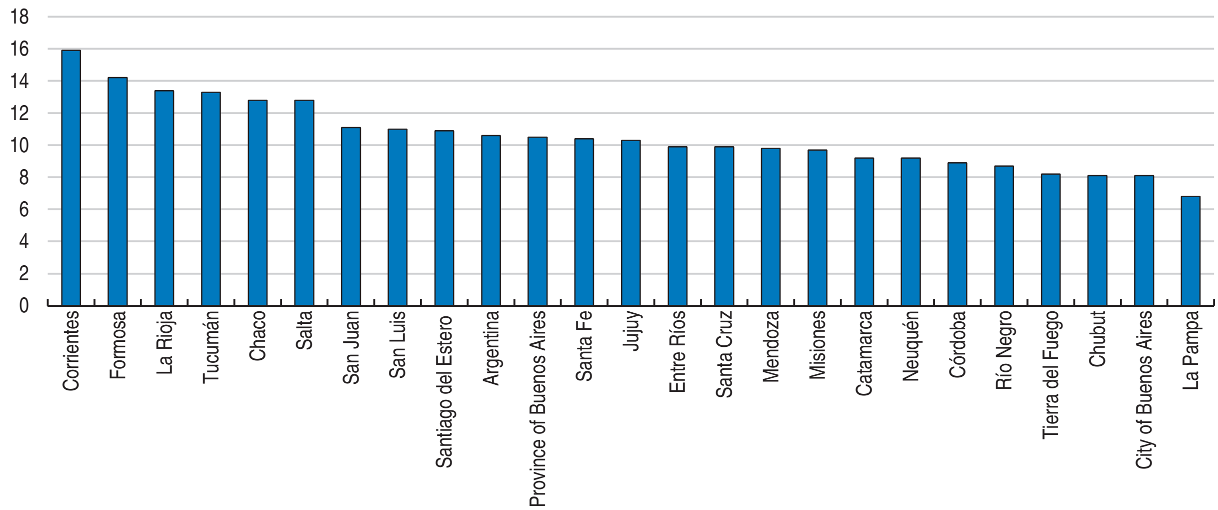
mortality in City of Buenos Aires is half the national average (Figure 39; INDEC, 2016a). Rising formal employment has improved health insurance coverage from 52% in 2001 to 64% in 2010, but informality, and correspondingly health insurance coverage, vary significantly across regions, as does the quality of healthcare. People face long waiting times and out of pocket spending is high, giving rise to inequities in access and quality of treatment (Ballesteros, 2014).

Modernising the health system is key to improve quality, preserve universal access and reduce regional disparities. The system's performance is hampered by excessive fragmentation, including public hospitals, private insurance schemes and union-administered sector-specific health insurance schemes financed through mandatory social security contributions (*obras sociales*). The more than 300 *obras sociales* cover all formal workers and their families and account for 55% of spending, while public hospitals primarily focus on the poor and uninsured population. Many *obras sociales* lack scale, suffer from weak governance mechanisms, a lack of accountability and poor incentives due to soft budget constraints and regular government bailouts. Most of them are not providers of healthcare services but operate through contracts with private providers, although some of

Figure 39. **Infant mortality shows significant regional disparities**

Deaths of children below one year of age per 1 000 live births, 2014



Source: Ministerio de Salud de la Nación. Dirección de Estadísticas e Información de Salud (DEIS), 2015.

StatLink http://dx.doi.org/10.1787/888933542175

them have frequently failed to cover services that are meant to be covered. Merging these schemes and professionalising their management bears the potential for significant cost savings and better health services.

Argentina will also need to prepare better for the aging of the population, which will change the profile of diseases and increase demand for healthcare services. Chronic conditions, which disproportionally affect the vulnerable population, will become more prevalent. Expanding basic health coverage would allow a better prevention of such diseases, thus reducing the number of those dropping out of the labour market for health reasons and reducing the future growth in public healthcare expenditures (World Bank, 2015). OECD countries are also putting a stronger emphasis on formal home care services as a preferable and less costly alternative to long hospital stays, a strategy that would be beneficial also in Argentina.

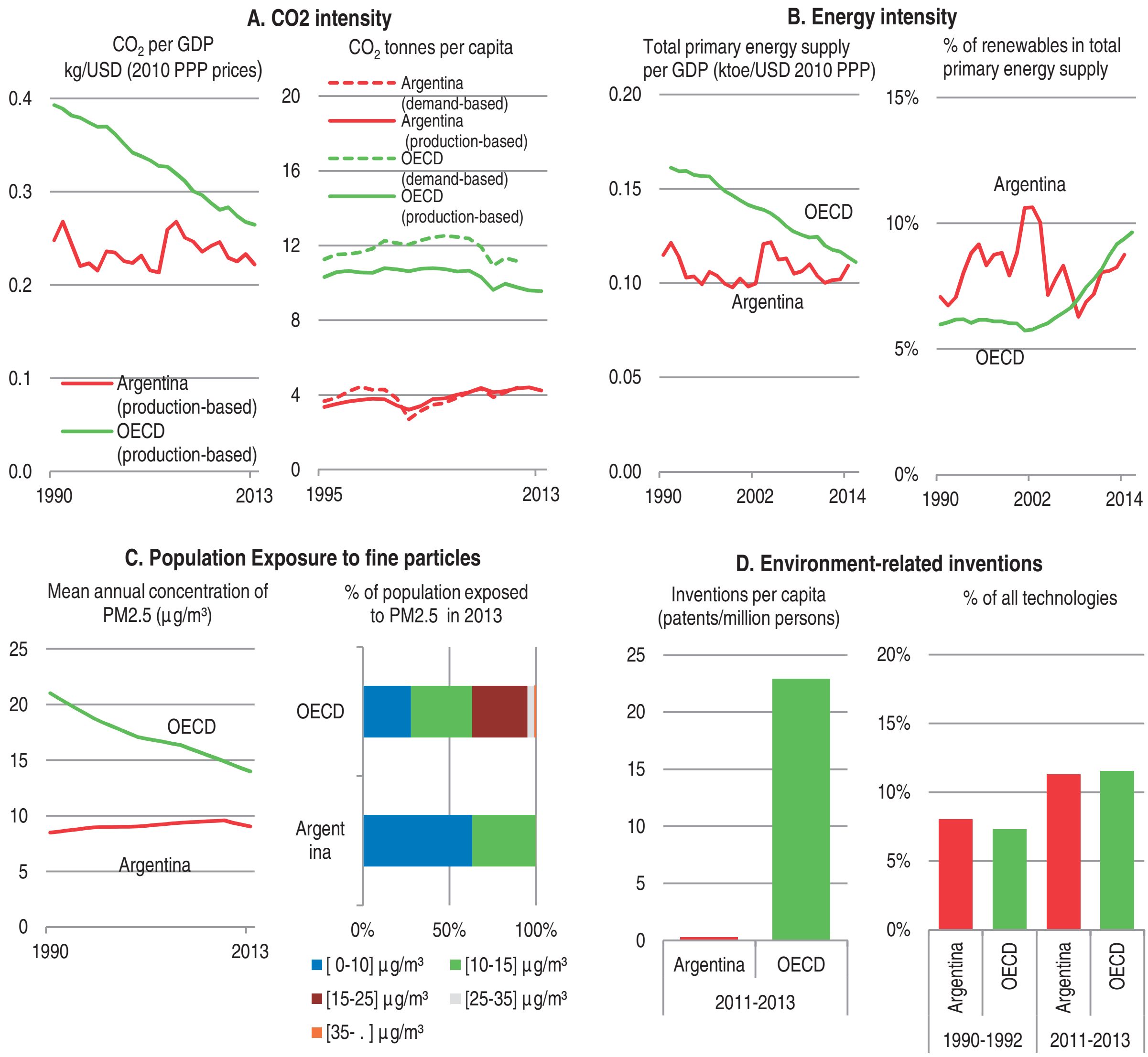
Green growth challenges

Argentina has committed to reducing greenhouse gases (GHG) emissions in 2030 to at least 37% below the level predicted under a business-as-usual scenario, including emissions due to land use, land-use change and forestry (LULUCF) (Figure 40, which based on IEA data, and exclude LULUCF). Under current projections this implies an 18% increase compared with 2005, 8% above the 2012 level. Nearly half current GHG emissions are due to energy and transport, with about a quarter due LULUCF, largely due to deforestation.

The CO_2 intensity (excluding LULUCF) has not fallen in recent years, contrary to OECD countries. Still, lower incomes in Argentina mean that per capita emissions are still well below OECD levels. Meeting emission targets will require phasing out energy subsidies, as planned, but also putting an end to deforestation, which is also reducing biodiversity. Although most recent expansion in soybean agriculture has relied on available agricultural land, there are aggressive targets to expand the agricultural area to increase soybean, wheat and sunflower seed production for export (WWF, 2017).

Renewable energy has been slow to expand in Argentina. Recent measures to encourage it by guaranteeing a foreign-currency fixed price will probably stimulate investment but are

Figure 40. **Green growth indicators**



Source: OECD (2017), *Green Growth Indicators*, OECD Environment Statistics database; OECD National Accounts (database); IEA (2017), IEA World Energy Statistics and Balances database; OECD (2017) National Accounts database; OECD (2017), Exposure to air pollution, OECD Environment Statistics database; OECD (2017), Patents : Technology development, OECD Environment Statistics database.

StatLink http://dx.doi.org/10.1787/888933542194

likely to lead to high costs in the longer term; countries like Italy or the United Kingdom who experimented with guaranteed feed-in-tariffs have withdrawn them because of this. If subsidies are required, an effective alternative is to use reverse auctions to find investors willing to install capacity with the least support rather than offering a fixed price.

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ANNEX 1

Rehabilitating Argentina's official statistics and statistical system

Troubled recent history of Argentinian statistics

Argentina's statistics deteriorated over the period 2007-15, as political pressures grew to adopt methods that would lead to the publication of "positive" data about the state of Argentina's economy and society. As a result, trade figures showed artificial surpluses, inflation was underestimated, GDP growth was exaggerated, and poverty levels were minimised. At the same time, the number and quality of underlying censuses, surveys and procedures declined.

In July 2011, the IMF found Argentina in breach of its minimum reporting requirements as an IMF member, on account of its inaccurate provision of CPI and GDP data. When this was not remedied, the IMF Executive Board issued a Statement of Concern in 2012 and a Declaration of Censure in 2013. By the time the new government entered office in December 2015, Argentina's statistics had lost credibility both domestically and internationally. The new President declared a state of administrative emergency in the National Statistical System (NSS) on 7 January 2016, allowing the new Director of the national statistical institute, INDEC, to reorganise the agency.

INDEC suspended regular publication of statistics for several months while reforms were under way, but since May 2016 new and more reliable data on inflation, GDP and trade have progressively come on stream. The IMF Executive Board lifted its Declaration of Censure and Statement of Concern on 9 November 2016.

OECD assistance to reform efforts

In a letter to the OECD Secretary-General on 30 June 2016, Argentina's Minister of Treasury and Public Finance expressed his country's willingness to adhere to the Recommendation of the OECD Council on Good Statistical Practice adopted in November 2015. This document sets out twelve specific recommendations for establishing a sound statistical system, and gives examples of good practice based on OECD countries' experiences.

The Committee on Statistics and Statistical Policy (CSSP) responded to Argentina's request by agreeing to a preliminary review to allow it to form a judgement whether Argentina is fully committed to putting in place a sound statistical system, in line with the Council Recommendation. Argentina agreed to this review, and asked the OECD to pay particular attention to the following aspects of its statistics:

- Legal and institutional framework for official statistics (LIF)

- National accounts (including public sector debt)
- Consumer price indices
- International Trade in Goods

At the time of writing the preliminary review is in the final stages of preparation before being submitted to the CSSP at its June 2017 meeting.

Recent progress is encouraging

The Argentinian authorities are moving rapidly to consolidate progress in re-establishing a sound national statistical system that can produce statistics free from political interference and distortion. The legal framework is being re-examined with a view to updating and consolidating the relevant laws and decrees and ensuring that the national statistical agency INDEC enjoys independence and functional autonomy. At the time of writing, the details and timing of these actions were still being decided. Among possible improvements are measures designed to reinforce INDEC's authority to decide on statistical methods and dissemination, and to protect its Director and staff from political interference in the exercise of their professional responsibilities. INDEC may also need greater freedom to control its financial, human and technical resources, and its presence in Argentina's regions may have to be reinforced.

INDEC has made significant progress since the beginning of 2016 on national accounts data, though gaps remain because of the lack of recent reliable censuses, an incomplete business register and the absence of a recent household expenditure survey. The single biggest gap is the absence of sector accounts, and there is an over-reliance on the production side of the accounts for estimating real GDP on the basis of industry-level quantity indexes. An improved coverage of public sector enterprises will be needed to develop comprehensive public sector debt statistics, and discussions may be necessary with provinces and municipalities to achieve speeder provision of sub-national debt data.

Argentina has also made rapid progress towards meeting international methodological standards and OECD requirements for CPI data. However, means to improve the length of the CPI series and revise weights and the treatment of owner-occupied housing will need to be considered further. Figures on international trade in goods are improving as INDEC works to improve seasonally adjusted trade balance statistics and analyse bilateral trade statistics with countries in and outside MERCOSUR.

Latest developments and outlook

The state of administrative emergency in statistics terminated at the end of 2016, and was not renewed. New statistical legislation may be presented to Congress in late 2017, but issues with the large number of temporary staff at INDEC may need to be regularised beforehand. A 2015 decree provided for an Honorary Consultative Council to be appointed by the Director of INDEC to assist him in his work, and now that the emergency decree has been allowed to expire, he may proceed to appoint this body.

At the OECD, Argentina has been invited by the CSSP to attend its meetings and those of its working parties as an invitee. If at its June 2017 meeting the CSSP expresses a positive opinion on Argentina's adherence to the Council Recommendation on the basis of the preliminary assessment, then a full review of Argentina's statistical system, in line with the well-established model used in the context of accession to the OECD, may be carried out.

Chapter 1

Structural reforms to boost growth and living standards in Argentina

Over the last decades Argentina's living standards have lost ground relative to other developed and emerging economies. Putting Argentina on a path to stronger, inclusive and job-rich growth requires boosting productivity and strengthening investment through wide-ranging structural reforms. Areas that require reforms include the regulation of product and labour markets, taxes, infrastructure, skills, innovation, trade policy, rule of law and financial markets. Beyond changing the rules, implementation and restoring institutional capacity are equally important. Enhancing competition, for which implementation and institutions are particularly relevant, would stimulate private investment, facilitating the creation of new firms and jobs, and would bring benefits to consumers through lower prices. Finding the right packaging and sequencing of reforms is important to exploit synergies across different areas, to manage trade-offs and to protect the vulnerable from the costs of adjustment. In this context, improving active labour market policies and training can support workers in acquiring new skills and in getting ready for new jobs, improving their capacity to adjust to a changing economy.

Chapter 2

Making growth more inclusive in Argentina

Commodity-led growth and strengthened social policies reversed the sharp increase in poverty that took place in the aftermath of the 2001 economic crisis. Well-being and living conditions further improved during the first decade of the millennium. However, between 2011 and 2015, increasingly inconsistent economic policies led to zero growth and threatened gains in well-being as well as additional reductions in poverty and inequality. Poverty still affects one-third of the population and eliminating it remains the priority. Besides that, one out of five Argentinians have moved out of poverty but were unable to join the middle class. This emerging socio-economic group faces substantial vulnerabilities, such as low labour income, insufficient skills, informal employment and poor access to quality public services, which put them at risk of falling into poverty. The situation requires embarking on a second generation of social policies that combine long-term poverty alleviation programmes with further support for these citizens to sustain poverty reduction over time and develop human capital. This chapter discusses a comprehensive policy package that would rebuild the social contract in Argentina. This includes improving the efficiency, targeting and progressivity of transfers and taxes, strengthening public services across regions, increasing education quality and providing incentives to promote better quality jobs, particularly by lowering labour costs, to protect the vulnerable and contribute to sustainable inclusive growth.

This Survey was prepared by Jens Arnold and Alberto González Pandiella of the OECD Economics Department and by Paula Cerutti, Angel Melguizo and Sebastián Nieto Parra of the OECD Development Centre, under the supervision of Piritta Sorsa and Federico Bonaglia. Statistical research assistance was provided by Anne Legendre and Hermes Morgavi with general administrative assistance provided by Mercedes Burgos and Raquel Páramo.

Further information

For further information regarding this overview, please contact:

Jens Arnold, e-mail: jens.arnold@oecd.org
tel.: +33 1 45 24 87 22
Alberto González Pandiella, e-mail: alberto.gonzalezpandiella@oecd.org
tel.: +33 1 45 86 77
Sebastián Nieto-Parra, e-mail: sebastian.nietoparra@oecd.org
tel.: +33 1 45 24 18 20
Paula Cerutti, e-mail: paula.cerutti@oecd.org
tel.: +33 1 45 24 93 36
Angel Melguizo, e-mail: angel.melguizo@oecd.org
tel.: +33 1 45 24 84 84

See also: http://oe.cd/20d

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