Statement by Balmiki Prasad Singh  
Date of Meeting: July 19, 2001

**Argentina: 1. Country Assistance Strategy Progress Report; and 2. Provincial Reform Adjustment Loan**

We welcome the discussion on the Argentina CAS Progress Report which has come at a time when the world is watching how the ongoing crisis will be tackled by the country, and how will its external development partners would react. The developments of the last 48 hours has been quite encouraging, though it is a little early to say that recovery is on the way. We have seen a number of promising developments over the past few months that did not turn out the way they should have.

In fact, the prevailing mood and situation look far worse than the macro fundamentals would suggest. The fiscal deficit is a little over 2.3% of the GDP, there is a primary surplus, the total domestic debt is under 45% of the GDP, inflation is under control and the export growth last year was robust. Other than last year when the economy shrank, throughout the nineties, annual growth was around 4.8%. The real problem has arisen from the very success of the Stabilization Plan, which in an era of the strong dollar has hit the country twice over. It has kept interest rates high and precluded the option of either a gradual easing of interest rates to stimulate the economy or of depreciation of the currency to increase domestic competitiveness. Therefore servicing the debt is a problem and a sustained export performance, key to this, seems hard to realize. We had referred to this when we discussed the Cordoba program last November – the situation has only deteriorated since then.

The Government has undertaken some very bold, and even risky, measures over the past few months, like the mega-swap of short-term debts to relieve the pressure on repayment, lowered tax rates to stimulate consumption and now switching over to the cash system of budget effectively limiting expenditure to actual receipts. Additionally, there is the roll-back on salaries and on pensions over $300 per month and other steps to curtail expenditure, which if sustained would reduce the fiscal deficit to zero. It is significant that this plan has been backed by the 14 Governors belonging to the opposition – the capital market responded very favorably to this development and even spreads have tightened by 150 basis points, a point highlighted in the CAS Update of 18th July.
Despite this bit of good news, we feel that there are still some lingering doubts and concerns about the short-to-mid term prospects.

One, is the issue of burden sharing. We saw an attempted fiscal stimulus a couple of months ago when tax rates were lowered. Now we see a cut in salaries and pensions. It must be noted that 50% of the pensioners would be affected by this roll-back in pensions over $300. What would be the impact on them specifically?

Two, what would be the impact of this budget-squeeze, particularly of the cash system, on social sector expenditure? We must recognize that poverty rates have gone up over the last few years, per capital income is stagnant since the mid-nineties and income inequality has increased. These contractionary steps have long-term consequences not only for exacerbated social inequality but for competitiveness of the economy.

Three, the 150 basis point reduction in spreads must be seen in the context of spreads which had widened to 1600 basis points over the last few months. Obviously, foreign and domestic debtors are gaining at the expense of the poor, and the middle class of Argentina. Is there not a moral hazard in continuing to service such high spreads? This issue will have to be addressed soon and debtors would have to lend their support in less expensive ways.

Fourthly, what is the likelihood of political consensus surviving since important elections are coming up in October. The reforms proposed last were far less drastic, still they were not acceptable. What are the chances of the present one becoming unstuck?

**Provincial Reform Adjustment Loan** We welcome this adjustment operation in the province of Santa Fe. The province has demonstrated a capacity to deal with its development challenges boldly. Equity enhancement is both a social and economic challenge, particularly at a time of economic downturn. The commitment to reforms has been demonstrated with the adoption of the privatization program including banks and infrastructure providers. At the same time, the really poor, particularly the female-headed households need special programs which have been drawn up. We believe that Bank’s involvement would add value to the overall reform program, and also encourage other provinces to follow on the lines of Santa Fe and Cordoba. Political consensus and backing is very critical to the reform process and this multi-tranche operation would help in the process.

**Conclusion**

Argentina’s performance and its ability to weather the crises that has constrained
its development for the last year or so, will have an impact far beyond its borders. It has one of the largest share of emerging market foreign debts and its capacity to service these loans will determine the cost and availability of money for other emerging economies. The World Bank and the Inter American Bank will have to continue to work with the federal and the state governments to see that the domestic financial sector is deepened, social sector spending is protected and the country is able to move on to a sustained growth path. We are encouraged by and supportive of the Bank's willingness to be flexible in its approach to working with the country as indicated in the CAS Progress report. We look forward to the proposed PSAL in FY 02 and other possible operations that would tackle the poverty angle directly.