

# Development Challenges in Argentina

Gabriel Sánchez

## Medium-Term Economic and Social Trends

**Argentina faces the challenge of increasing both short- and long-term growth.** Argentina's GDP per capita fell 6.2% between 2011 and 2016, recovering by 1.3% in 2017. GDP per capita growth is projected at 1.9% for 2018. Historically, the country has suffered from large GDP collapses associated with external shocks and macroeconomic imbalances. Total factor productivity and capital per worker have displayed sluggish performance over time, with average annual growth rates of 0.1% and 0.3%, respectively, between 1975 and 2014. During the last decade, the average investment rate has been systematically lower than that of fast-growing economies in East Asia, such as China and South Korea, and that of some Latin American countries like Chile and Mexico.

**Despite macroeconomic turbulence, there has been significant social progress over the last years.** In the second half of 2017, poverty affected 25.7% of Argentines, lower than the 40.6% registered in 2006. The Gini index decreased from 0.529 in 2003 to 0.415 in 2015.

## Medium-Term Economic and Social Outlook

**Economic growth is expected to rise in the medium-term with inflation and the fiscal deficit gradually decreasing.** In 2018 economic growth is expected to weaken to 2.5% from 2.8% in 2017, due to fiscal and monetary constraints, but is then expected to increase to 3.2% by 2022, according to IMF estimates. The federal primary fiscal deficit is projected to decline by 2% of GDP by 2019 and to remain broadly stable afterwards. This would contribute to reducing pressures on the real exchange rate and current account deficit. While a high real interest rate will curb growth, it would help to contain inflation expectations and bring the inflation rate to single digits after 2020. After falling in 2016, real wages are expected to recover, strengthening consumption in the following years. Investment is also expected to accelerate, although the strength of the real exchange rate could slow its pace. Argentina's growth prospects will also benefit from the pick-up in global growth and trade as well as from the increase in international commodities prices. However, medium- and long-term growth rates will also depend on the much-needed progress of a set of structural reforms.

## Risk Factors

**The main risks to the outlook are related to external factors.** A reversal of favorable international financial conditions could generate pressure on sovereign financing costs and the exchange rate, threatening debt and external sustainability. In particular, the pace of interest rate hikes in the United States and/or monetary policymaking in the Euro Zone could pose challenges.

## Development Challenges

The main structural challenges for long-run growth and sustainable development are related to deficiencies in human capital and skills, shortcomings in the business environment, limited technological innovation and integration, and regional income and sectoral development gaps.

**Among the most significant constraints on economic growth are deficiencies in the quantity and quality of human capital.** The country has deficits in the quality of education, in workforce training, in managerial practices, and in labor market institutions, as well as health issues (e.g., a relatively high incidence of chronic non-communicable diseases). These deficits lead to employability problems, which result from a mismatch between the job skills of workers and the requirements of businesses. According to the 2014 World Enterprise Survey, Argentina is one of the countries with the highest percentage of businesses (56.6%) that identify an inadequately educated labor force as a major constraint on their activities. These problems create eventually a perverse cycle of low labor productivity, and poverty and inequality.

**Bottlenecks in the business environment and microeconomic efficiency also hinder productivity and investment.** The country is in 117<sup>th</sup> place in the World Bank's *Doing Business* ranking, below its expected position based on per capita income. The bottlenecks are mainly compounded by deficits in transportation and energy infrastructure, as well as insufficient levels of domestic and external savings and financial intermediation. Moreover, Argentina exhibits inefficient management of public policies and low institutional quality, adversely impacting productivity and investment.<sup>1</sup> According to the World Economic Forum (2017), Argentina is ranked 113<sup>th</sup> out of 137 countries in terms of institutions quality. Historical macroeconomic instability also affects the overall business environment and appetite for investment, which puts a premium on the consolidation of robust and credible monetary policy frameworks.

**Unsatisfactory levels of integration are one of the factors limiting the available technology frontiers and diminishing incentives to innovate in Argentina.** Argentina's export diversification and participation in global value chains (GVC) is relatively low. According to the Inter-American Development Bank INTrade database, Argentina's top five export markets represent 40% of total exports, and nearly 70% of Argentina's exports are concentrated in resource-intensive goods. Manufacturing export performance has been lackluster, reflecting competitiveness bottlenecks which limit diversification, sophistication, and knowledge transfer. Nevertheless, there is scope for improving integration, particularly with advanced economies, to enhance participation in global and regional value chains while increasing the degree of complexity and technological content of goods and services produced in the country, especially in sectors such as agribusiness, knowledge-based services, and biotechnology.

**Regional disparities within the country pose an important development challenge.** While at the aggregate level many social indicators do not show significant gaps in comparison to relevant norms, this is not the case for all regions. Particularly, the region of Norte Grande presents significant gaps in most economic and social sectors. Other regions exhibit gaps in specific sectors, such as poverty, water and sanitation, and health in the Greater Buenos Aires area, and financial markets, institutions and citizen security in Cuyo.

---

<sup>1</sup> For example, distortionary and discretionary taxes and regulations, contractual insecurity, delays in the justice system and in bureaucratic procedures, and impact of insecurity on companies' costs.

## Conclusion

**The country faces a combined challenge of pursuing structural reforms to boost growth and sustainable social progress while maintaining fiscal and monetary stability.** Argentina's lackluster medium term growth performance is associated to both low investment and low productivity growth, which in turn are explained by: a) high cost of finance associated to low access to domestic and foreign savings and low financial intermediation, b) physical and digital infrastructure deficits that hinder competitiveness, c) human capital inadequacies in the form of low educational quality, poor managerial practices and insufficient human capital for innovation and structural change toward more sophisticated activities, d) government failures leading to policy distortions that hinder productivity enhancing resource reallocation, and lower the appropriability of returns to investment, and e) linked low levels of technological innovation and trade integration. On top of these determinants, the country has had a long history of large macroeconomic volatility and catastrophic macroeconomic events that have shortened the time horizon for investment and that have fed into frequent policy regime changes and large redistributions of wealth, together with the adoption of distortionary policy responses. The country's challenges are thus to ensure both macroeconomic stability and to progressively remove the binding constraints to growth enumerated above in a way that they contribute positively to higher sustained and inclusive growth.

**Argentina has taken important steps toward ensuring macroeconomic sustainability and reducing volatility,** including policy initiatives such as gradual fiscal consolidation and tax reform<sup>2</sup>, the adoption of an inflation targeting regime, and the liberalization of foreign exchange markets, among others. Additionally, the government is implementing ambitious structural reforms to tackle these development challenges. For example, the new Public-Private Partnerships (PPP) regulatory framework will help to close the infrastructure and social gaps by financing projects through PPPs in sectors like energy, transport, communications, water and sanitation, housing, health, and education. Argentina displays also significant potential for growth through innovation and further development of high value-added service exports, which have been significantly growing over last years.<sup>3</sup> The ongoing structural reform agenda along with Argentina's strengths would complement and put the country in a better position to overcome its development challenges.

---

<sup>2</sup> The goal of this reform is to boost competitiveness, investment, labor formality, and growth. The reform measures feature a gradual reduction of the corporate income tax on retained earnings, the reduction of the social security tax for low-income workers, and a cut in provincial turnover taxes, among other measures. The government also removed virtually all taxes and quantitative restrictions on agricultural exports.

<sup>3</sup> Indeed, exports of knowledge-based services have grown remarkably, showing high competitiveness, leading to market share increases in key categories, such as information and communications technology, and business and personal services. The country has also experienced success episodes in biotechnology, involving human health as well as plants and animals.

## **References**

World Economic Forum. 2017. *The Global Competitiveness Report 2017–2018*. Geneva, Switzerland:

World Economic Forum.