Argentina: Country Assistance Strategy

1. Argentina’s performance has been remarkable, but the risks remain high. In recent years the Government of Argentina has achieved remarkable results in preserving exchange rate and price stability in the wake of the international financial crisis of 1997 and 1998. However, this CAS document shows a sharp deterioration of exposure indicators. In only two years, the debt to GDP ratio has increased from 41.8 to 49.4 in 1999. Debt service to exports, which was already at a very high level of 64.2 per cent in 1997, will reach an exceptionally high level of 90.7 per cent in 2001. Hence, the resolve of the government not to devalue has not yet led to a substantial reduction of long term rates, whose spreads over major sovereign bond rates are still close to 600 basis points, a level almost twice as high as the pre crisis one.

2. We broadly agree with the policy prescriptions presented in the CAS… Argentina is now confronted with the difficult task of strengthening its macroeconomic adjustment efforts while at the same time limiting any further deterioration of social conditions. We agree that, in order to reduce the country risks perceptions and the vulnerability to shocks, the first and foremost priority is a reduction of the public sector deficit, both at the federal and provincial levels. This is necessary to stabilize the debt, reduce the crowding out of the private sector, and promote higher domestic savings. However, higher growth rates also require higher productivity, an acceleration of investments and greater labor market flexibility, even though it has to be acknowledged, as the document points out in the interesting Appendix A, that unit labor costs have already been substantially reduced. To achieve better social conditions it is also important to strengthen institutional reforms in areas such as health and education, as well as a renewed effort by the government to address governance and distributional issues.

3. Though we would have appreciated a more extensive treatment of trade issues. Obviously an acceleration of export is another essential condition for improvement of exposure
indicators. Therefore, I think that a more extensive analysis could have been presented of the initiatives to be undertaken in order to improve market access and to promote regional as well as global integration. I would appreciate if Management could present its views on this issue, and especially on the perspectives of extensions of regional arrangements within Mercosur.

4. We broadly endorse the Bank program. We agree on the emphasis placed on the program of provincial reform loans envisaged for 2001. Orderly provincial finances are essential if fiscal balance is to be achieved. On social protection, health and education, we wonder whether there is any room for accelerating the present program. We wonder, for instance, whether the Urban Poverty project, presently scheduled for 2003, could be anticipated, given the gravity of the situation of the poor in urban areas. I would also appreciate to hear a comment on recent Government initiatives to limit the growth of the informal sector and the role that the Bank intends to play in this important policy area.

5. Could be done by the Bank Group to develop and diversify the financial sector? Greater reliance on domestic capital markets by the Government and the private sector should be encouraged. What is the status of the Government bond market? Is the Bank involved in reforming it? On the reasons why the private credit market is not sufficiently developed, we are not convinced, as B.P. Singh, that the only explanation is the crowding out by the public sector. We believe that financial deepening could be promoted by increasing diversification of financial intermediation, introducing effective collateral laws, reforming capital markets, accelerating the transformation process of Banco Nacion. To what extent is the Bank active in this area?

6. Especially to support small and medium enterprises. The insufficient development of the financial sector has curtailed the growth potential of medium and small enterprises. Only large firms, with access to international capital markets, have been able to substantially improve productivity and lead private sector growth (annex A, page 2). To correct this imbalance the Bank group could play an important role, especially through the newly created unit on SMEs. IFC could promote the development of new intermediaries and new products that are particularly helpful for SMEs such as leasing and micro-credit arrangements (though careful attention should be given to possible adverse impact on the propensity to save).

7. On the triggers to higher case scenarios. As a concluding remark we would like to raise the issue whether the overall size of the program is appropriate. Certainly, the high level of debt and of the income per capita of Argentina appears to justify a progressive scaling down of the lending program. At the same time we note that the IMF has recently more than doubled its credit facility. The Bank itself indicates that it stands ready to increase the program in case of a crisis. One wonders whether it wouldn’t be more appropriate not to wait for a crisis and introduce the option of a scaled up scenario, subject to very explicit conditions on a further improvement of the Bank's portfolio performance -already rated by OED as one of the best Bank-wide - and major accomplishments in fiscal performance and in social and structural programs. I think the program would benefit by an explicit consideration of broader conditions. Should they be fulfilled, as it could be the case with a renewed Government’s commitment to reforms, market perceptions of country risks could greatly improve, with a clear signal of the Bank’s willingness to increase its lending program to Argentina. This could contribute to setting
in motion a virtuous circle of lower interest rates, higher investment and exports, and further improvements in exposure indicators.