OECD Economic Surveys

ARGENTINA

Multi-dimensional Economic Survey

JULY 2017

OECD

OECD Economic Surveys: Argentina 2017

MULTI-DIMENSIONAL ECONOMIC SURVEY

BETTER POLICIES FOR BETTER LIVES

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Please cite this publication as:
OECD (2017), *OECD Economic Surveys: Argentina 2017: Multi-dimensional Economic Survey*, OECD Publishing, Paris.
http://dx.doi.org/10.1787/eco_surveys-arg-2017-en

ISBN 978-92-64-27804-2 (print)
ISBN 978-92-64-27805-9 (PDF)
ISBN 978-92-64-27806-6 (epub)

Series: OECD Economic Surveys
ISSN 0376-6438 (print)
ISSN 1609-7513 (online)

OECD Economic Surveys: Argentina, Multi-dimensional Economic Survey
ISSN 1995-3127 (print)
ISSN 1999-0189 (online)

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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 OECD Development Centre on 16 May 2017. It is published under the responsibility of the Secretary General of the OECD.

BASIC STATISTICS OF ARGENTINA, 2016

(Numbers in parentheses refer to the OECD average)*

LAND, PEOPLE AND ELECTORAL CYCLE

Population (million)	43.8		Population density per km^2	15.8	(35.4)
Under 15 (%)	25.1	(18.0)	Life expectancy (years)	76.9	(81.0)
Over 65 (%)	11.1	(16.5)	Men	73.2	(78.4)
			Women	78.1	(80.6)
Latest 5-year average growth (%)	1.0	(0.6)	Latest general election	November 2015	

ECONOMY

Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	545.7		Primary sector	12.6	(2.5)
In current prices (billion ARS)	8 050.2		Industry including construction	25.6	(26.6)
Latest 5-year average real growth (%)	-0.2	(1.8)	Services	61.8	(70.9)
Per capita (000 USD PPP)	20.0	(42.1)			

GENERAL GOVERNMENT

Per cent of GDP

Expenditure[a]	39.5	(40.9)	Gross financial debt[a]	52.0	(112.1)
Revenue[a]	33.7	(38.0)	Net financial debt[a, b]	25.0	(72.8)

EXTERNAL ACCOUNTS

Exchange rate (ARS per USD)	14.751		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	9.194		Food and live animals	41.5	
In per cent of GDP			Machinery and transport equipment	13.5	
Exports of goods and services	12.7	(53.9)	Crude materials, inedible, except fuels	10.6	
Imports of goods and services	13.4	(49.3)	Main imports (% of total merchandise imports)		
Current account balance	-2.8	(0.3)	Machinery and transport equipment	44.7	
Net international investment position (2014)	8.3		Chemicals and related products, n.e.s.	18.9	
			Manufactured goods	12.1	

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate for 15-64 year-olds (%)	61.7	(67.0)	Unemployment rate, Labour Force Survey (age +14 and over) (%)	7.6	(6.3)
Men	72.8	(74.7)	Youth (age 15-24, %)	23.9	(13.0)
Women	51.4	(59.3)			
Participation rate for 15-64 year-olds (%)[a]	67.6	(71.3)	Tertiary educational attainment 25-34 year-olds (%, 2015)	18.2	(40.7)
			Gross domestic expenditure on R&D (% of GDP, 2014)	0.6	(2.4)

ENVIRONMENT

Total primary energy supply per capita (toe, 2014)[c]	2.0	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes, 2014)	4.5	(9.3)
Renewables (%, 2014)	8.7	(9.6)			
Exposure to air pollution (more than 10 μg/m^3 of $PM_{2.5}$, % of population, 2015)	44.2	(75.2)			

SOCIETY

Income inequality (Gini coefficient)[c, d]	0.36	(0.31)	Education outcomes (PISA score, 2012[e])		
Relative poverty rate (%)[c]	16.6	(11.1)	Reading	396	(496)
			Mathematics	388	(494)
Public and private spending (% of GDP)			Science	406	(501)
Health care (2014)	4.8	(9.0)	Share of women in parliament (%)	38.9	(28.7)
Pensions (Public[c])	8.1	(9.1)			
Education (primary, secondary, post sec. non tertiary, 2013)	4.4	(3.7)			

Better life index: *www.oecdbetterlifeindex.org*

* Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

a) 2015 data for the OECD.

b) Excludes public debt held by public sector entities including the Central Bank and the Social Security Administration ANSES.

c) 2013 data for the OECD.

d) For Argentina, based on household data for the thrid quarter of 2016, using the new OECD income definition.

e) For PISA 2015, only results on capital city of Buenos Aires.

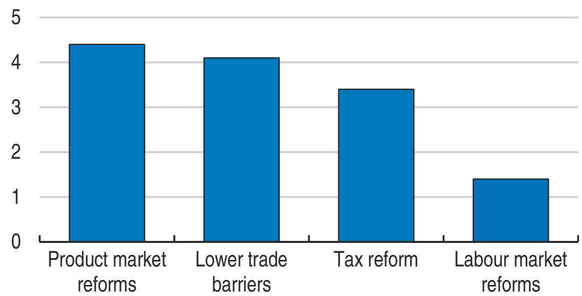
Source: Calculations based on databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

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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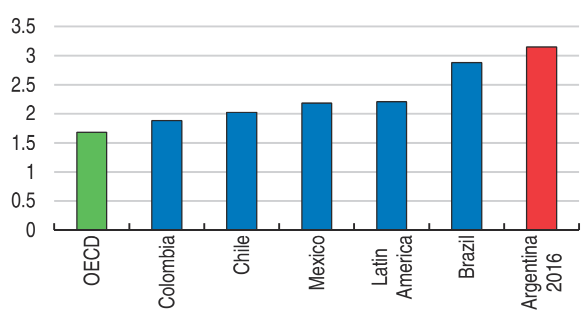
Following years of unsustainable economic policies, Argentina has recently undertaken bold reforms and a turnaround in policies that has helped to avoid another crisis and stabilise the economy. Reforms such as those already implemented and those currently planned should help lay the foundations to raise 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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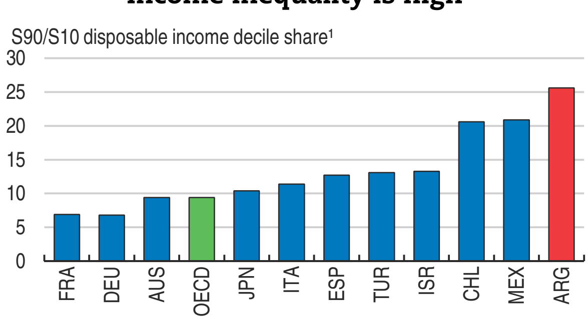
Structural and institutional reforms encompassing regulation on product markets, labour markets, competition, taxes, infrastructure, education, trade policy and financial markets can raise investment and productivity, which is the basis for sustainable income gains. Such reforms will involve adjustment 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.

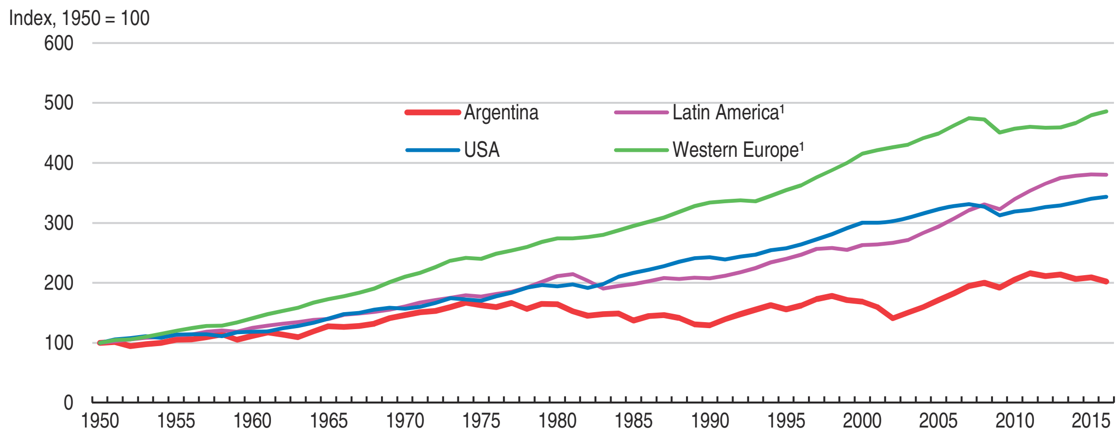
However, the weakness of both the external and fiscal balances continued into the 1960s and early 1970s, leading to an unstable growth performance and bouts of inflation, including a first hyperinflation in 1975. The military dictatorship of the 1970s and the democratic government of the 1980s continued 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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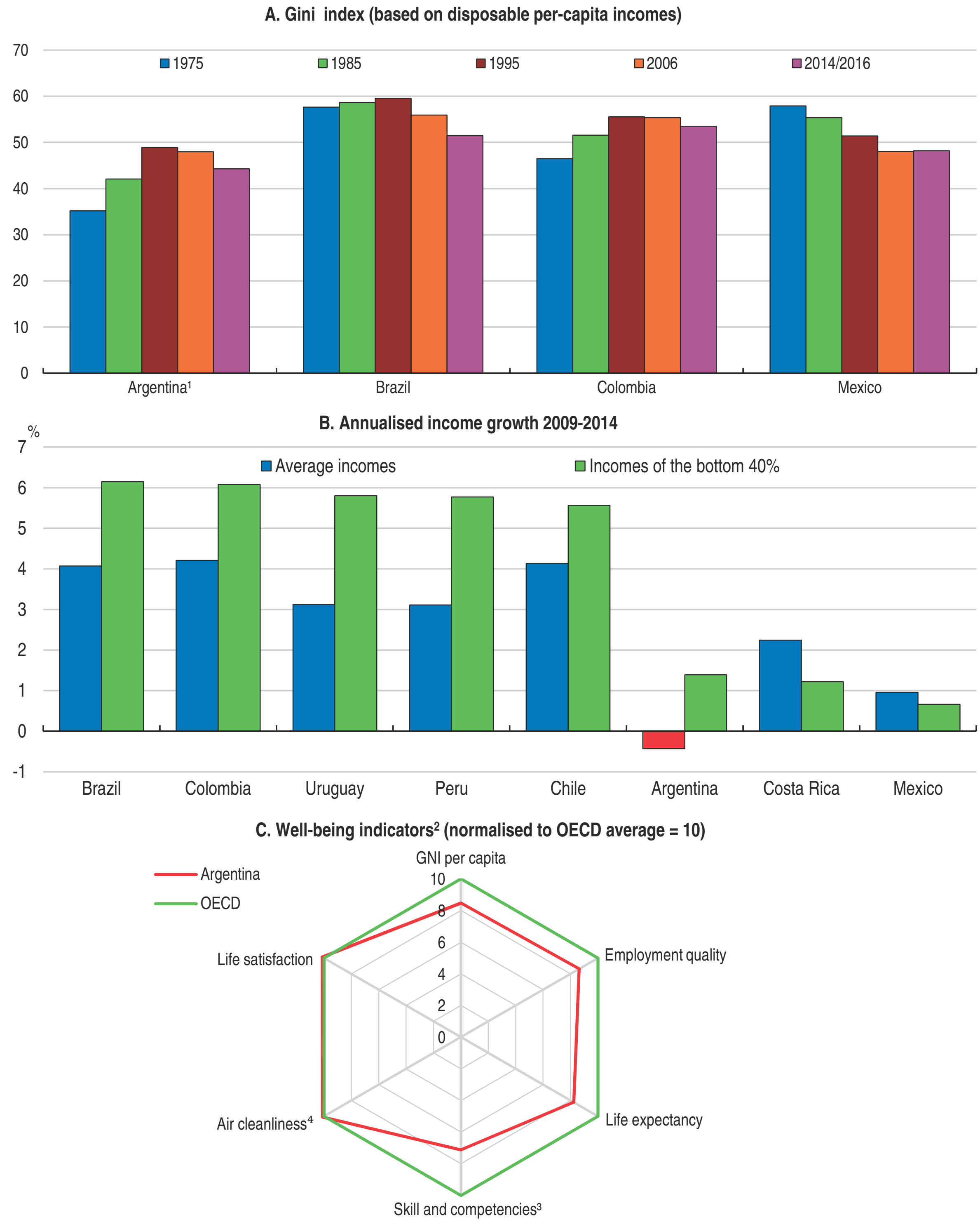
growth was negative during 2009-14 and that of the bottom of the distribution modestly positive (Figure 2). Poverty now affects close to a third of the population and a third of employment is informal. Indicators of well-being are below the OECD average, particularly with respect to skills, life expectancy, 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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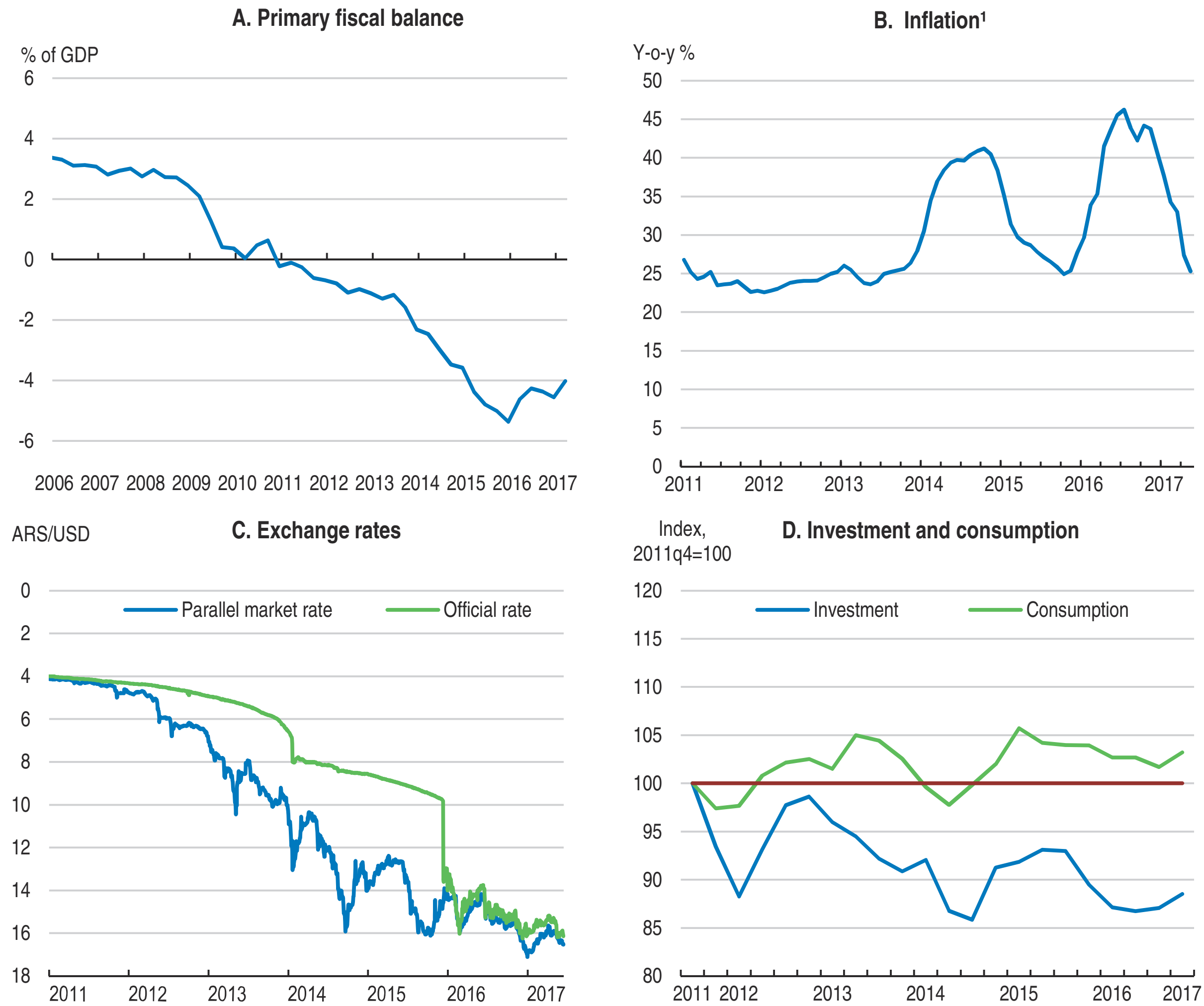
Figure 3. **Macroeconomic imbalances have built up**



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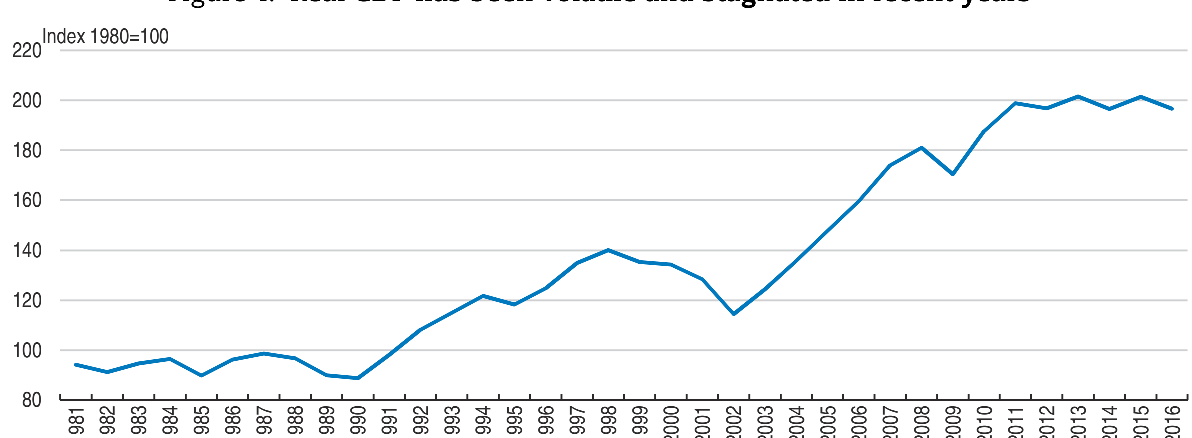
Figure 4. **Real GDP has been volatile and stagnated in recent years**



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**

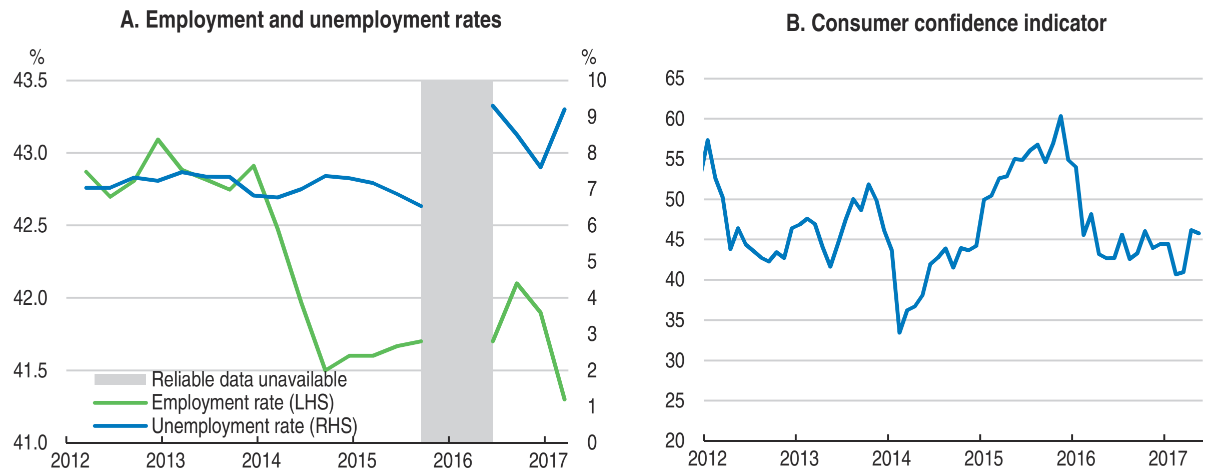
	2014	2015	2016	2017	2018
	Percentage changes, volume				
GDP at market prices	-2.5	2.6	-2.2	2.9	3.2
Private consumption	-4.4	3.5	-1.4	2.5	3.7
Government consumption	2.9	6.8	0.3	3.4	2.3
Gross fixed capital formation	-6.8	3.8	-5.1	4.5	5.8
Total domestic demand	-3.9	4.0	-1.6	3.6	3.9
Exports of goods and 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.

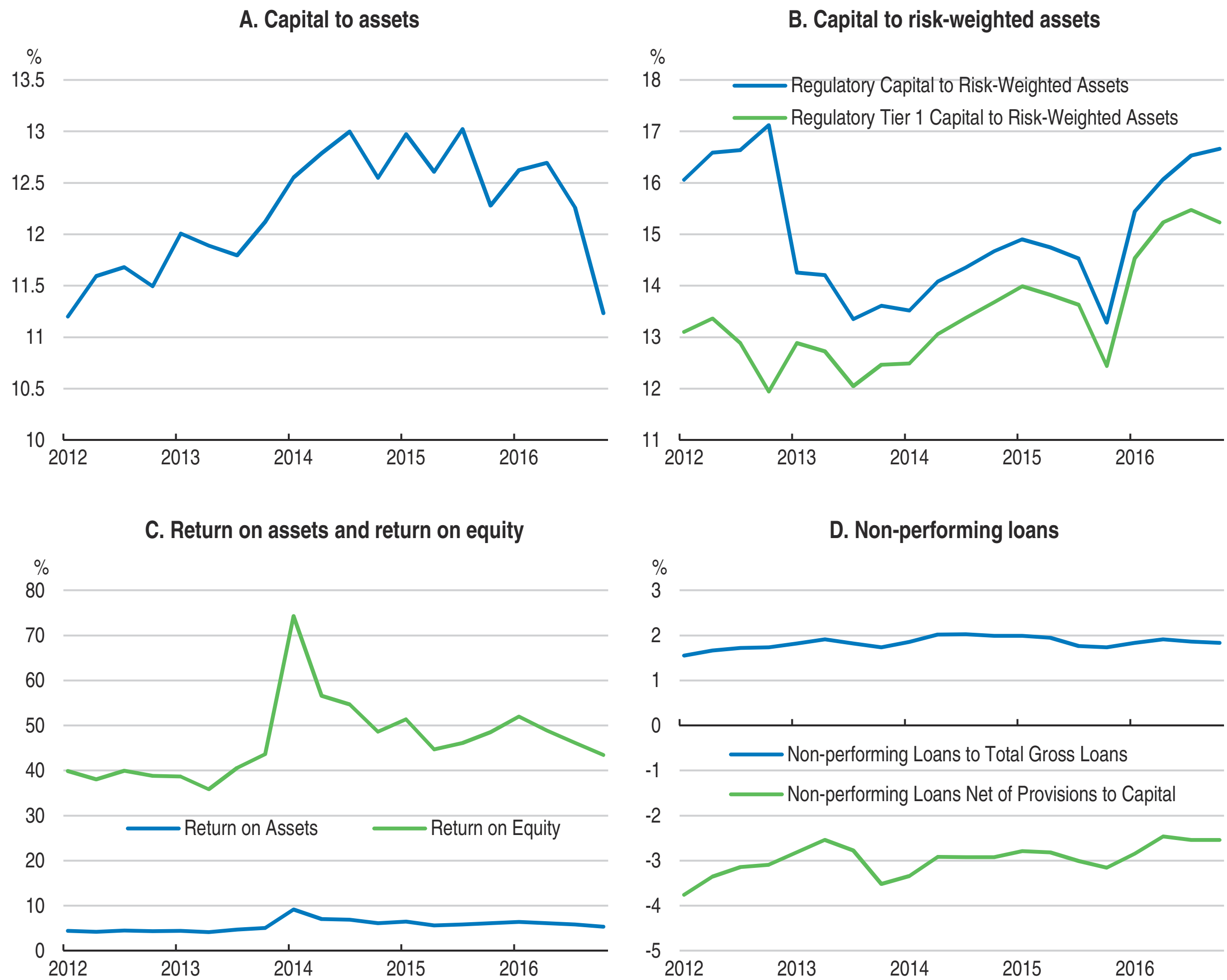
Due to past restrictions on accessing foreign capital markets, the stock of total external debt amounts to only around 25% of GDP, and corporate external debt is significantly below the Latin American average, at 13% of GDP. Foreign currency reserves have increased recently to USD 48 billion or 9% of 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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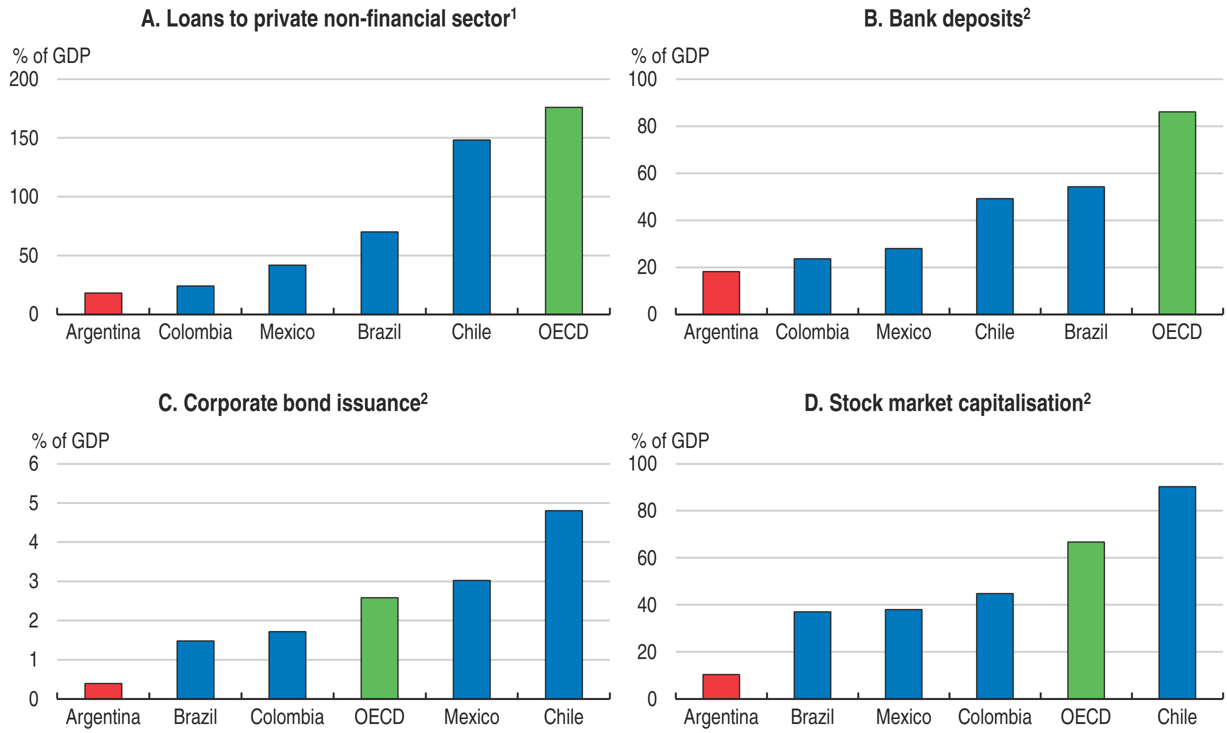
increase lending. However, building up the necessary confidence for savers to venture into longer maturity instruments, which would enable banks to lend more long-term, will probably take time. The additional resources flowing into the domestic financial system as a result of the tax amnesty are also 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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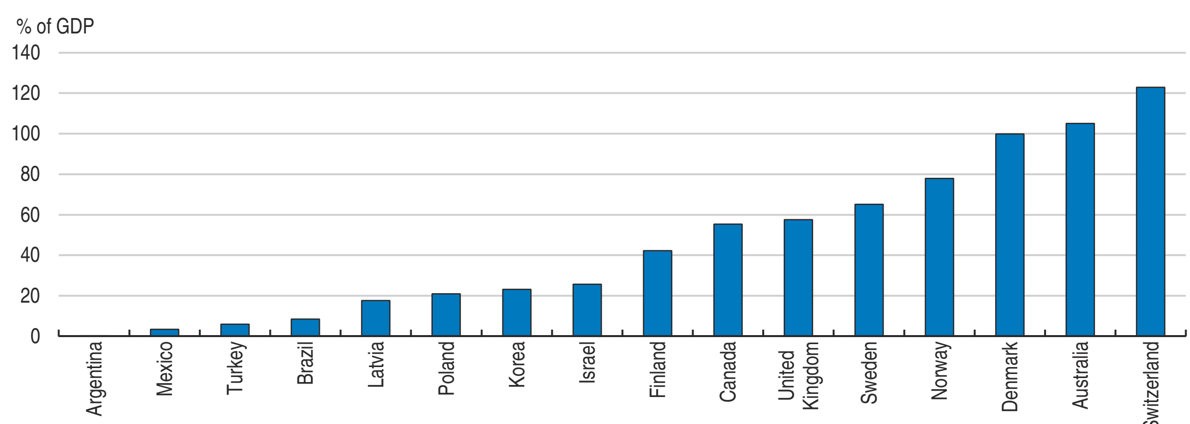
Figure 8. **Residential real estate loans are underdeveloped**

2016q3 or latest available year



Source: IMF Financial stability indicators database.

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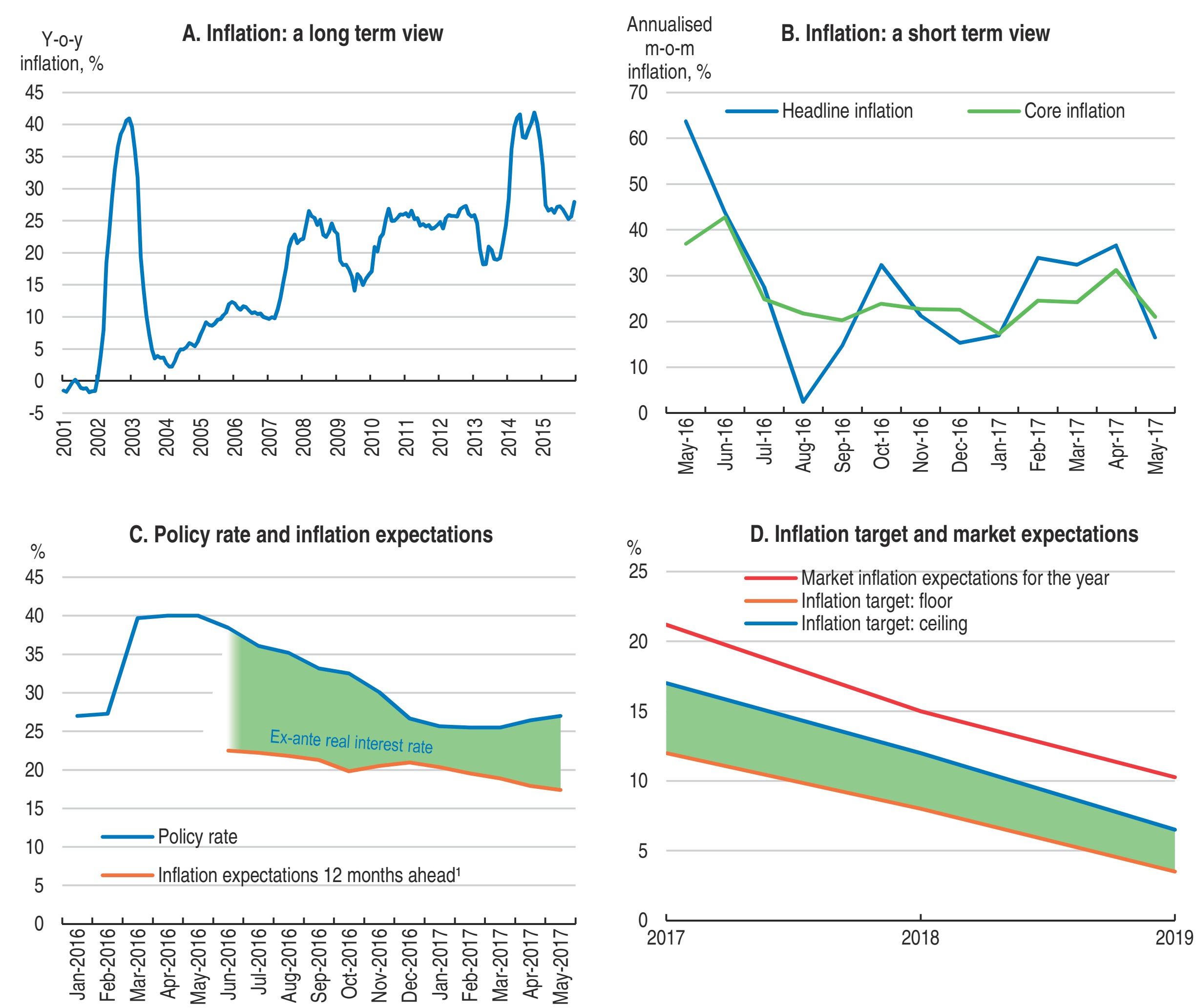
charge of financial stability, should stand ready to use macro-prudential tools, including limits on debt-service to income ratios, to ensure high asset quality as credit grows. Another initiative to develop the local mortgage market has been to use part of the public sector reserve fund endowment to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

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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.

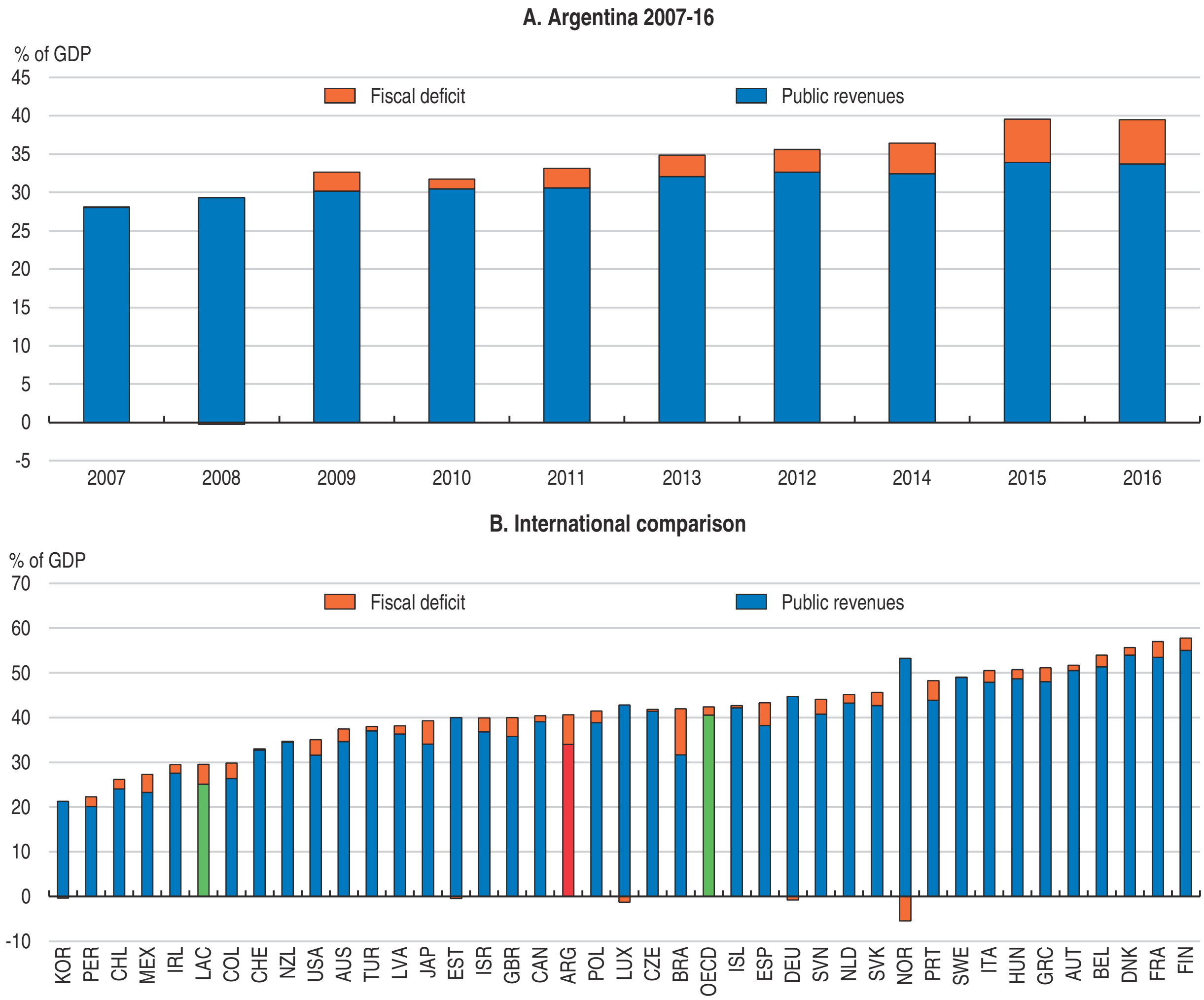
Current market expectations regarding inflation are falling. However, they are consistently above the inflation target ranges, by almost 5 percentage points, suggesting that more work is needed to strengthen central bank credibility and anchor inflation expectations. Institutional reforms would strengthen 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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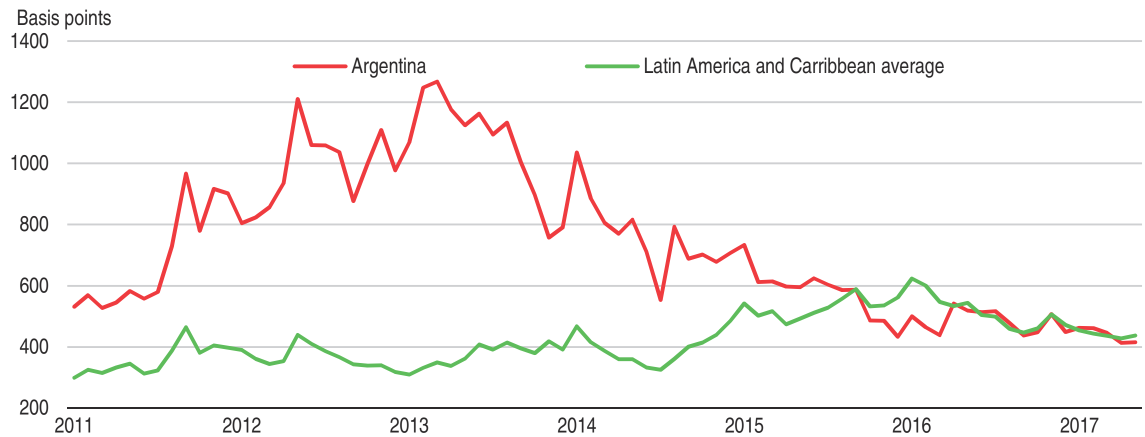
At 54% of GDP the level of gross public debt is moderate, which has allowed Argentina to tap into international capital markets on several occasions since the agreement with holdout creditors in April 2016, at reasonable cost as sovereign bond spreads have declined and converged towards the regional 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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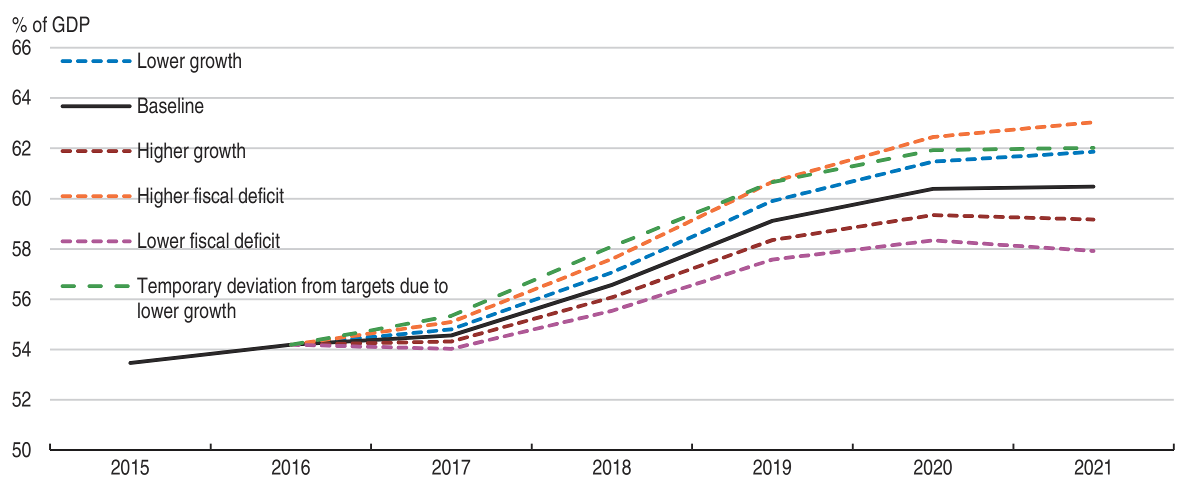
Figure 12. **Public debt is sustainable under several scenarios**



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.

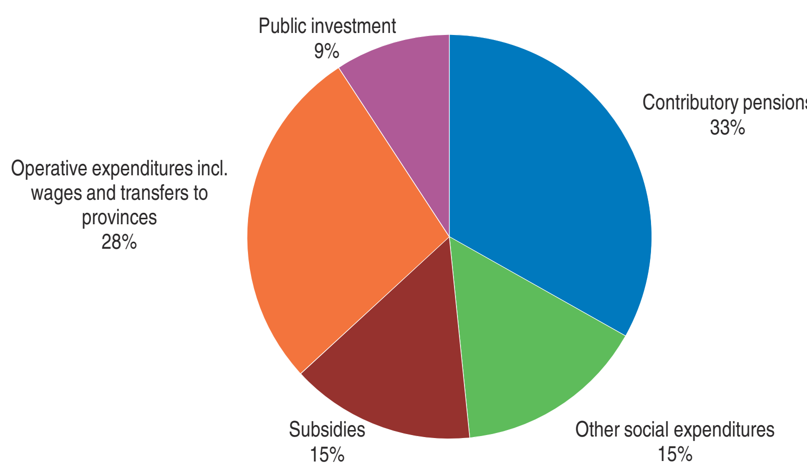
Making public spending more efficient

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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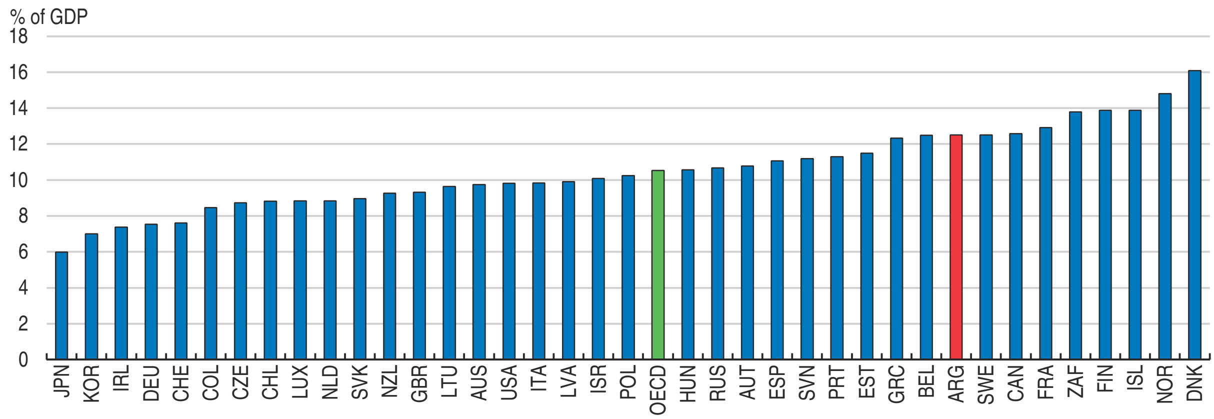
Subsidies for energy and transport still account for 2.2% of GDP, even after having been reduced by approximately 1.5% of GDP during 2016. Utility prices in the Greater Buenos Aires area still cover only around 50% of costs, up from around 25%. Current plans to phase out the subsidies should be pursued 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).

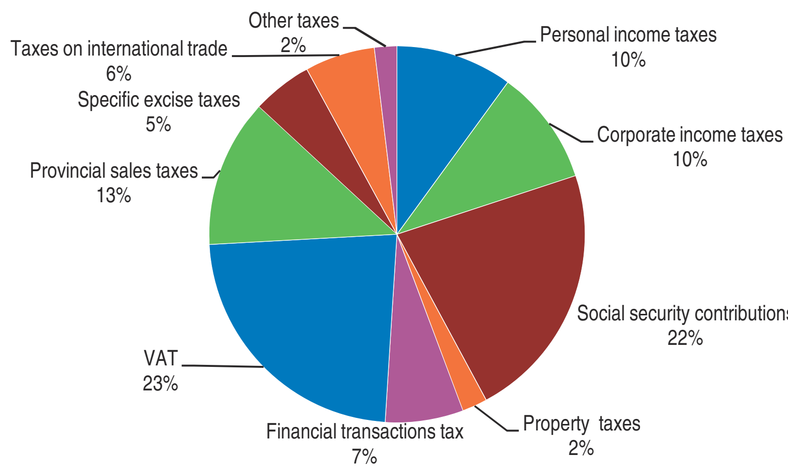
Tax reform is a key priority

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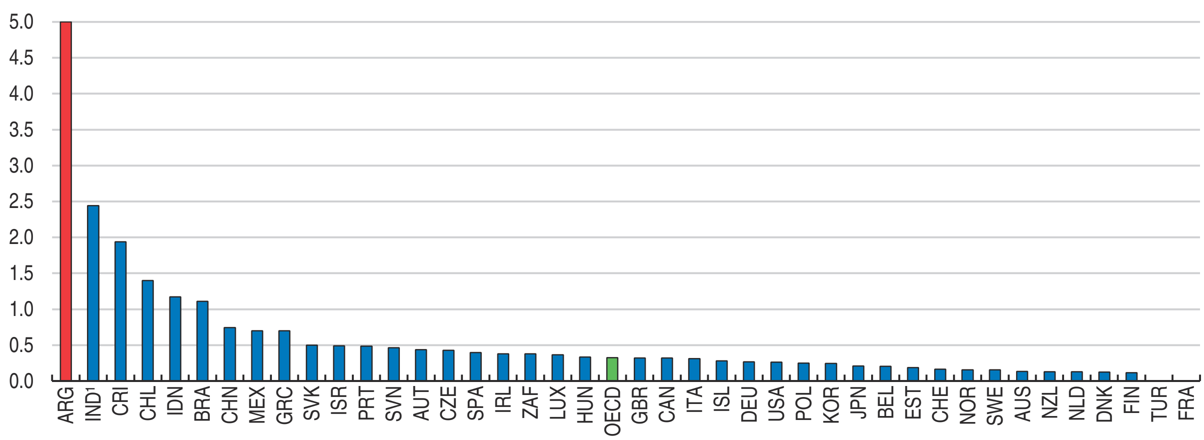
Figure 16. **Few people pay personal income tax**

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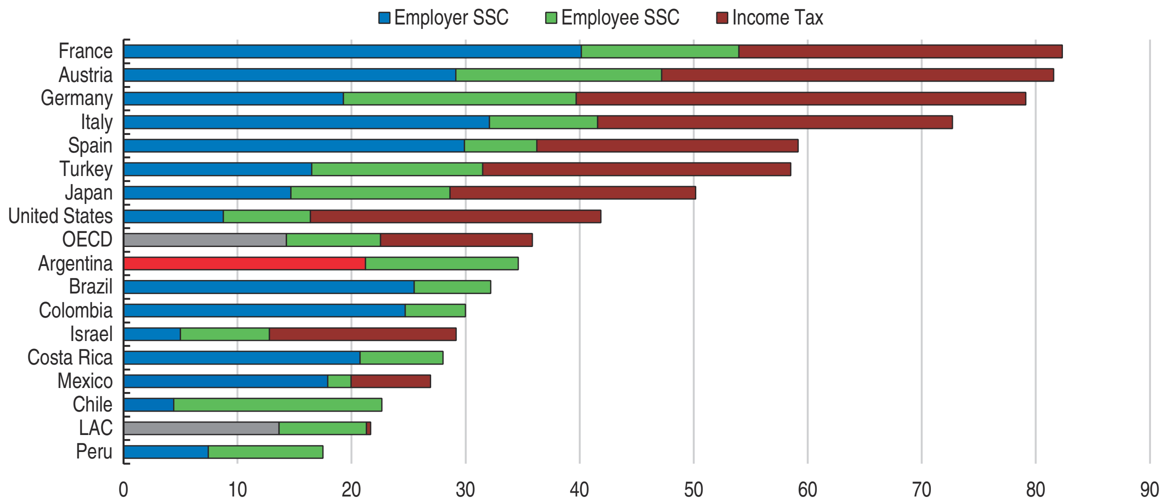
affected by informality. Bringing more people into the personal income tax system could also help to foster a culture of compliance.

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).

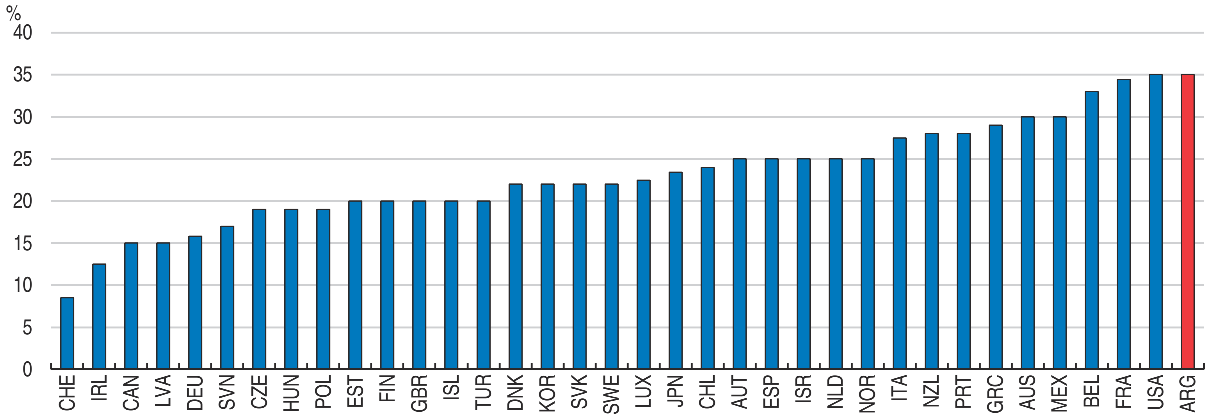
Such measures should go along with other efforts to raise formalisation, including easing formal labour market regulations, expanding training programmes to upgrade the skills of informal workers, enhancing enforcement through more labour inspections and promoting enterprise registration. Since 4 percentage 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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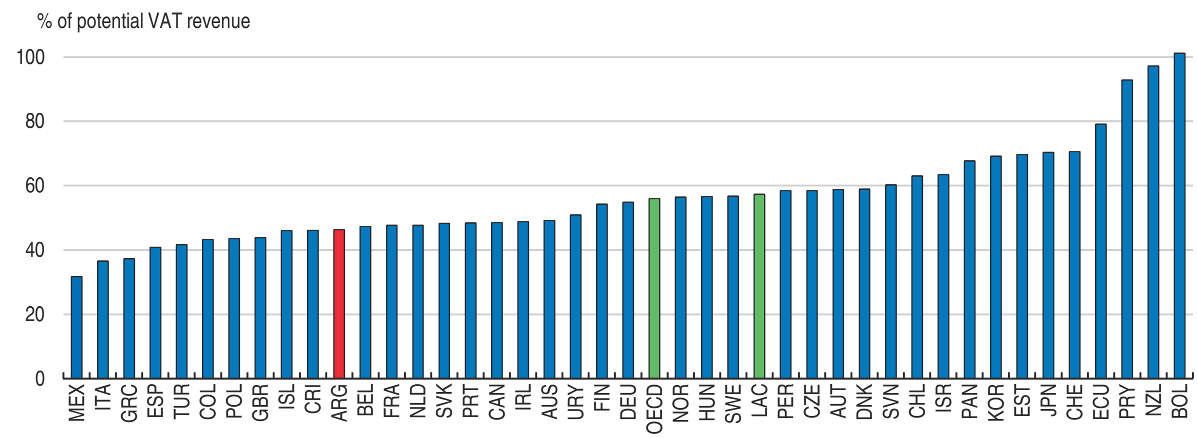
Figure 19. **VAT revenues could be higher with stronger compliance and less use of reduced rates**

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.

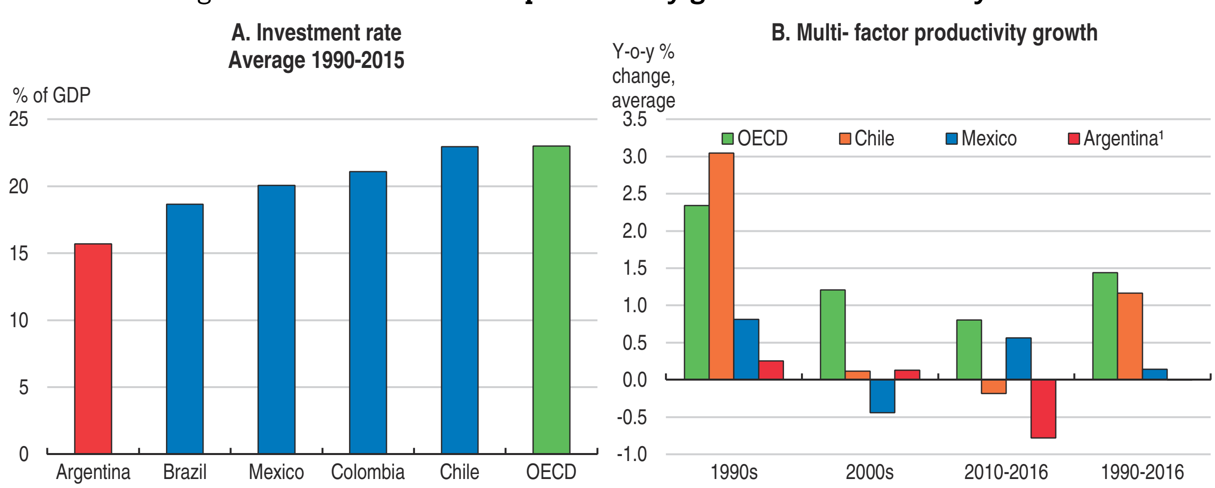
Separating the preventive and investigative powers of the recently revamped anti-corruption agency would be one way to enhance its effectiveness. At the same time, the capacities and de facto independence of the judiciary bodies responsible for the investigation of corruption should be strengthened, 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

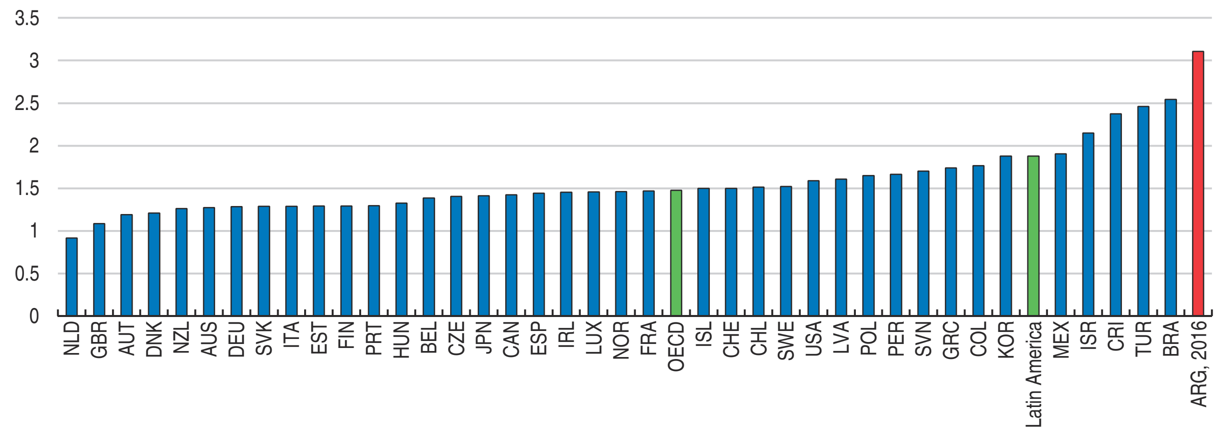
Regulations on product market serve a variety of legitimate objectives, but if ill-designed they can impose unnecessary restrictions on competition, and therefore on growth, living standards and ultimately well-being. Competition, which induces firms to become efficient or exit, has been traditionally 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.

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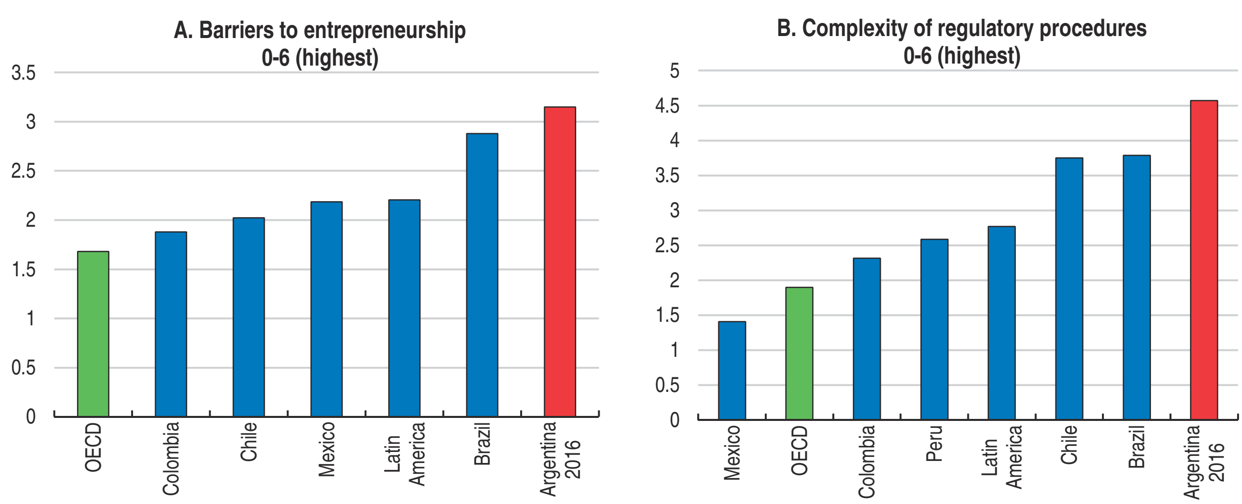
Figure 22. **Barriers to entrepreneurship are high and regulatory procedures are complex**



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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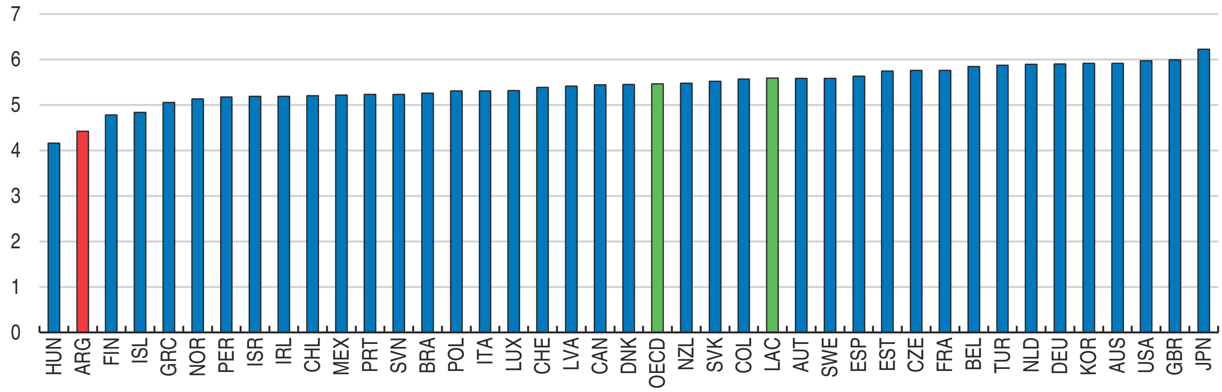
regional and central government that are found to effectively fragment the domestic market must be amended within six months and mutual recognition principles between regions are being established (González Pandiella, 2014). The Council of Australian Governments, established in 1992, has focused on in-depth 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.

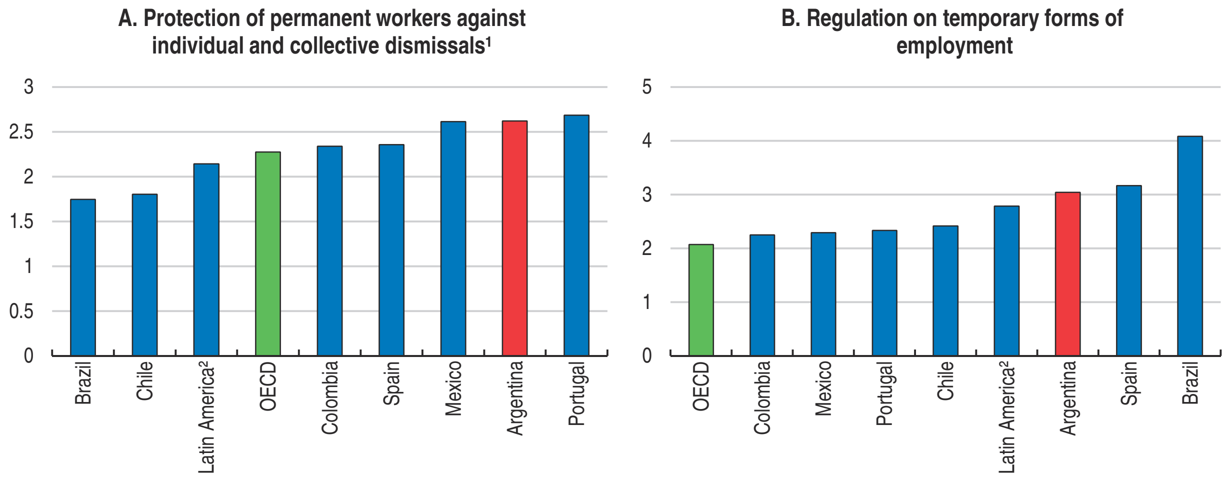
Evaluating whether planned or existing regulations can restrain competition should also form a more substantial part of the work of the Authority. Introducing a legal obligation for the executive to systematically submit all new laws with a potential to affect competition to a regulatory impact assessment 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.

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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

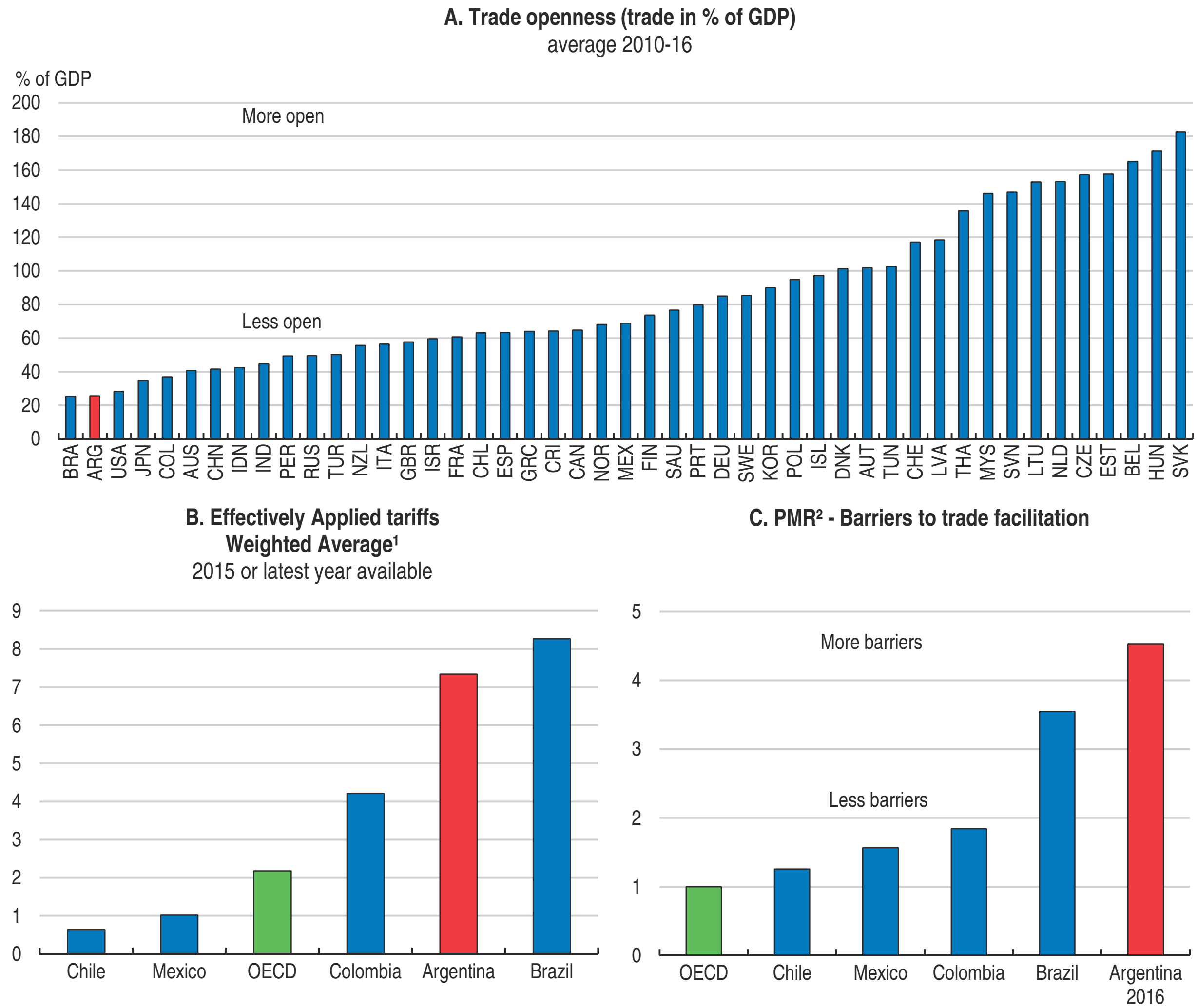
Rising trade barriers have isolated Argentina's economy more and more from the global economy in recent years. Imports plus exports amount to less than 30% of GDP, a low degree of openness for a country of the size of Argentina (Figure 25). The largest export items are food and agriculture products, 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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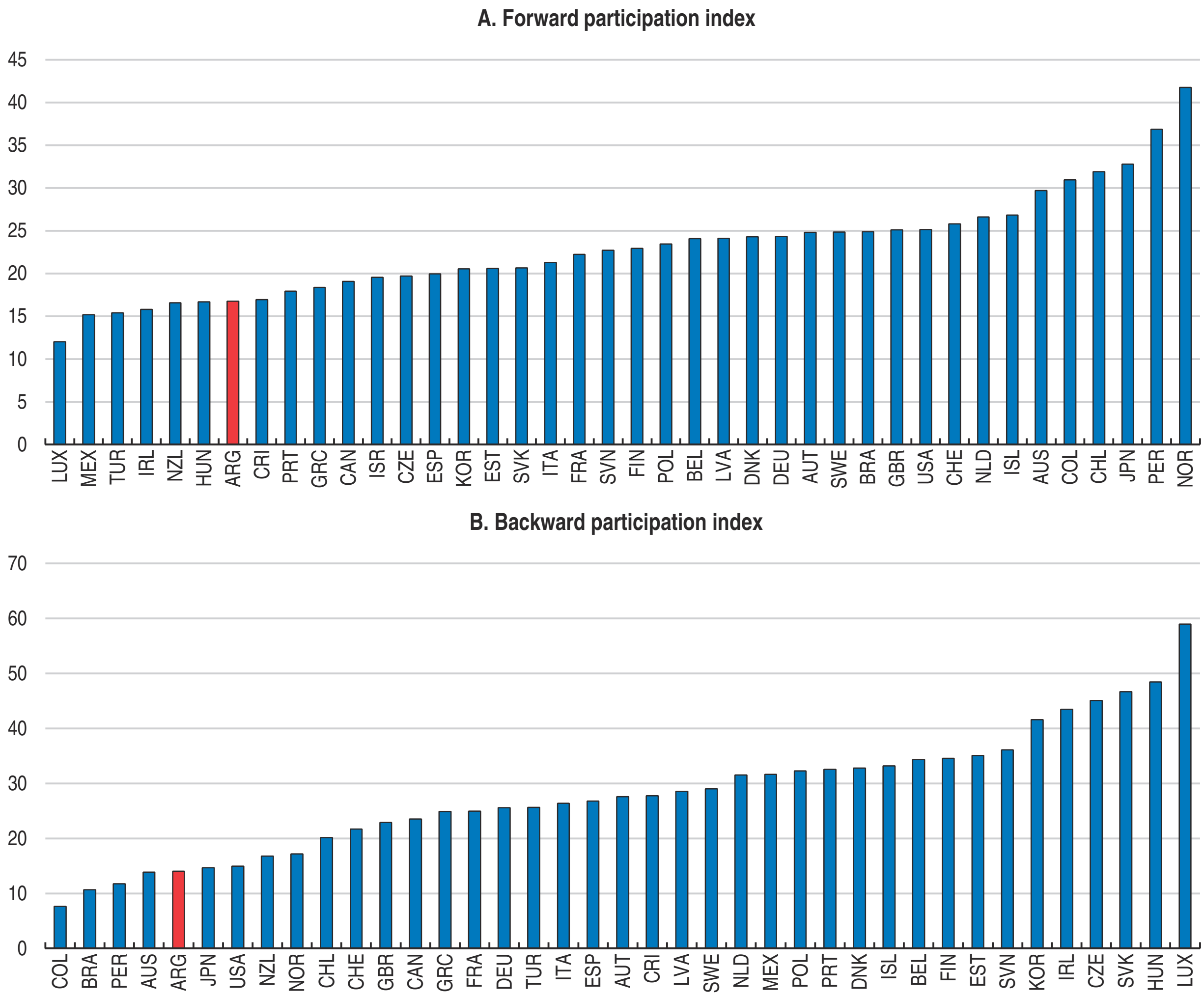
It is important to acknowledge that trade opening combines strong medium-term benefits such as more and better jobs with short-run adjustment costs. Jobs will be lost in some firms and sectors and created in others. But it is precisely this reallocation process that will allow capital and labour to flow 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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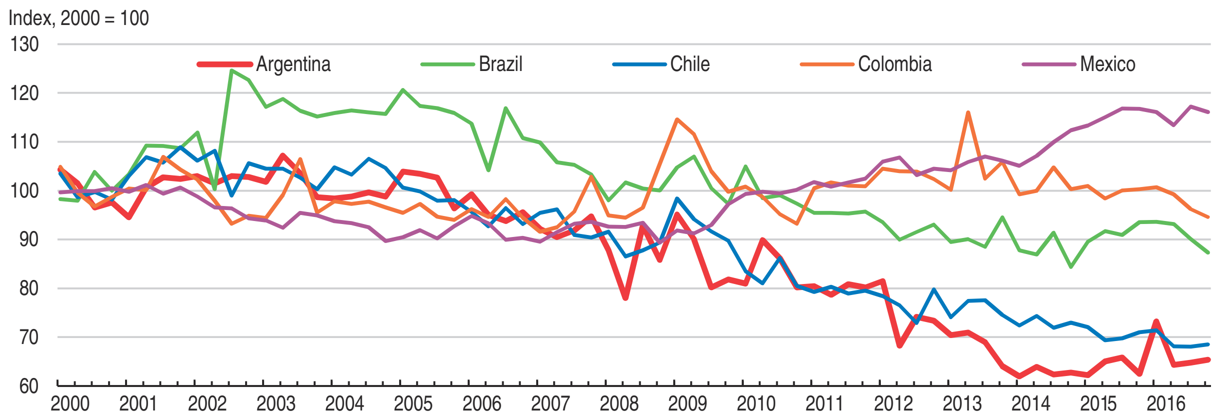
policy levers in this context. The focus of such accompanying policies, however, should be on protecting workers rather than on protecting jobs, economic sectors or firms (World Bank, 2013; Flanagan and Khor, 2012).

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

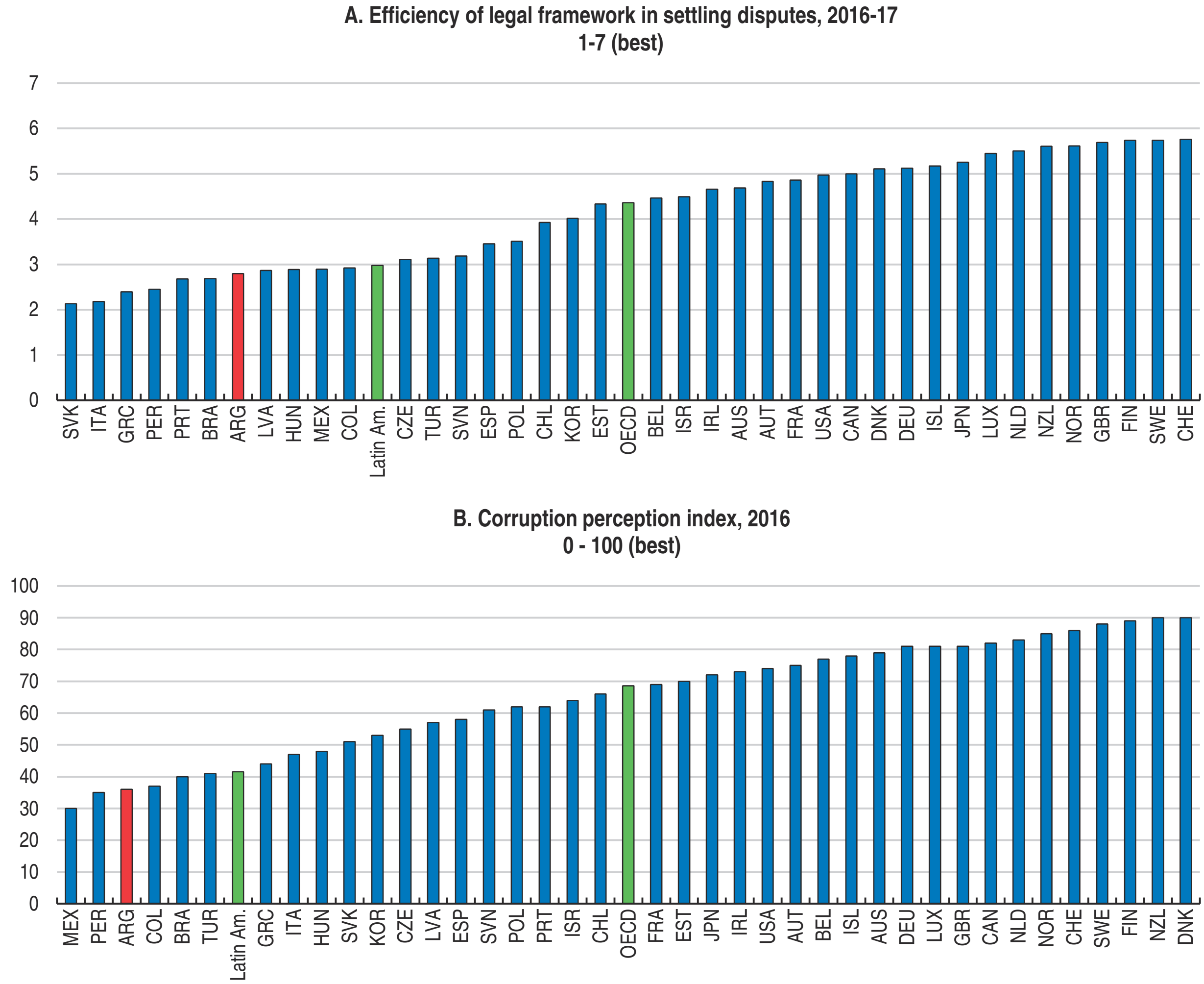
In the past, Argentina has attracted far less foreign direct investment (FDI) inflows than other Latin American countries such as Mexico or Brazil, and far less than regional top performers such as Costa Rica. Besides opening up new sources of investment financing that go beyond domestic savings, FDI 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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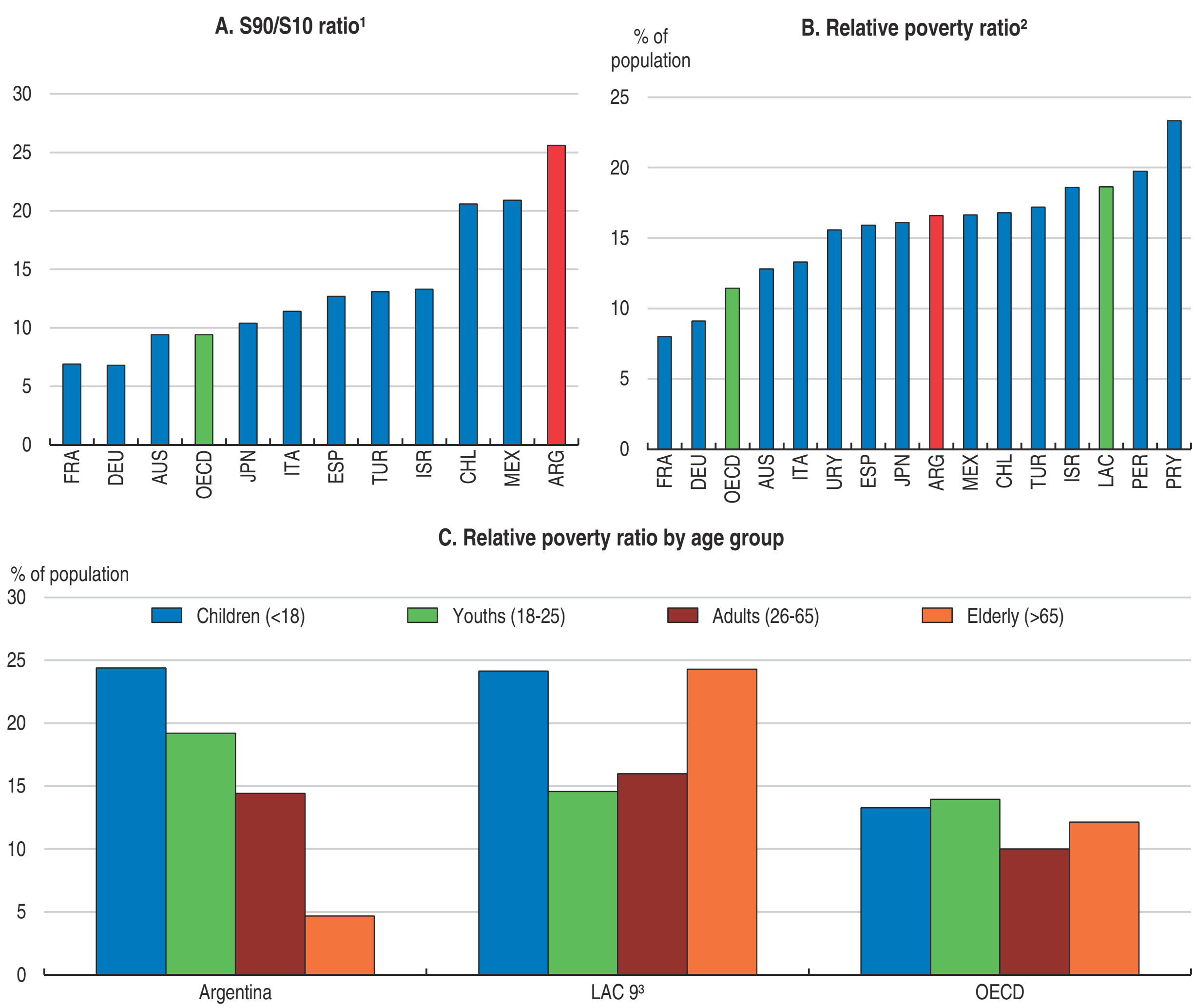
contributes to high logistic costs, especially in the Northern provinces without alternatives to road transport, and it also makes it more difficult low-income people in remote and isolated areas to get access to jobs and leads to higher carbon emissions.

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

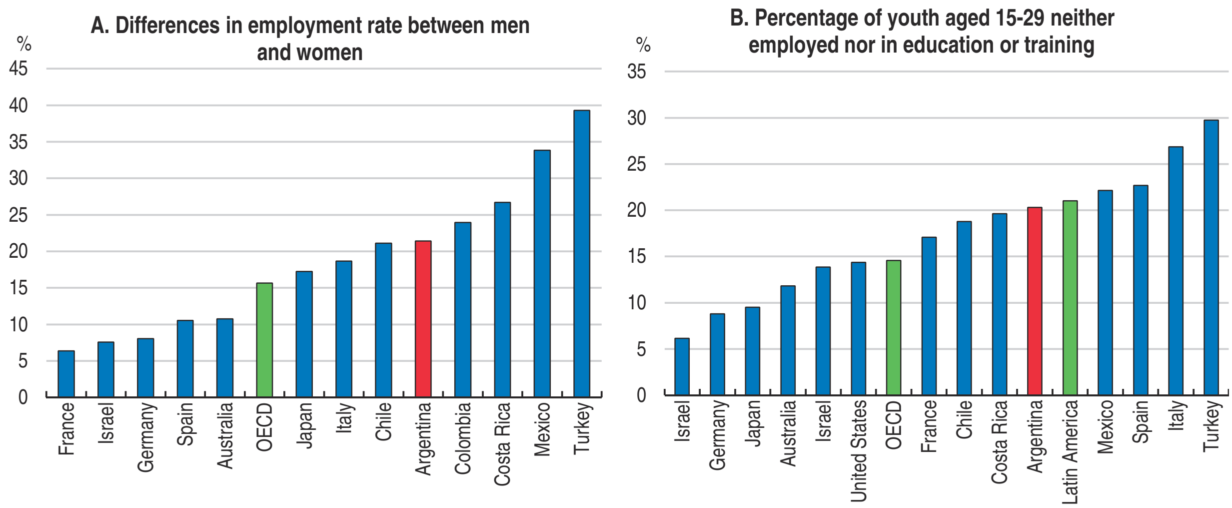
Creating quality jobs with good pay is the most effective and sustainable way to reduce poverty and provide opportunities for everybody. The role of market incomes in reducing poverty decreased substantially in Argentina between 2008 and 2015, in contrast to many other countries in the region where poverty 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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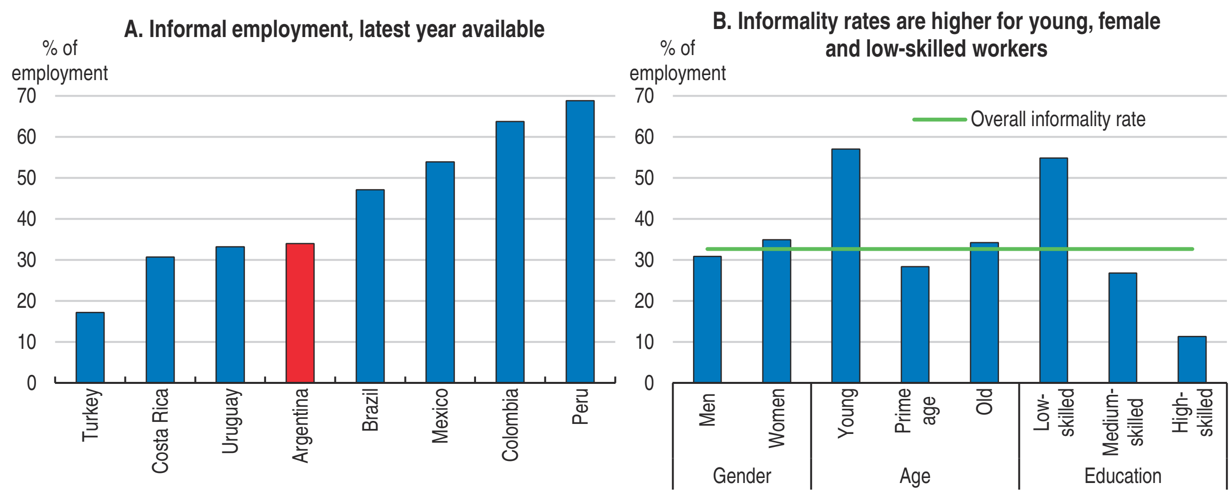
Figure 31. **Informality is high**



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).

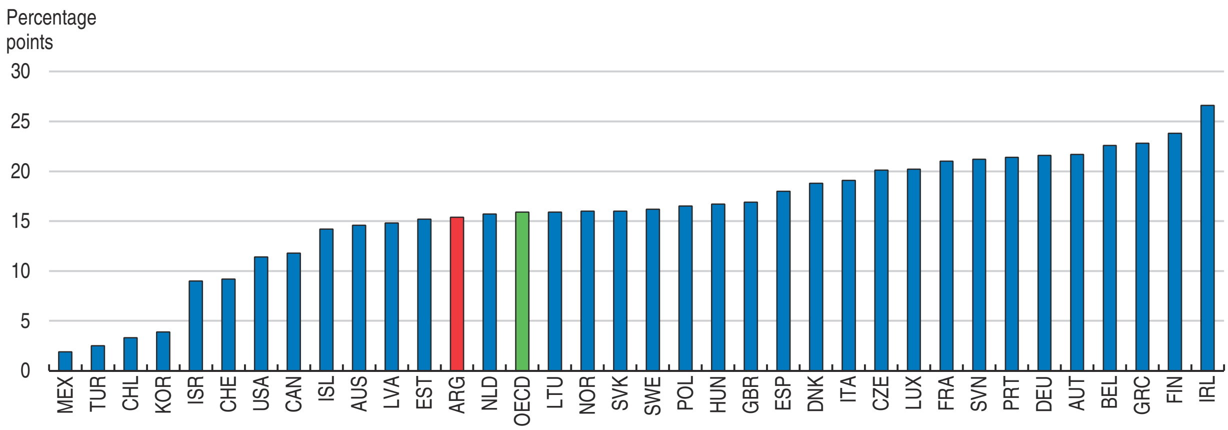
The role of taxes and transfers

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.

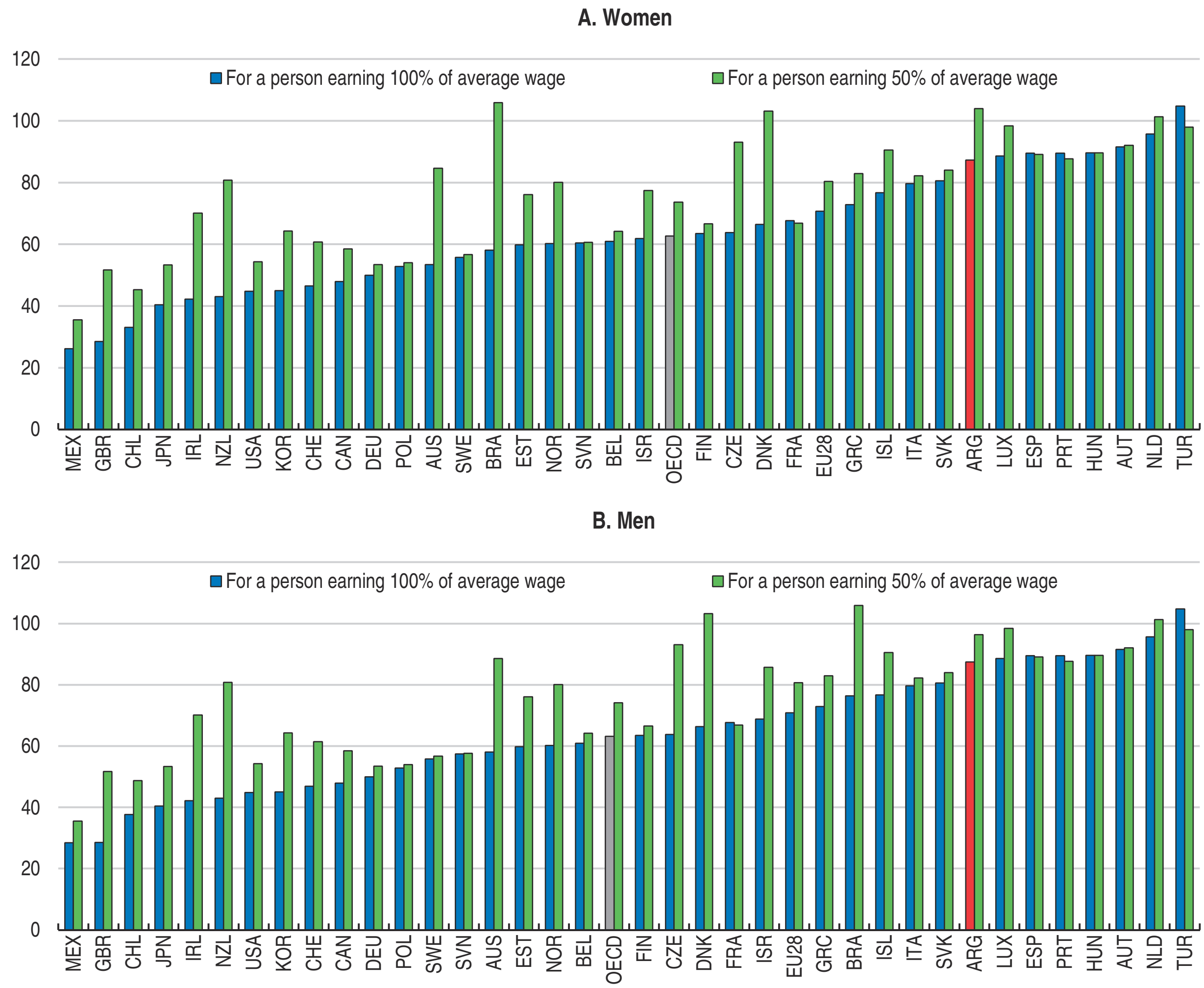
In the contributory system, 70% of beneficiaries get the minimum pension of approximately 80% of the minimum wage, equivalent to 54% of the average wage. Benefits are capped at around 6 times the minimum wage. Replacement rates, which link benefits to the last wage, are about 72% for an average wage, 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.

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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.

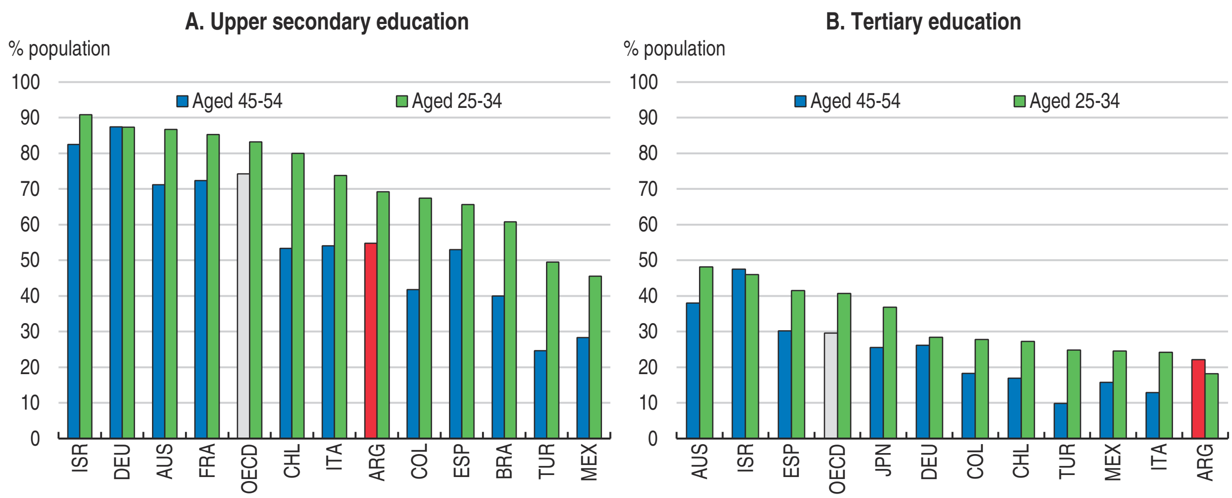
Education policies

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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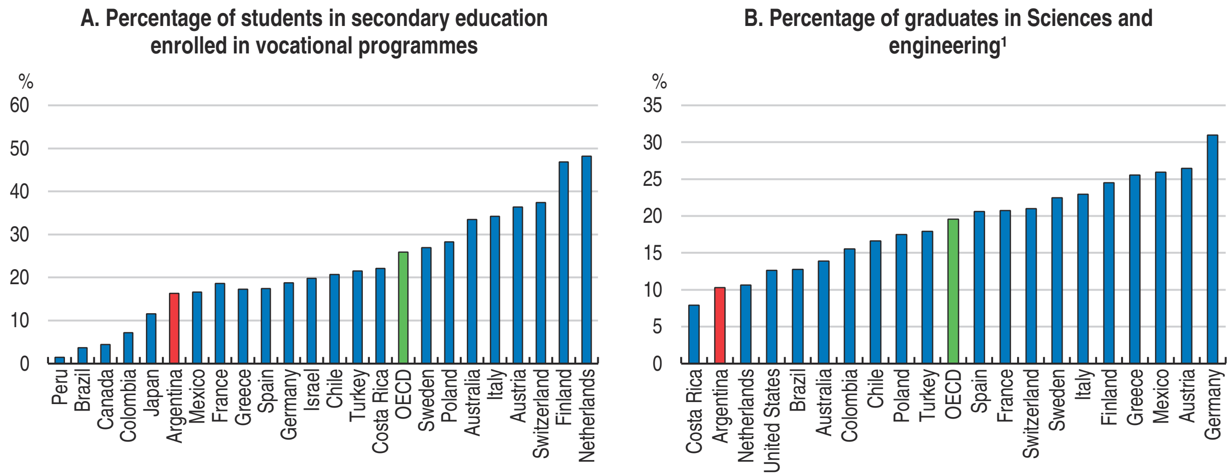
Besides lost opportunities for workers, this also generates shortages for some skills, especially for technicians, skilled trades and engineers (INET, 2016). Vocational education and training, which is attended by fewer students than in other countries, could be expanded (Figure 35, Panel A). This would 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.

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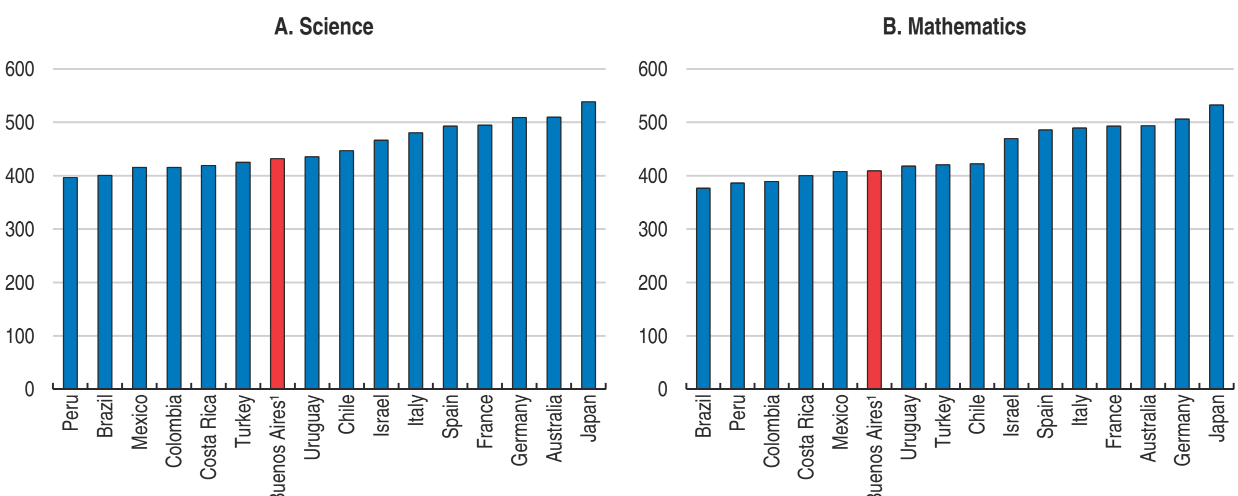
Figure 36. **Learning outcomes show room for improvement even in the capital of Buenos Aires**



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.

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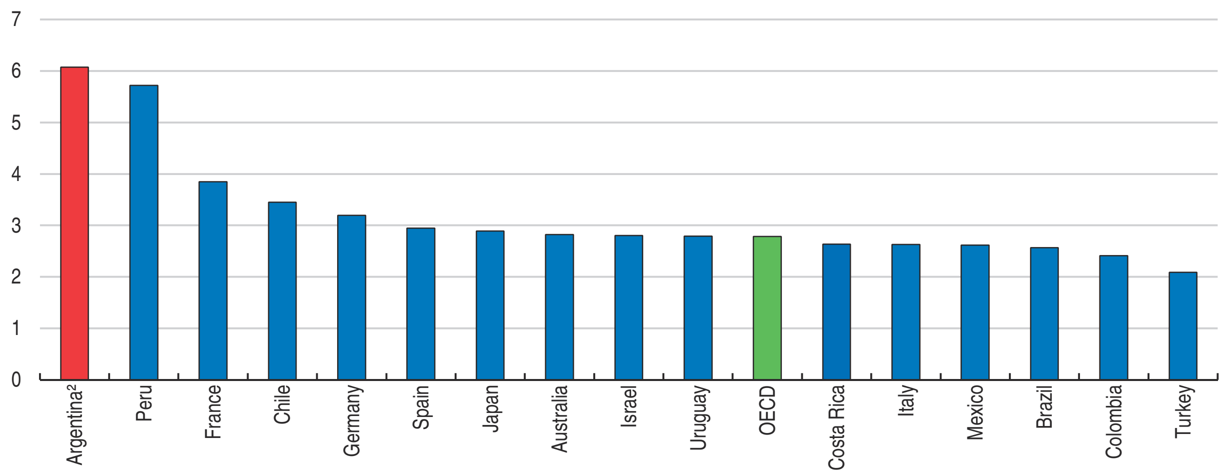
in major urban centres generally tend to be above the national average. Two-thirds of 15 year old students in the city of Buenos Aires do not have basic-level proficiency in reading, mathematics and science facing significant disadvantages in their transition into higher education and the labour force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

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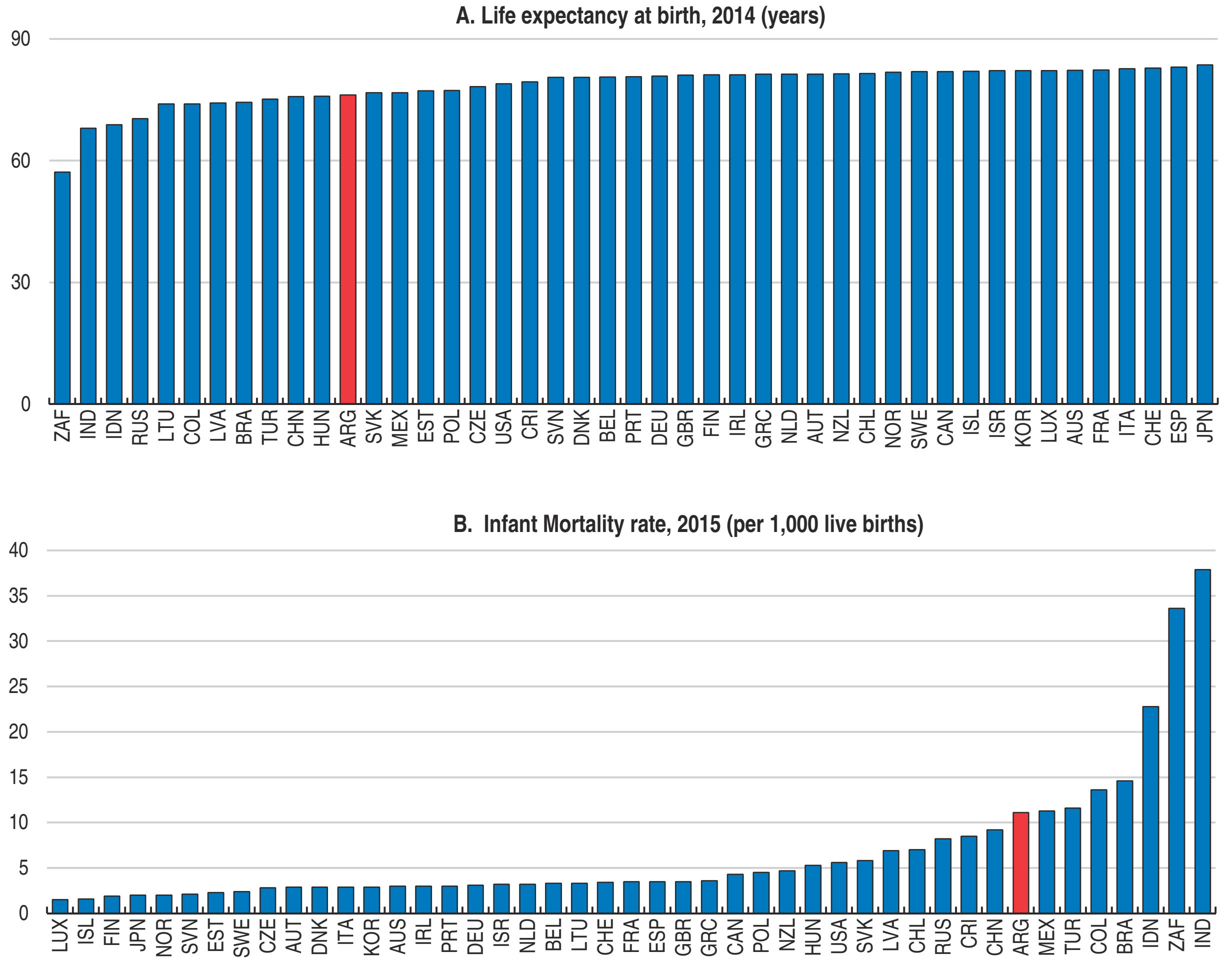
Improving teacher quality through better teacher training is a key challenge (World Bank, 2015). Argentina has 1296 teacher training institutions, with a generalised lack of quality standards and evaluations. Part of these are administered by teachers' unions and suffer from weak governance, insufficient 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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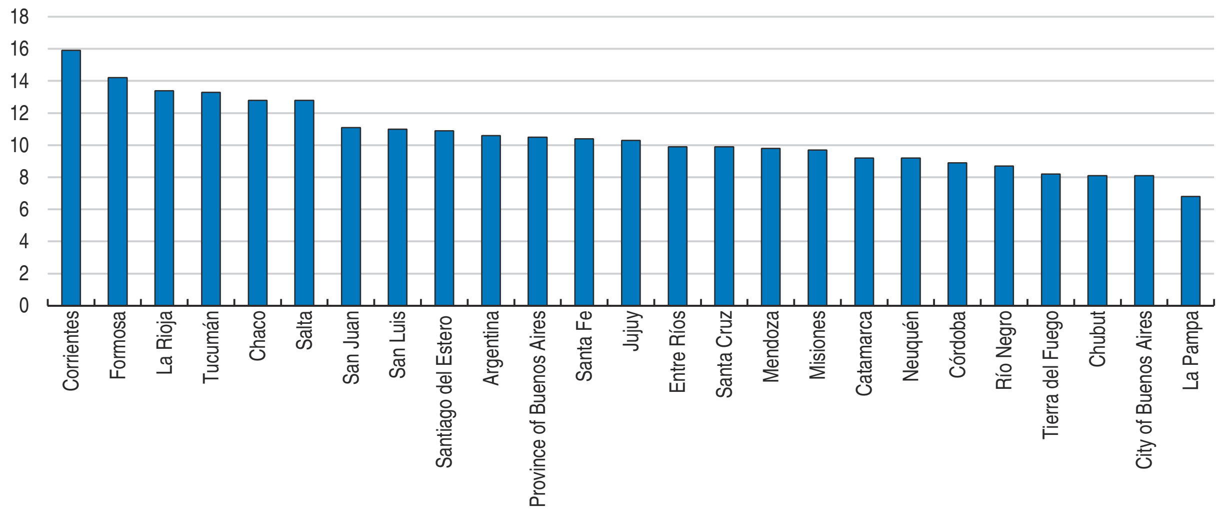
mortality in City of Buenos Aires is half the national average (Figure 39; INDEC, 2016a). Rising formal employment has improved health insurance coverage from 52% in 2001 to 64% in 2010, but informality, and correspondingly health insurance coverage, vary significantly across regions, as does the quality 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.

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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.

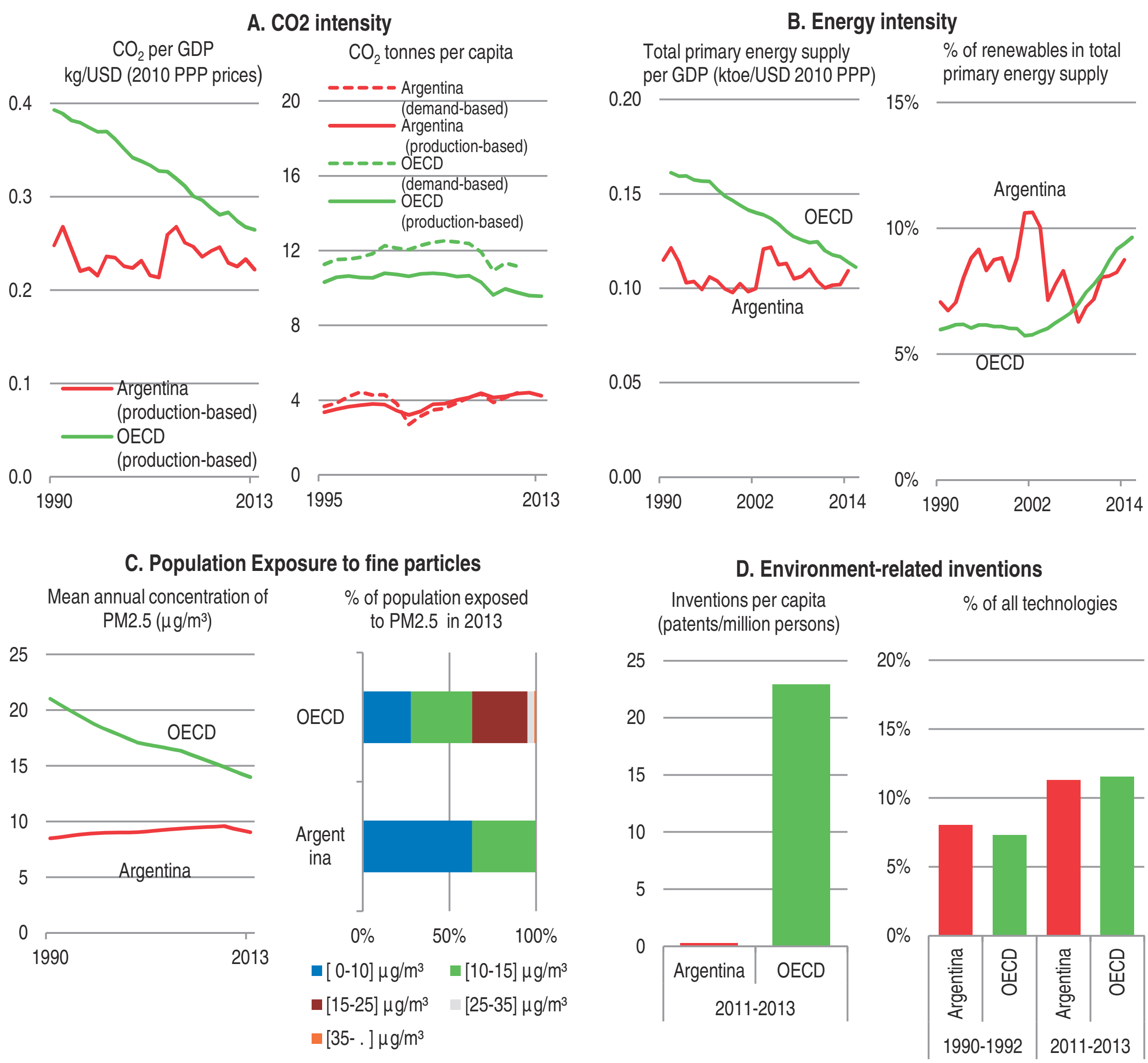
Green growth challenges

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.

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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.

Thematic chapters

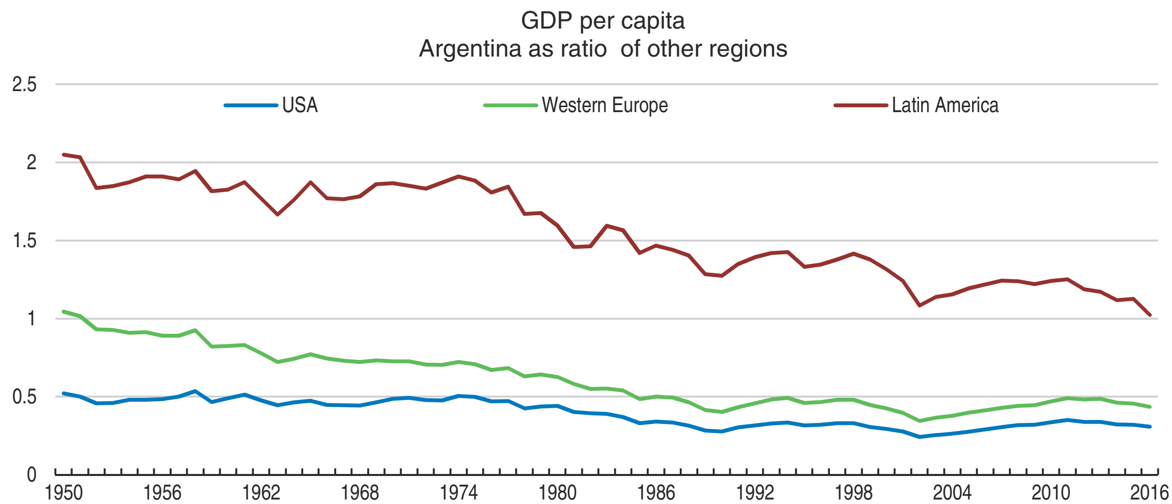
Chapter 1

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.

Over the last decades, Argentina has persistently lost ground relative to OECD countries and also relative to Latin America, hurting living standards and weakening confidence in public institutions. In 1950, per capita income was comparable to that of Western Europe and more than twice as high as in the rest of Latin America. Today GDP per capita is half of that of Western Europe and the historical income premium over other Latin American countries has almost disappeared (Figure 1.1).

Figure 1.1. **Argentina has lost ground**



Note: 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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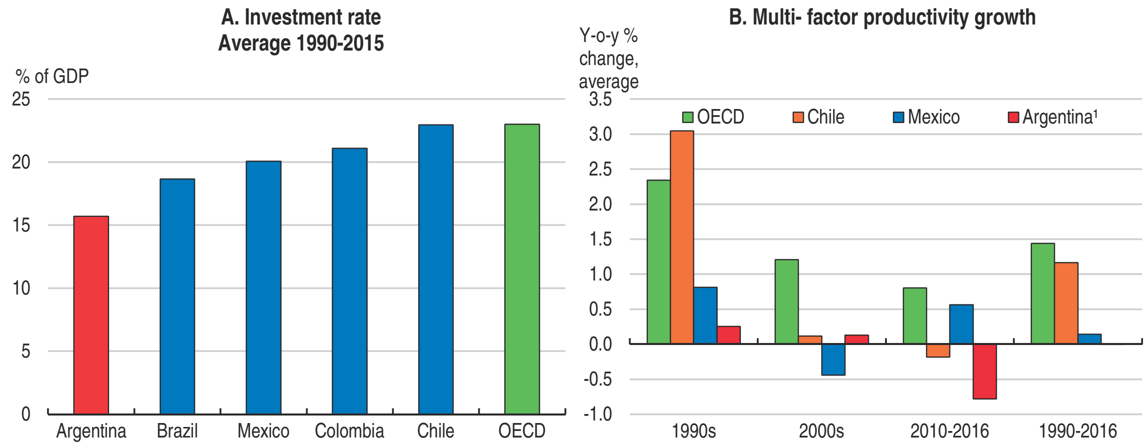
More recently, terms of trade were highly favourable between 2003 and 20011 and led to higher incomes. But growth has been hampered by weakening institutions, widespread interventionist policies and longstanding distortions in prices and incentives. Competition, which induces firms to become more efficient or exit, has been traditionally weak and poor domestic policy settings have held back the competitiveness of Argentinian firms, impeding them from realising their full productivity potential. All of this has translated into one of the lowest investment rates in Latin America (Figure 1.2, Panel A), and into stagnant multifactor productivity (Figure 1.2, Panel B). The latter masks important differences across sectors. Agriculture or telecommunication services show a relatively good performance, but other sectors, notably non-tradable services, perform weakly (Coremberg, 2012). Price levels are also high in international comparison (Figure 1.3), affecting purchasing power and signalling the need for stronger competition.

The economy has also been volatile (Figure 1.4, Panel A), well beyond the levels observed in other advanced and Latin American countries (Figure 1.4, Panel B and Campos et al., 2014), due to poor economic policies and weak institutions (Acemoglu, 2003). Macroeconomic

Figure 1.2. **Investment and productivity are low**



1. Data for Argentina end in 2015.

Source: OECD Economic Outlook 100 database and Centro de Estudios de la Productividad.

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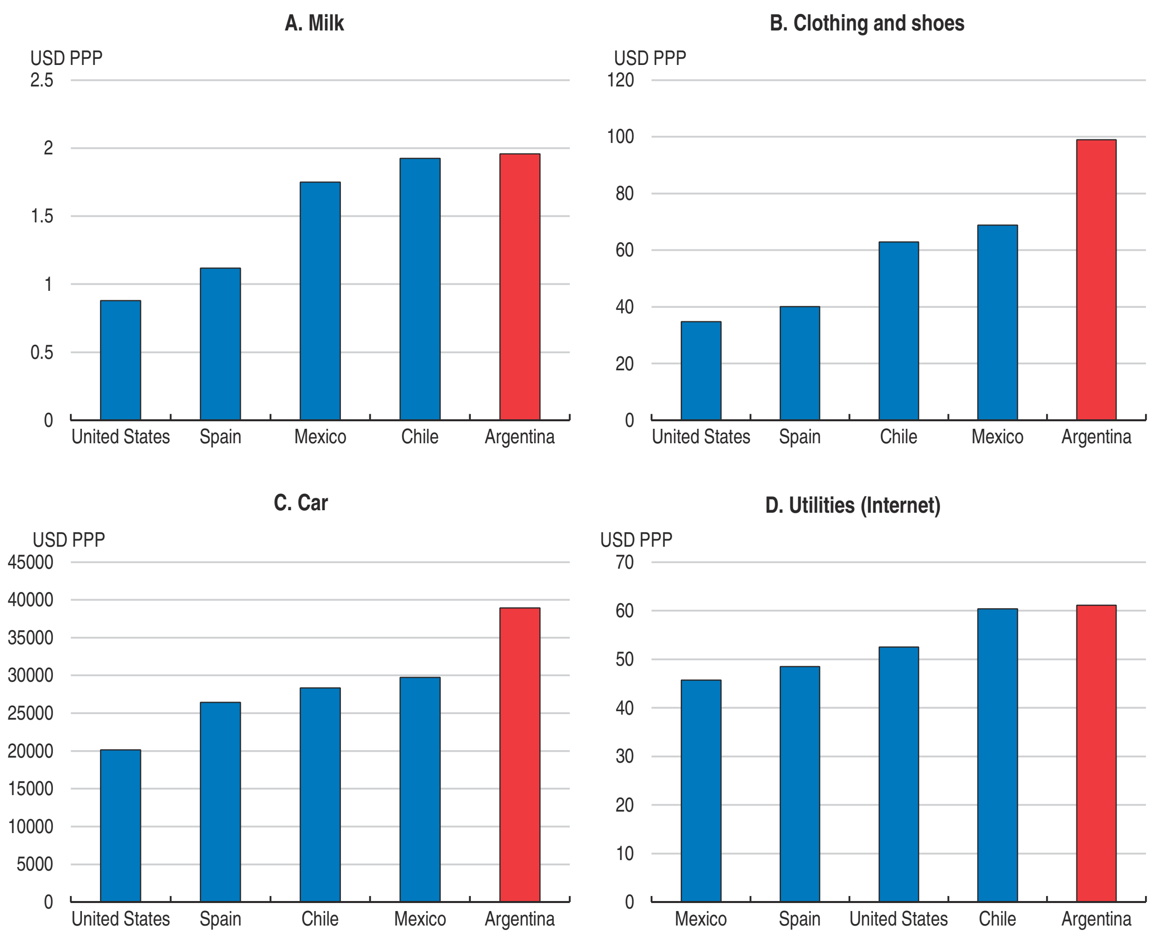
Figure 1.3. **Prices are high**



Note: Clothing and shoes prices are proxied by the price of a dress in a Chain Store. Car prices are proxied by the price of a Toyota Corolla or equivalent new car. Internet prices are those of a 10 mbps, unlimited data, cable/ADSL connection. Prices are converted to PPP dollars by using conversion rates published in IMF's World Economic Outlook.

Source: OECD computations based on Numbeo data.

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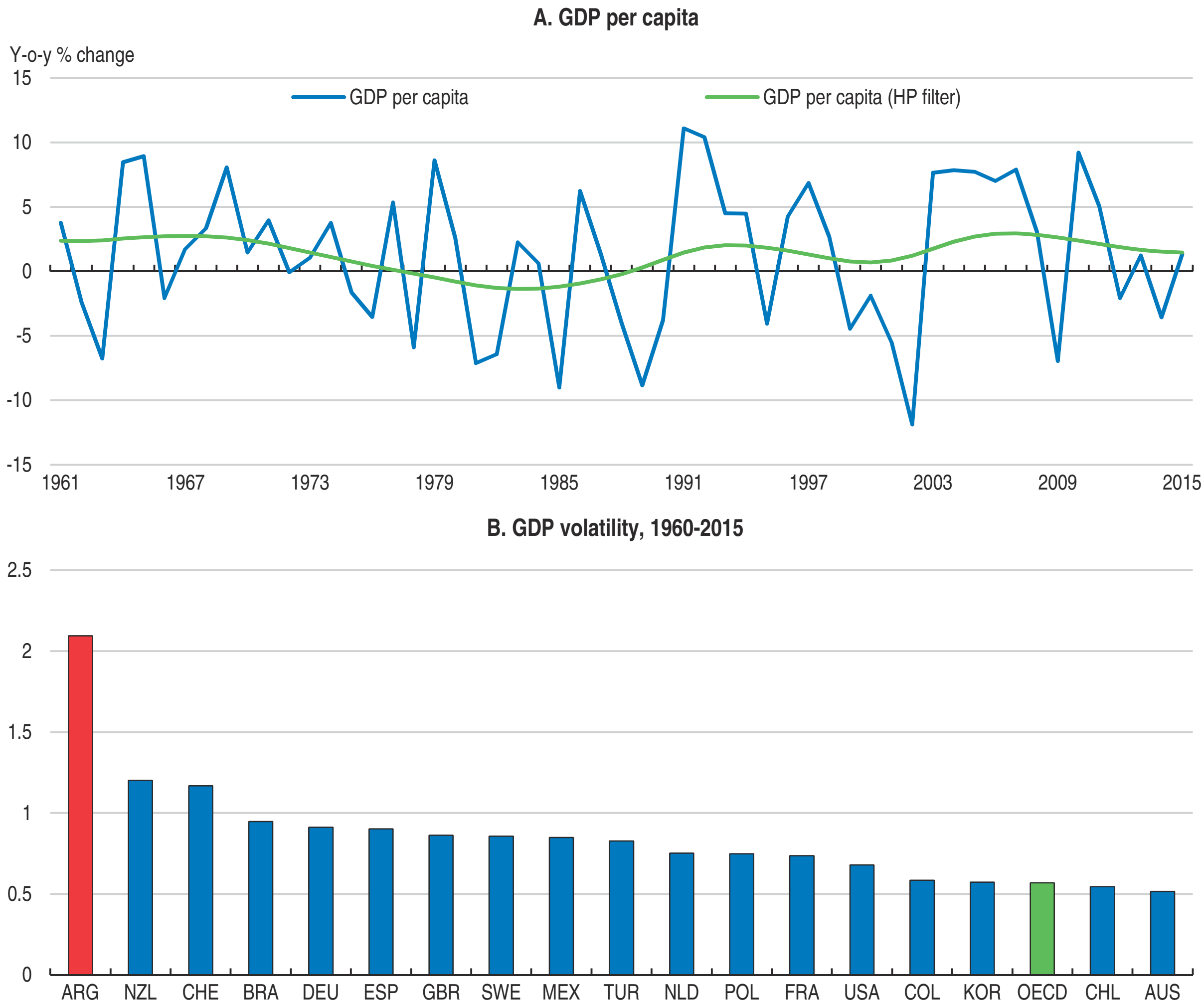
Figure 1.4. **Volatility has been high**



Note: GDP volatility is calculated as the standard deviation of GDP year-on-year growth rates divided by the mean GDP growth rate.
Source: World Bank World Development Indicators database; and OECD Economic Outlook 100 database.

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instability has generally been associated with poor growth performance, as both domestic and foreign investors tend to stay away and resources are diverted elsewhere (Ramey and Ramey, 1995). Macroeconomic volatility also places a heavy burden on the poor. For example, the burden of the high inflation that accompanied Argentina's boom and bust cycles is typically borne disproportionately by those in lower income brackets, whose real incomes plunge during busts and who lack access to financial instruments to protect themselves against inflation. Moreover, the low output growth typically associated with macroeconomic instability has a long-term impact on poverty and inequality of opportunities, as children from poor families tend to drop out of school during crises (Behrman et al., 1999).

Argentina's potential to achieve high living standards remains large (Table 1.1). Its relatively large size provides opportunities to achieve economies of scale. Natural resources and the associated revenues they can generate, if properly managed, can be used to speed up growth, reduce inequality, and lift people out of poverty. In comparison to other countries, Argentina is relatively close to the United States, Europe and Japan, and it is also in a

Table 1.1. **Argentina's potential is large**

	Argentina	*Ranking of Argentina with respect to*		
		Latin America	OECD plus Argentina	World
Country size				
Surface area (sq. km)	2 780 400	2	4	8
Population	43 416 755	4	11	37
Labour force	19 540 451	4	12	37
GDP PPP (million of current international $)	884 155	3	14	30
Natural resources				
Arable land (hectares)	39 200 000	2	4	8
Soybean production (million metric tons)	53.4	2	2	3
Natural gas production (terajoules)	1 512 840.0	2	8	23
Oil gas production	2 847	3	3	19
Lithium mine production (tonnes)	2 900	2	3	4
Proximity to markets	12 612	2	3	4

Note: Proximity to markets is proxied by the average distance to Brussel, Tokyo and New York (kilometres).
Source: World Bank World Development Indicators; U.S. Department of Interior U.S. Geological Survey; UN Energy Statistics Database; and OECD calculations.

convenient time zone, which is attractive for companies requiring real time communications with customers or headquarters.

To seize those opportunities raising productivity is crucial, underpinned by stronger investment and international trade. That would require comprehensive actions to reform institutions and regulations across multiple policy areas such as competition, business regulations, infrastructure, taxes, innovation, the rule of law, trade or education. Those reforms would also reduce the likelihood of further boom and bust cycles as those that Argentina has been through in the past, and would facilitate that living standards improve for all, in an enduring way. They would also put Argentina on a path to job-richer and more inclusive growth. Stimulating investment would facilitate the creation of firms and jobs, while improving productivity and competitiveness would enhance the prospects of Argentinians to move into better paying jobs. Argentina's success in some specific sectors, such as agriculture, wine or information and communication technology (ICT) services (more below), is suggestive of its capabilities to compete successfully in the global economy.

Structural reforms will lift growth and well-being

In December 2015 the authorities put in place a landmark package of reforms (see the Annex for details). These reforms have already improved confidence and created conditions for reigniting growth and job creation. Going forward, a full implementation of the reforms already initiated and of complementary reforms to tackle remaining structural bottlenecks is crucial to make the on-going recovery stronger, increase employment and raise living standards and well-being. OECD estimates show that a package of reforms could boost GDP significantly over the next decade (Table 1.2). Policy reforms that would align Argentinian policy settings with the OECD average could increase GDP by 15% in 10 years. Less ambitious reforms that would align Argentina with Chile, Colombia and Mexico would raise GDP by 8% over the same horizon. These estimates represent a lower bound since some reforms, such as those in education, access to finance and the rule of law, 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). Among the different policy areas, product market reforms are the ones with the highest growth pay-off, followed by a

Table 1.2. **Additional structural reforms will pay off**[1]

	Scenario 1	Scenario 2
Accumulated effect on GDP per capita over 10 years from:	Convergence to selected Latin American peers[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
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. These estimates are subject to uncertainty with respect to their size and timing. See Annex for the methodology used to estimate the impact of reforms.
2. For this exercise peer Latin American countries refer to OECD Latin America countries (i.e. Chile and Mexico) plus Colombia.

Source: OECD calculations.

reduction in trade barriers, improvements in the tax structure and labour market reforms. The potential benefits from reforms in these individual policy areas will be discussed in more detail in the rest of the chapter.

The reform agenda will improve people's material living standards. Reforms boosting productivity should translate into higher wages, but there is a need to ensure that all Argentinians benefit from the fruits of reforms and that those who may be initially hurt by the transition get adequate support. This will be essential to overcome political economy obstacles to fundamental reforms in Argentina (Box 1.1).

Box 1.1. **Making reform happen in Argentina**

Carrying out reforms is complex and involves a wide range of political economy and country-specific considerations, but OECD evidence suggests a number of basic principles that have often been successful in making reform happen (OECD, 2010). For example, 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 that facilitate the entry of new firms, as this is likely to translate into job creation (OECD, 2016a). Likewise, shifting the composition of public spending towards investment in infrastructure can both boost medium-term potential growth and stimulate demand in the short-term. Given how closed the economy is, a swift removal of trade barriers in certain sectors, such as those providing capital inputs to other parts of the economy, could also provide significant short-term benefits.

Reform packaging can also facilitate the implementation of reforms, as it helps to maximise the benefits through synergies across multiple areas (OECD, 2017a). Reforming product and labour markets simultaneously would allow new firms to create new jobs and workers to transition more smoothly between jobs. Changes to job protection or trade policies could be best done in tandem with improving active labour market policies and training so as to support workers in acquiring new skills and in getting ready for new jobs. A package of reforms will also share their burden between various interest groups helping acceptance.

Box 1.1. **Making reform happen in Argentina** *(cont.)*

Finally reducing policy uncertainty helps. Reform strategies that are well communicated can provide clearer guidelines and incentives for firms and workers. Communicating clearly the direction, the sustainability and the expected benefits of policy decisions, with a special focus on communicating 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. Communication should shift from emphasising the cost for some firms towards the benefits for consumers and job creation, particularly as concerns trade policies.

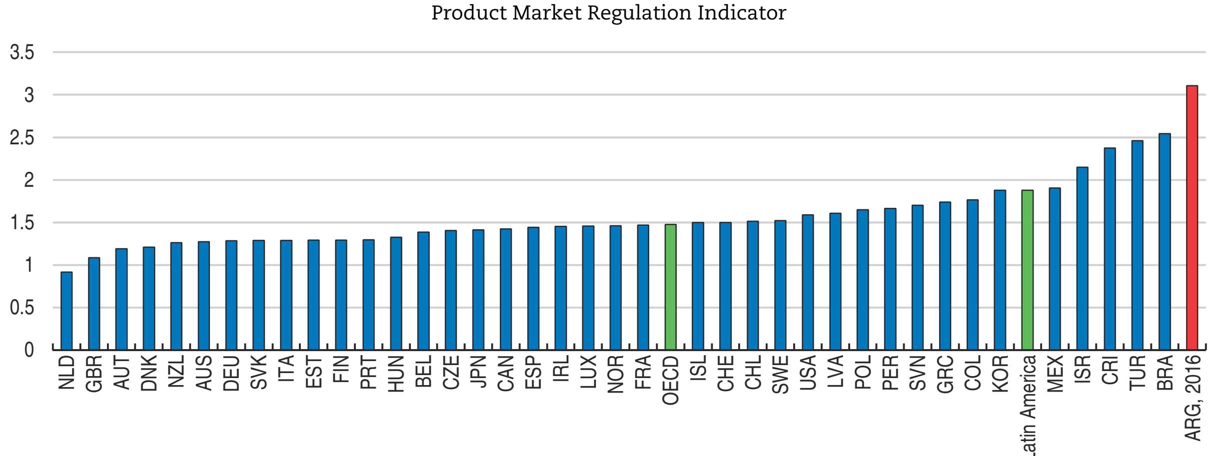
There are also benefits to ensure co-ordination across different policy areas and to avoid policy silos so as to manage trade-offs and exploit synergies. To that end, many countries in the region and in the OECD have established productivity commissions (Banks, 2015). Argentina has set up a presidential council labelled *Argentina 2030*, tasked with advising on how to boost growth, involving both academics and private sector participants. This council has the potential to play a similar role as productivity commissions in identifying obstacles to productivity growth and proposing policy options to overcome them. The experience of other OECD countries shows that successful reforms are generally based on a good diagnostic and quantification of the benefits. Thus, providing the presidential council with the support of a technical unit could be useful so that the council can provide evidence-based policy advice, contributing to improving the quality of policy and the prospects for its implementation.

Gains from product market reforms would be large

Regulations on product markets serve legitimate objectives but can impose unnecessary restrictions on competition, and therefore on growth, living standards and ultimately well-being. They can also have "knock-on" effects on non-regulated sectors of the economy that use the output of the regulated sectors as intermediate inputs. For example, inadequate regulation of the electricity sector will have effects on other sectors such as manufacturing

Figure 1.5. **There is room to improve product market regulations**

Product Market Regulation Indicator



Note: 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 for Argentina are for 2016 and preliminary, based on an update undertaken jointly with the World Bank. For other countries data are for 2013 or last available year.
Source: OECD Product market regulation database.

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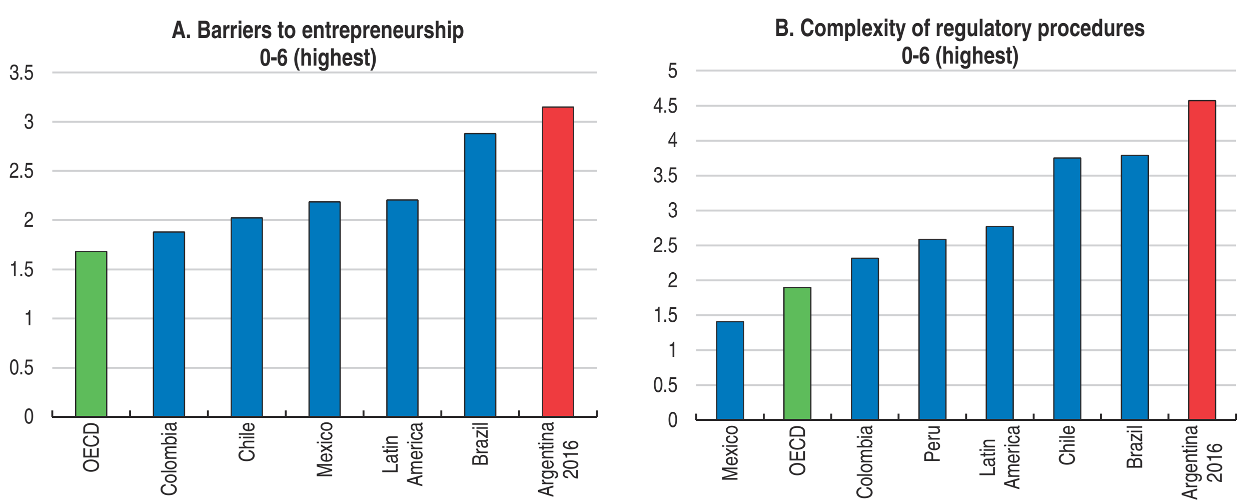
where electricity is an important input. A recent update of the Product Market Regulation (PMR) indicator for Argentina, undertaken jointly with the World Bank, suggests that Argentina tops the list of countries with respect to the restrictiveness of its regulations (Figure 1.5). Improving product market regulation will allow stronger competition, which will raise productivity and hence the ability to pay higher wages. By reducing entry barriers in sectors with large pent-up demand it can facilitate firm creation, boosting investment and job creation relatively fast (OECD, 2016a). Moreover, product market reforms can be inclusive in that they tend to lift incomes of all households across the income distribution by boosting both employment and productivity growth (Causa et al., 2016). OECD estimates suggest that GDP would be up to 4.4 percentage points higher over the next years if Argentina were to align its product market regulations with international standards. Reducing barriers to entrepreneurship, including obstacles for firm's start-up and growth, improving the governance of state owned enterprises and buttressing the competition framework towards best standards offer large pay-offs in terms of growth (Table 1.2).

Barriers to entrepreneurship are high

According to OECD's Product Market Regulation indicators, Argentina has one of the highest barriers to entrepreneurship in Latin America, well above those in Mexico or Chile (Figure 1.6, Panel A). The World Bank's Doing Business indicators show a similar picture, with Argentina ranking 116th out of 190 countries. Regulatory procedures are complex and long, especially those related to obtaining licences and permits (Figure 1.6, Panel B). Procedures and regulations depend on the location of the firm and on the economic activity, and there is no co-ordination between different levels of government. On average there are 40 procedures to comply, half at federal level and half at local level, and it takes from 45 to 60 days to open a business. Besides acting as a barrier to investment and entrepreneurship, these barriers can also enhance the scope for corruption.

Figure 1.6. **Barriers to entrepreneurship are high**



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

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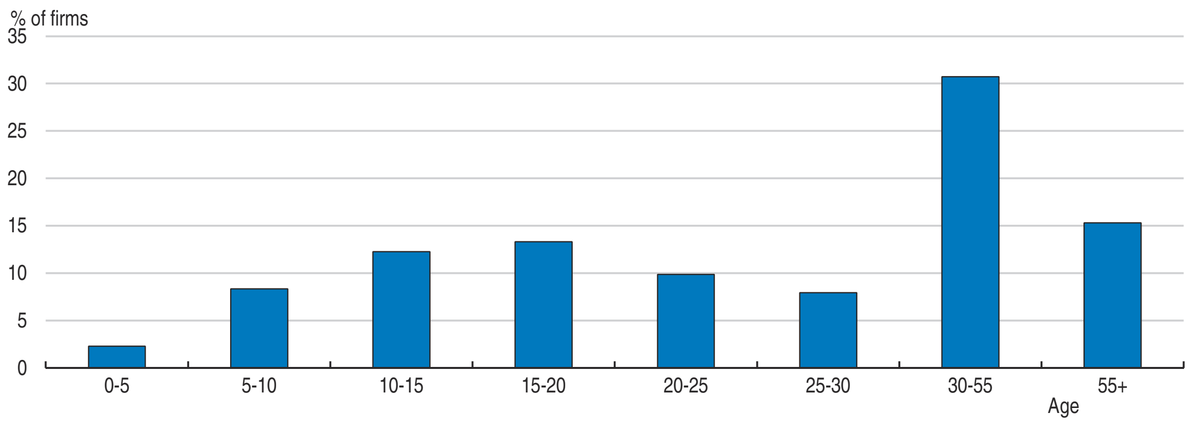
High barriers to entrepreneurship, and in particularly those deterring entry, can hamper significantly the creation of new firms. In the absence of the disciplining effect of competition from new entrants, firms tend to grow less, remain small and be less productive

(Klapper et al., 2006). Some of these features are very noticeable in Argentina's manufacturing sector, with few young firms (Figure 1.7). The average Argentinian firm is 27 years old, well above average ages observed in Latin America (21 years) and OECD economies (17 years) (Enterprise Survey, 2014). OECD work based on cross-country firm level data indicates that young firms create more jobs (Criscuolo et al., 2014). Over the last decade and across all countries analysed, 42% of all jobs were created by enterprises less than 5 years old.

Figure 1.7. **There are few young firms**



Source: OECD computations based on World Bank Enterprise survey database.

StatLink http://dx.doi.org/10.1787/888933542327

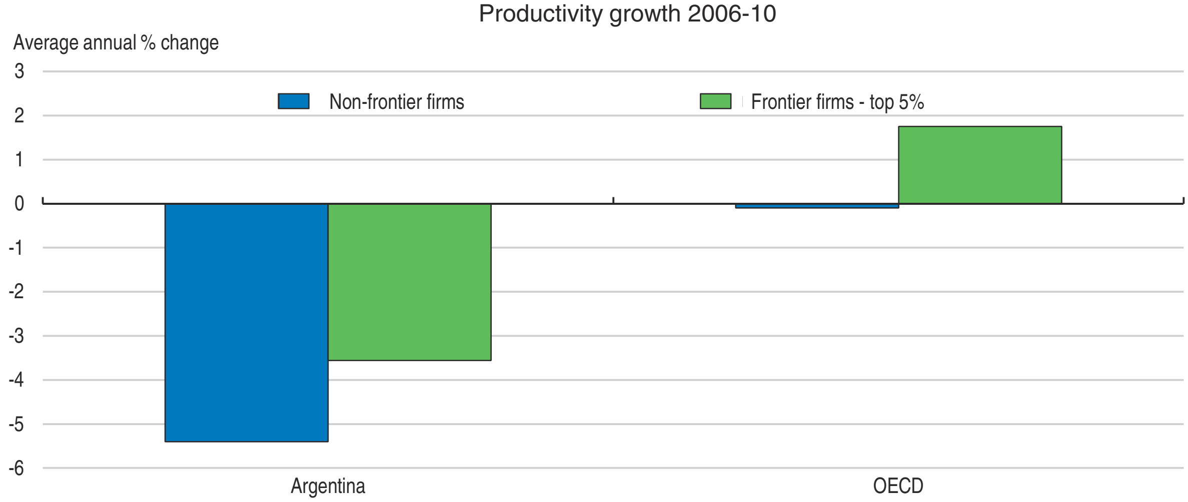
Reflecting the key role of young firms in job creation, public policies have increased their focus on start-ups both in OECD countries and in Latin American countries (OECD, 2016b). Argentina recently approved a new entrepreneurship law (*Ley de emprendedores*), aimed at supporting the creation and financing of start-ups, and a SMEs law (*Ley de PYMEs*), reducing some taxes for SMEs and aiming at improving financing. Given the role for young firms in job creation, it will be important to undertake a sound evaluation of both laws and assess their effects on firm creation and on improving access to finance by young and innovative firms. The evaluation would provide evidence about which of the support and finance mechanisms introduced by both laws work and should be extended, and which ones are not effective and should be phased out.

Effective insolvency regimes can also play an important role to foster entrepreneurship and productivity (Adalet McGowan and Andrews, 2016). Argentina's insolvency procedures are in line with the Latin America average but are less efficient that in some regional peers such as Colombia or Chile, or than those found in OECD countries (World Bank, 2017). Improving insolvency procedures, by making them more agile and less costly, would boost entrepreneurship by providing second chance opportunities to entrepreneurs. They can also help to boost productivity and competition by increasing firm creation (Cumming, 2012) and by facilitating that capital and financing moves to new and young firms, which, in turn, would boost job-creation.

Lack of comprehensive firm level data impedes a detailed firm-level productivity analysis, but existing information for the manufacturing sector indicates that the gap between the best performing firms and the rest has increased. This is in line with evidence for OECD countries (Andrews et al., 2015). Nevertheless, contrary to evidence in OECD countries, where firms at the global frontier experienced robust productivity growth in the 2000s, productivity of best performing firms in Argentina has also fallen (Figure 1.8). This suggests that the impediments for productivity growth in Argentina are binding and affect all firms in the manufacturing sector. Firm level analysis indicates that resource misallocation in the Argentinian manufacturing sector is large (Neumeyer and Sandleris, 2010). The potential gains in terms of aggregate total factor productivity of moving to a more efficient allocation of capital and labour could have reached 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. Improving product and labour market regulations, boosting competition and skills, enhancing access to finance and reforming the tax system, as discussed in this chapter, would help to move towards a better allocation of resources.

Figure 1.8. **The productivity of all firms have fallen**

Productivity growth 2006-10



Note: “Frontier firms” is the average labour productivity (value added per worker) of the 5% most productive firms. “Non-frontier firms” is the average of all firms, except the 5% most productive firms. For the OECD calculations frontier firms are selected among all firms in the OECD within each sector, as described in Andrews et al., (2015). For Argentina frontier firms are the 5% most productive Argentinian firms in the manufacturing sector.

Source: OECD computations based on Enterprise Surveys for Argentina; Andrews et al., (2015) for OECD.

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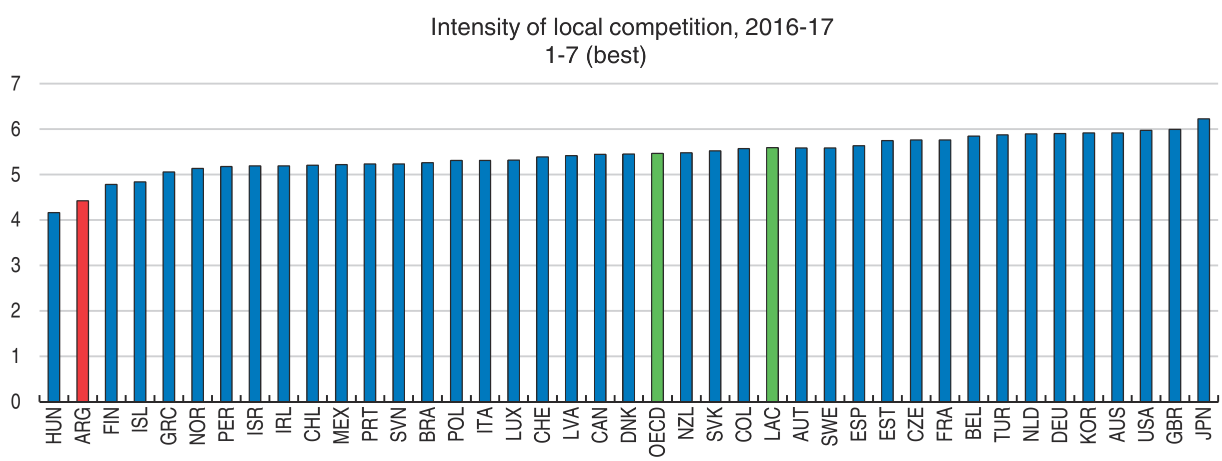
Facilitating firms start-up and growth

The recently approved entrepreneurship law (*ley de emprendedores*) aims at facilitating firms’ start-up by creating a new type of firm, which can be set up in one day. To complement this initiative, Argentina would benefit from adopting OECD best practices in the area of licensing, such as using systematically the “silence is consent” rule, whereby the licenses for non-hazardous activities are issued automatically if the competent licensing office has not acted by the end of a statutory response period. Additionally, setting-up single contact points for issuing or accepting notifications or licences have proved useful across OECD countries to reduce barriers to entrepreneurship. Portugal’s experience exemplifies how effective these initiatives can be: procedures, costs and delays for opening a business are now 4, 6 and 19 times lower, respectively, than a decade ago (OECD, 2017b). One-stop shop services, including online, have also proved useful in countries with high incidence of informality, such as Brazil and Mexico. By facilitating more flexible and simple registration procedures, especially online, they reduce the cost of going formal, particularly for micro and small firms and can reduce opportunities for corruption.

The existing regulatory framework also fragments the domestic market, acting as a barrier for firms to grow. Regional and local authorities often impose extra requirements on companies from other parts of the country. This results in a very low intensity of local competition (Figure 1.9), contributing to a loss of competitiveness abroad and higher prices domestically. By reducing the scale of production, these barriers also hamper productivity, and they also have a detrimental impact on job quality, as employment conditions tend to be better in larger firms (Gibson and Stillman, 2009). Argentina would benefit from introducing an explicit programme to reduce and eliminate administrative burdens imposed by government at all levels. Similar programmes have been set up in some OECD countries such as Australia, Canada and Spain. In Spain, all legal texts enacted by local, regional and central governments found to be inconsistent will have to be amended in the subsequent six months if they create internal barriers to trade, 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. Canada also faces challenges with internal barriers to trade and investment arising from overlapping federal, provincial and territorial regulatory responsibility over many economic policy areas. It established the so-called Agreement on Internal Trade in 1995, an intergovernmental agreement according to which parties agree to a set of general rules to prevent governments from establishing new trade barriers and to reduce existing ones. The Agreement has been recently updated and its scope enlarged (OECD, 2016c).

Figure 1.9. **The intensity of local competition is low**



Source: World Economic Forum Global Competitiveness Index Dataset.

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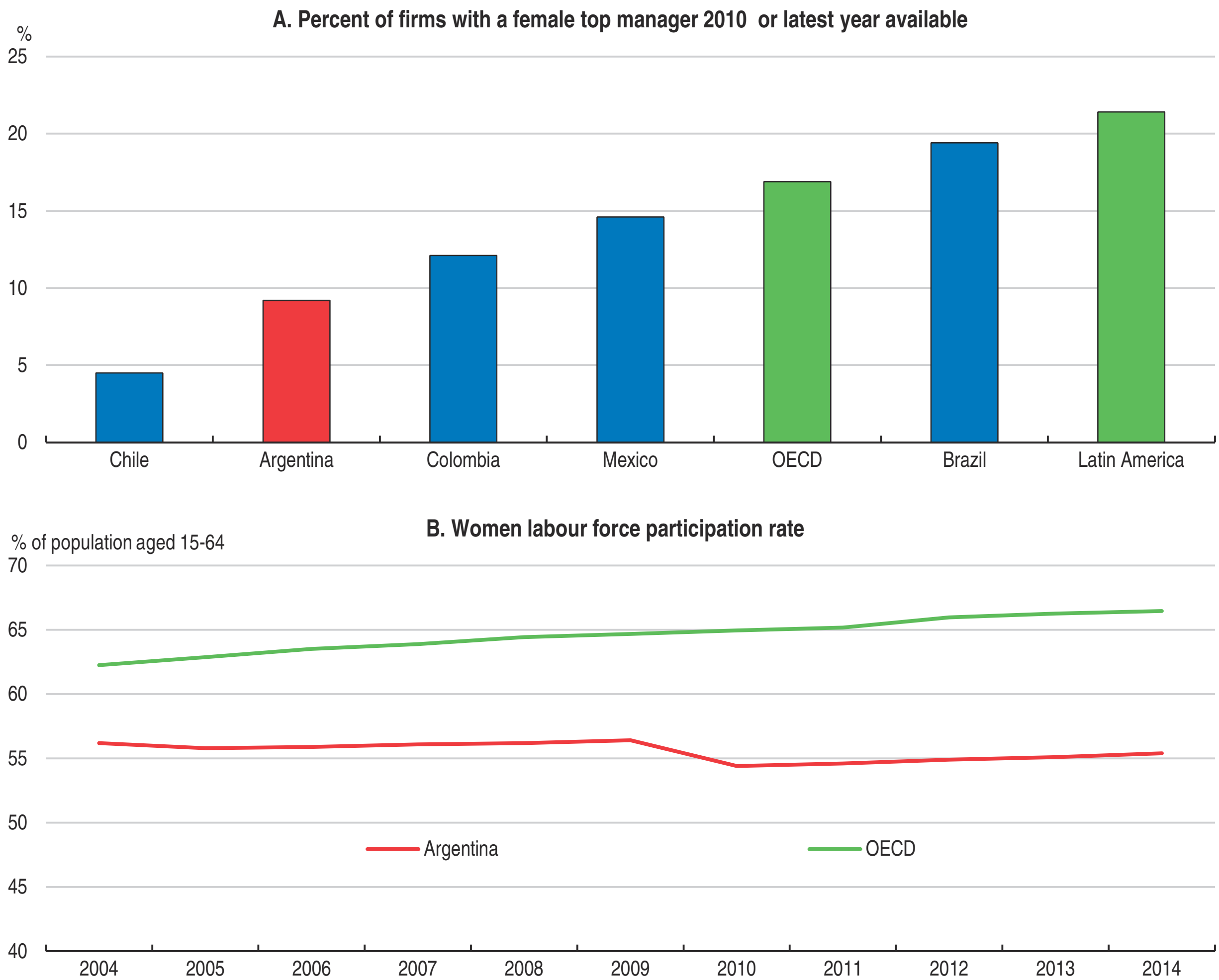
Making the business sector more gender inclusive

The business sector has few firms with female top managers (Figure 1.10, Panel A), well below those observed in other Latin America and in the OECD. This indicates that Argentina is not exploiting the potential that a more gender inclusive business sector can offer, for example by providing a broader understanding of customer needs and a wider range of management practices. The presence of female top managers signals the existence of high paying jobs for women and therefore can effectively encourage other women to seek better employment (Amin and Islam, 2014). This would be particularly important in Argentina,

Figure 1.10. **The share of firms with a female top manager is low**



Source: World Bank Enterprise survey database; World Bank World Development Indicators database.

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where female labour market participation is relatively low (Figure 1.10, Panel B and Chapter 2), including among high-qualified women.

Promoting gender diversity in leadership positions both in private companies and public sector, for example by using gender quotas in management, can contribute to enhance diversity and improve economic outcomes. Policies that promote gender balance on boards and in senior management have been initiated in a majority of OECD countries. Countries that have adopted a quota, such as Norway (Sorsa, 2016), saw a more immediate increase in the number of women on boards, while those that took a softer approach, using disclosure or targets, have seen a more gradual increase over time. More generally, bringing gender issues into the public debate through information campaigns would help to raise awareness for the existence of gender inequalities and for the potential benefits of a more gender-inclusive business sector.

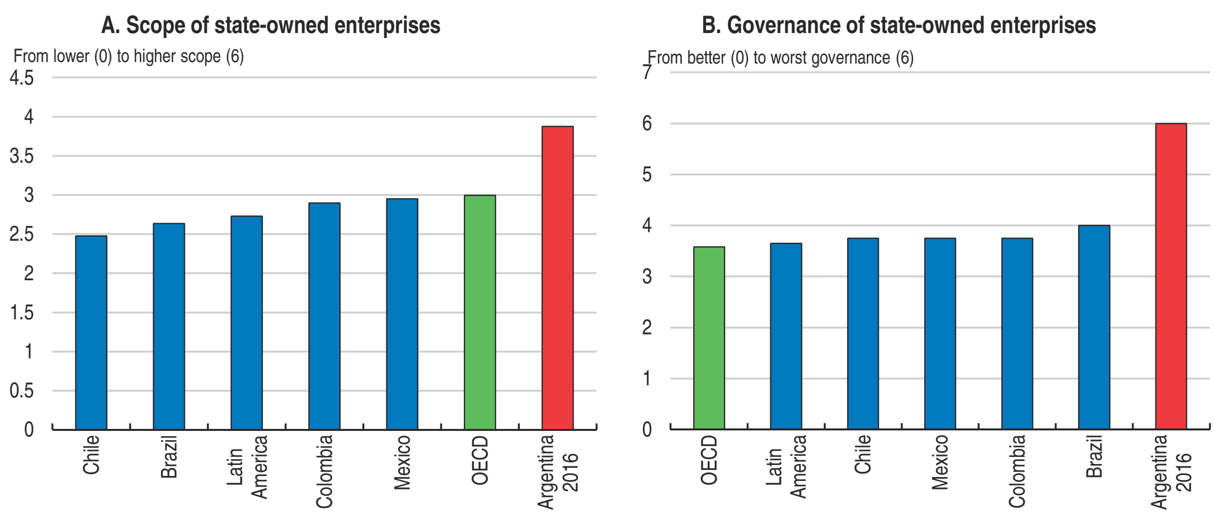
Increasing female representation in top management can also help to improve management quality and firm performance (Dezsö and Ross, 2012). This would be particularly relevant for Argentina, as internationally surveys of management quality suggest that Argentina's manufacturing sector hosts a significant fraction of firms whose quality of management lags behind management practices in other countries (Bloom et al., 2014). Empirical research suggests that many of these firms would probably have been driven out of the market if competitive pressures were stronger (Bloom et al., 2014). The quality of management plays a crucial role for productivity, as better-managed firms can avoid losing time on non-productive tasks and employ more efficient production technologies or better intermediate inputs (Andrews and Westmore, 2014).

Strengthening the governance of state owned enterprises

State owned enterprises (SOEs) play a sizeable role in Argentina. The SOE sector is large (Figure 1.11, Panel A), with 67 fully owned SOEs and minority share ownership in another 70 enterprises (OECD, 2015a). They are important in many sectors such as oil and gas, electricity generation, air and rail transport, paper, banking and shipyards, among others. The performance of these sectors has wide-ranging knock-on effects in the whole economy. The budget allocation for SOEs has increased significantly, with transfers amounting to approximately 1.1% of GDP.

SOEs performance is heterogonous, with some of them generating large deficits despite sizeable government subsidies and monopolistic conditions. Argentina ranks unsatisfactorily in terms of SOEs governance, both in comparison with OECD and other Latin American countries (Figure 1.11, Panel B). Auditing processes are heterogeneous. A paradigmatic case is *Aerolineas Argentinas*, the re-nationalised airline company making large losses despite receiving 300 USD millions (0.06% of GDP) in subsidies in 2016. Most recent approved accounts date back to 2013.

Figure 1.11. **The scope of SOEs is large and its governance could be improved**



Note: How to read this chart: In Panel A, a higher value indicates a larger scope of SOEs. In Panel B, a higher value indicates less sound governance. Data refer to 2013.
Source: OECD Product market regulation database.

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Due to their privileged position, SOEs may also negatively affect competition and it is therefore important to ensure that, to the greatest extent possible, they are subject to similar competition disciplines as private enterprises. Although enforcing competition rules against SOEs presents enforcers with particular challenges, competition rules should apply to both private and state-owned enterprises (OECD, 2009a).

International evidence shows that corporatizing SOEs can yield large efficiency gains (OECD, 2016d). Adherence to the OECD Guidelines on Corporate Governance of State-owned Enterprises (OECD, 2015b) can help in addressing governance challenges usually faced by state-owned enterprises attributable to political interference, lack of incentives to improve performance and complex institutional arrangements. A review of SOE corporate governance to align practices with OECD/G20 Guidelines on SOEs is currently underway.

Argentina should establish a central state ownership agency, as outlined in the OECD Guidelines on Corporate Governance of State-owned Enterprises. Alternatively, if this is not feasible, sufficient co-ordination to ensure that ownership is exercised on a whole-of-government basis should be ensured. The government has recently created a Coordination Council of State owned enterprises, under the umbrella of the office of the Cabinet of Ministers, which is a promising initial step to move towards a more consistent, co-ordinated and transparent treatment of SOEs. The authorities should also define more clearly the rationale for owning individual SOEs, and establish and monitor the implementation of mandates and objectives, including financial and non-financial targets. The ultimate purpose of state ownership should be to maximise value for society, through an efficient allocation of resources and quality of services. For those SOEs displaying recurrent poor performance, the government should consider alternative ownership structures or revising the management incentives.

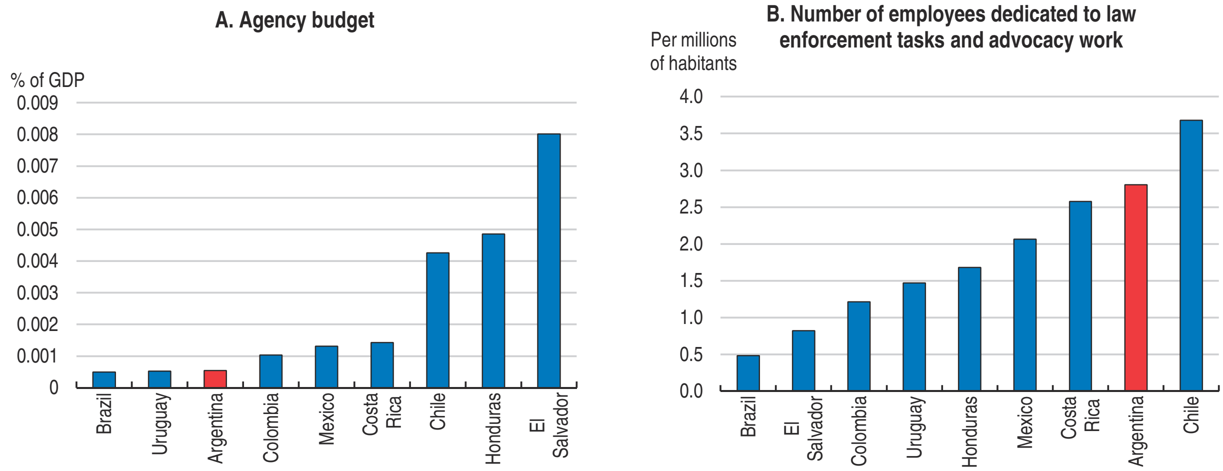
For those SOEs remaining in public ownership, another acute challenge concerns the selection and accountability of SOEs board members. Argentina has no mandated requirements for a formal nomination process, with the exception of listed companies. Positions on the board are not openly advertised and nominations are based on political decisions (OECD, 2015a). Well-structured, merit-based and transparent board nomination processes would likely lead to better management choices.

Fostering competition

Aligning to OECD standards in competition policy could generate significant growth and well-being dividends. Competition has been weak due to inefficient regulations, a deficient anti-cartel framework, extensive state ownership and arbitrary government interventions. Argentina was once a regional pioneer with respect to its competition framework, but today it is well behind regional peers, following years of insufficient budget (Figure 1.12), lack of independence of the competition agency and weak enforcement. Improving the competition framework should be a cornerstone of the on-going effort to improve institutional quality. Good progress has already been achieved. The National Competition Authority has been restructured and a law has been sent to Congress, intending to grant the Authority more independence, a clearer mandate, more resources to conduct investigations and the ability to impose higher fines. The law also introduces a leniency program and a specialised competition court. The latter would increase efficiency and decision quality due to the skills and experience of the judges reviewing and understanding economic evidence, and to the standardisation of tasks (OECD, 2016f).

Argentina has in the past enacted relatively good competition laws (OECD, 2006) but implementation and enforcement of existing laws has been weak. To avoid repeating mistakes of the past, an effective independence of the competition authority is crucial. Two aspects that could be reinforced are the formal status of the authority in relation to the executive and its budget. While it is foreseen that the authority will become a decentralised

Figure 1.12. **The competition authority has a low budget**



Note: Data are for 2012. Chile includes the sum of the Tribunal de Defensa de la Libre Competencia and Fiscalía Nacional Económica. Budget data for Brazil is provided in Brazil Real and converted to USD using 2012 average exchange rate.
Source: Centro Regional de Competencia para América Latina and World Bank, World Development Indicators.

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body, it will still depend on the executive branch, which may limit its de facto autonomy. Establishing a legal separation from the executive will provide the authority with clearer and more effective autonomy. Similarly, it is foreseen that the budget will be decided on an annual basis. Since it is fundamental to guarantee that the authority will have adequate funds and human resources on a long-term basis, introducing multi-annual budgets would provide the authority with more 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 turn-over, would allow a better focus on investigating cases of anti-competitive conduct rather than minor concentration cases. Competition powers tend also to be more effective when they are supplemented by a requirement for entities subject to recommendations to provide a written response within a fixed time period, as is done in the United Kingdom. Implementing a “comply or explain” rule would boost competition culture.

Evaluating whether planned or existing regulations can restrain competition should also be a more substantial part of the work of the authority. At present, when ministries or government agencies pass new laws or rules, they are not formally obliged to assess the impact on competition. It is up to the ministries or government agencies to do so. 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 Latin America countries, including Mexico (OECD, 2014a).

There is also a need to focus limited resources to areas where competition assessment may be most needed. The OECD’s Competition Assessment toolkit can be helpful for that, as it provides a systematic method to efficiently screen laws and regulations in specific sectors for unnecessary side-effects on competition (OECD, 2016e). It also helps to identify and develop alternative, less restrictive measures that still achieve government policy objectives.

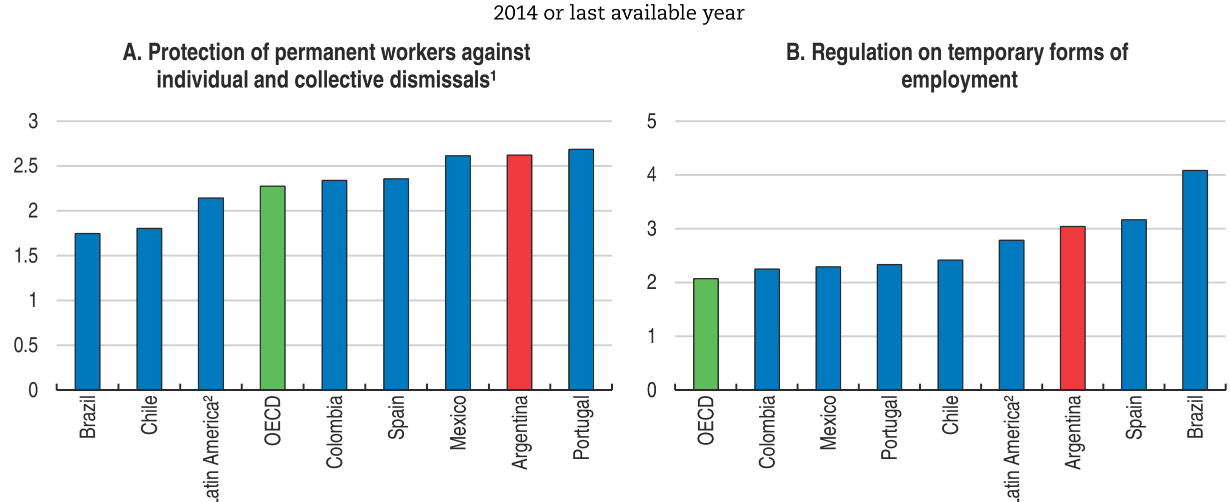
Improving labour market regulations

Labour market regulations should strike an adequate balance between protecting workers' rights and avoiding excessive rigidities that can hamper the good functioning of the labour market. Excessive rigidities or burdensome regulations raise labour costs and may prevent the reallocation of workers to more productive activities, as the one the Argentinian economy needs to undertake. Excessive labour market rigidities also tend to favour relatively better-off groups, such as formal sector workers on regular contracts, at the expense of more disadvantaged groups, including the unemployed or informal workers (OECD, 2016g). Where formal hiring presents high risks, for employers as a result of excessive rigidities, they may also be more inclined to resort to informal employment (OECD, 2008). With a third of the workforce in informal employment, this is a relevant issue for Argentina.

Some aspects of labour market regulations are more rigid in Argentina than in other Latin America countries and in the OECD on average, as measured by the OECD's employment protection legislation indicators (Figure 1.13). In particular, termination costs are among the highest, and the procedures for collective dismissals, for example notification requirements, are relatively complex and can apply already from a relatively low level of 10 workers.

Figure 1.13. **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 three 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.

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The use of temporary contracts, including apprenticeships, is restricted to a limited number of specific circumstances (Figure 1.13, Panel C) and may imply significant legal risks for employers. This increases incentives for informality because businesses may resort to informal labour to smooth fluctuations in demand or seasonal production schedules (OECD, 2008). Temporary employment can be a stepping stone for young to enter the labour market under specific circumstances (OECD, 2014c). This would be particularly pertinent for Argentina, given the number of youths outside the labour market and education (see

Assessment and Recommendations and chapter 2). At the same time it is important to avoid creating a dual labour market, where workers on permanent contracts enjoy protection and job stability while the rest of workers are confined to move from one temporary contract to another. A useful balance can be struck by allowing temporary contracts with relatively few restrictions while at the same time increasing protection on such contracts, particularly termination costs, gradually as job tenure increases. In practice, this creates a gradual convergence between temporary and permanent contracts, although it is unlikely that full convergence can be achieved (see OECD, 2014c).

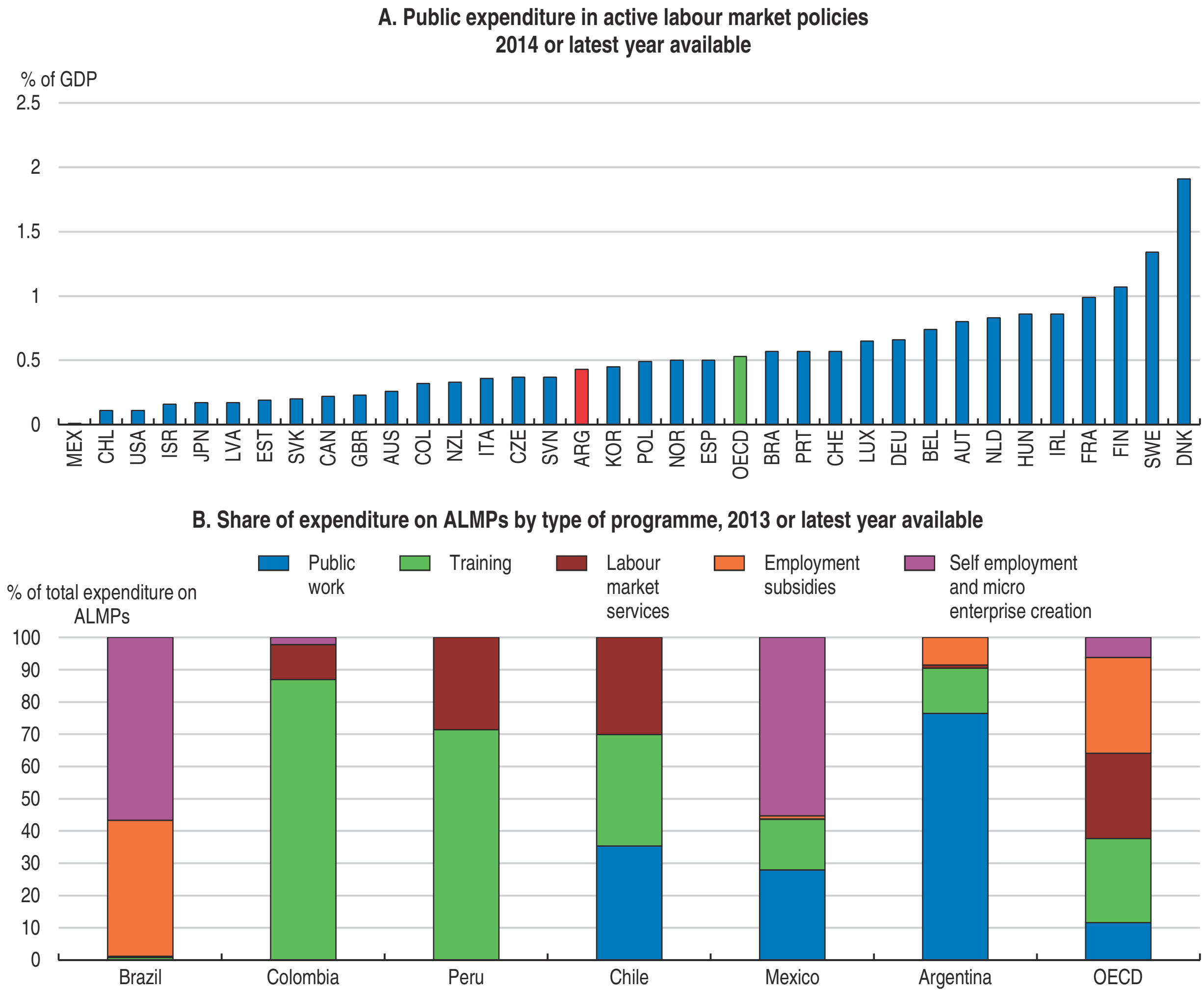
Protecting workers with training and unemployment insurance rather than with strict regulations

Modernising labour market regulations would lead to more formal and better matching between the supply and demand of skills, thus resulting in higher productivity and better-paying jobs. At the same time, there is 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. Therefore changes to regulations should be implemented in tandem with stronger active labour market policies, in particular training, and also with adequate income support for the unemployed (see also Chapter 2). Spending on active labour market policies remains below the OECD average (Figure 1.14, Panel A). In addition, 75% of the spending goes to finance public work schemes, while the share of spending on training is lower than in Chile, Colombia or the average OECD country (Figure 1.14, Panel B). Public work schemes provide a safety net and contribute to local development but are less effective in increasing the future employability of participants (Brown and Koettl, 2015). Thus, scaling up active labour market policies and shifting spending towards those schemes that support the acquisition of new skills, such as training, would better support that Argentinians get ready for the new jobs that will be created.

Several Latin American countries managed to make labour market policies more effective by adding an active labour market component, such as training and education, to existing conditional cash transfer programmes (Cecchini and Madariaga, 2011 and González Pandiella, 2016). Cash transfers provide income support in times of need but they can become more effective if supplemented by a training component that improves participants' chances to find more autonomous and sustainable income generation opportunities. The experience of Argentina with these types of programmes is positive. Empirical evaluations suggest that participation in a scheme combining a cash transfer with training is associated with better wages and higher chances of accessing formal employment (Lopez Mourelo and Escudero, 2016). Thus, expanding such schemes can be an effective way to provide support to those more affected by the reallocation process that the Argentinian economy has started and, at the same time, empower participants to benefit from the new jobs that Argentina will be creating.

Collective bargaining systems are also a fundamental ingredient of well-functioning labour markets. OECD evidence suggests that employment can decline when wage agreements become binding far beyond workers and firms that were represented in the negotiations (Gal and Theising, 2015). In these cases, the inability to adjust wages can shift the adjustment onto employment (De Serres and Murtin, 2013). In Argentina, collective bargaining tends to take place at the level of entire sectors and covers more than 70% of workers although only 30% of workers are unionised (Lamarche, 2015). Empirical work based on Argentinian data suggests that more decentralised bargaining at the firm level would increase productivity by

Figure 1.14. **Spending on active labour market is very concentrated in public work schemes**



Source: OECD Public expenditure and participant stocks on LMP database; ILO; and ILO (2016) "What works. Active labour market policies in Latin America and the Caribbean".

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providing more flexibility to respond to market changes (Lamarche, 2013). 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 (Calmfors and Driffill, 1988). However, in the context of emerging market economies with highly dispersed productivity levels across sectors and firms, and given the rapid structural transformation that the economy is going through, this avenue may 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.

Argentina could also benefit from making work time arrangements more flexible through the introduction of an individual bank of hours, according to which employees and employers agree on a number of hours that can be used flexibly in agreement between the employee and the employer. This scheme has proved useful in a number of countries, such as Portugal (OECD, 2017b), as it helps to respond smoothly to production cycle fluctuations or variable work patterns.

High non-wage labour costs can also curb employment. Argentina's social security contributions amount to 35% of wages, which is high in international perspective. In addition, insurance premiums against work risks can reach a further 20% of wages. The high insurance premiums are driven by high levels of litigation, which have risen in recent years despite a significant fall in the number of accidents. The government has recently introduced compulsory medical procedures to be pursued prior to referral to the justice system. This may curb litigation in certain cases, although care should be taken to avoid simply adding another administrative step to the dispute settlement process. There is a broader need to establish agile administrative out-of-court procedures to settle labour disputes and avoid that nearly all labour disputes end up in courts, implying high costs and uncertainty. This avenue has been followed by many OECD countries, which have institutional procedures to resolve labour disputes before they reach court (OECD, 2013a).

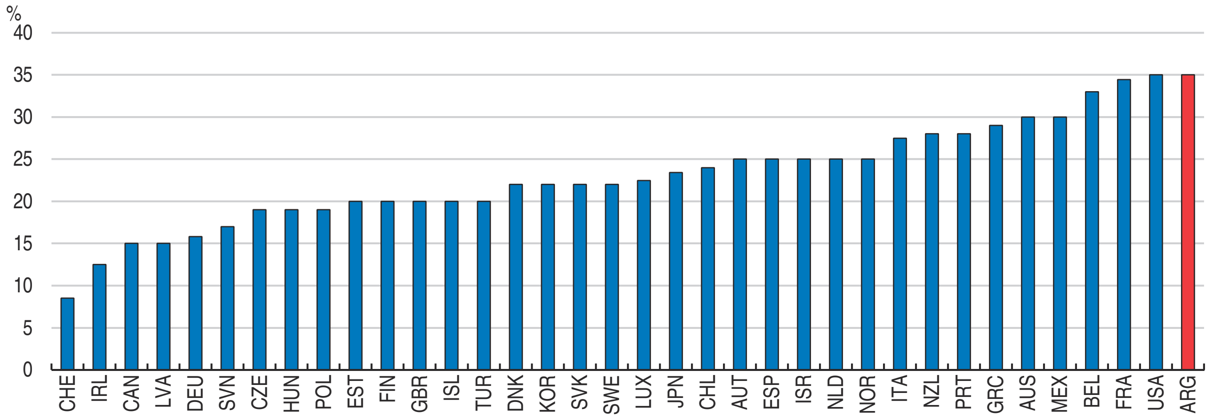
Making the tax system more conducive to investment

A complex and inefficient tax system is hampering productivity, investment and the competitiveness of firms. At the same time, it contributes little to improve distributional outcomes. The tax burden has increased by over 7 percentage points of GDP over the last decade and at 32% of GDP, it is well above the regional average and only slightly below the OECD average.

The statutory corporate income tax rate of 35% is high by international standards (Figure 1.15), even among Latin America countries, which tend to have higher rates than advanced economies. But the effective tax burden is even higher due to a provincial turnover tax (see below). Moreover, in the current high inflation environment, a failure to adjust depreciation allowances for inflation increases significantly the marginal tax rate on new investment (Artana et al., 2015). The negative effect on incentives to invest are a likely channel why higher corporate income taxes have been associated with lower productivity in the empirical literature (Schwellnus and Arnold, 2008). Shifting some of the tax burden away from corporate taxes could therefore be part of a productivity-enhancing tax reform. There is also room to broaden the corporate tax base by eliminating some deductions and loopholes.

Recurrent taxes on immovable property have generally been found to be less harmful for economic growth than income taxes (Arnold et al., 2011) and could be used more in Argentina. While the average OECD country raises 3.3% of tax revenues from such taxes, they account for only 1.2% of revenues in Argentina. Updating housing values on a regular basis will be crucial for raising more revenues from property taxes. Moving towards a progressive tax schedule could improve the distributional footprint of 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 some room to collect more taxes from environmentally related taxes: Argentina raises 1.2 % of GDP, in comparison with an OECD average of 1.6% and with 2.2% raised by Costa Rica.

Figure 1.15. **The statutory corporate income tax rate is high**



Source: OECD Tax database; and Ministry of Economics of Argentina.

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While particularly distortive export taxes have been largely eliminated, some highly distortive taxes remain. One of them is the provincial turnover tax (*impuesto sobre los ingresos brutos*), which is levied on sales at every stage in the supply chain. As a result, this tax has a cascading effect and, creates an artificial incentive for vertical integration, as there is no deduction for the tax paid at earlier stages (as there would be in a VAT), and reduces competitiveness. It also acts as an interprovincial tariff barrier, as different tax rates are applied depending on the origin of goods. Some provinces have increasingly and arbitrarily even taxed economic activities undertaken in other jurisdictions (Dapena and Volman, 2014), creating additional distortions and regulatory uncertainty. In its current form, the turnover tax is clearly a poor choice, but it raises significant revenues for provinces, which would need to be replaced by revenues from other sources.

Integrating this turnover tax into the existing VAT by converting it into a surcharge on the same tax base would reduce distortions and make the tax system more conducive to investment. 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, 2017c). In Argentina, such a step would lead to very high VAT rates unless some tax revenue is shifted towards other taxes, such as property and environmental taxes and a base broadening for personal income taxes, which is currently only paid by 10% of the population. There is also room to broaden the base of existing value added taxes (see Assessment and Recommendations).

Another highly distortive tax is the financial transaction tax, which is levied on every transaction in checking and saving accounts. This tax creates incentives to settle payments in cash, acting as a barrier for financial inclusion and formalisation. Moreover, it also hampers the development of financial markets by driving down the level of deposits (Fenochietto et al., 2014). Its rate of 0.6% on the volume of transactions is the highest among the countries that levy this type of tax, which include Colombia and Peru. Currently this tax raises 1% of GDP in revenues, which makes it more difficult to replace. But given the pressing need to curb informality and to foster the development of capital markets, alternatives with less distortive effects should be considered.

Argentina has also put in place a system of tax reimbursements (*reintegros a la exportación*) to compensate exporters from the effect of certain taxes deemed by the authorities to be "distortive" and detrimental for exporters, such as the provincial turnover tax, the financial taxes or municipal taxes. However, these reimbursements also create distortions of their own as they are discretional, subject to political negotiations, and favour incumbent firms to the detriment of new and young firms. A better way forward would be to tackle the problem at the root through a comprehensive tax reform that would strengthen investment, exports, productivity and job creation at the same time. Chile, Colombia and Mexico have recently implemented comprehensive tax reforms and are now starting to reap the benefits (OECD, 2015c, OECD, 2017d and OECD, 2017e).

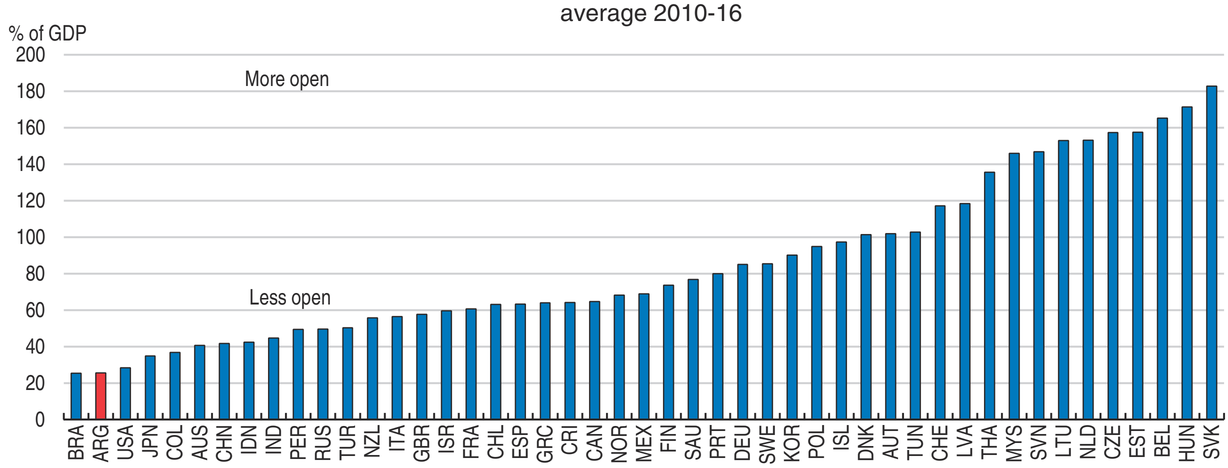
More generally, there is also a pressing need to simplify the tax system. There are more than 35 taxes and a complex system of cross-exemptions across taxes, depending on the type of activity and location. Simplifying the tax system would reduce compliance costs, which would help to raise more revenues and would particularly benefit SMEs and young firms, which tend to suffer more from complex tax structures (Dabla-Norris et al., 2017).

Reaping the benefits of international trade and global value chains

The economy shows ample room to become more integrated into the global economy. Exposure to trade has been persistently falling, with imports plus exports amounting to less than 30% of GDP (Figure 1.16). This reduces competition from abroad, adding to existing domestic barriers to competition. It also precludes the economy from reaping the benefits of trade for growth and job creation. Greater openness to trade can unleash productive potential by raising the scope for cross-borders knowledge diffusion and boosting competition (Andrews and Cingano, 2012). The participation in global value chains – activities where goods and services cross several borders along different value-added stages – has allowed lower-income countries to access world demand and advanced technologies without having to cover all production stages of a particular industry (Kummritz and Quast, 2016).

Figure 1.16. **Exposure to trade is low**

Trade openness (trade in % of GDP)
average 2010-16



Source: OECD Economic Outlook 100 database.

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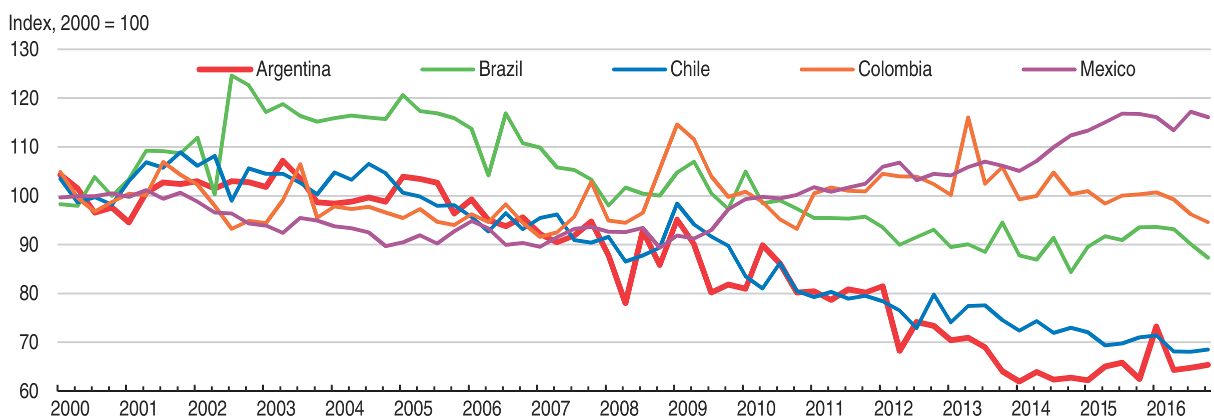
Export performance has been worsening persistently since 2006 (Figure 1.17). This can be explained by previously existing export taxes up to 35%, increasing labour unit costs (Figure 1.18), with wages growing above productivity, high tax and administrative burdens, infrastructure shortcomings and severely limited access to finance (more below). Low participation in trade is also a result of high tariffs and other trade restrictions (Figure 1.19). 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. These resources could be used more effectively to foster job creation in sectors where Argentina does not require protection to compete internationally. 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 agreements.

Figure 1.17. **Export performance has been weak**



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 100 database.

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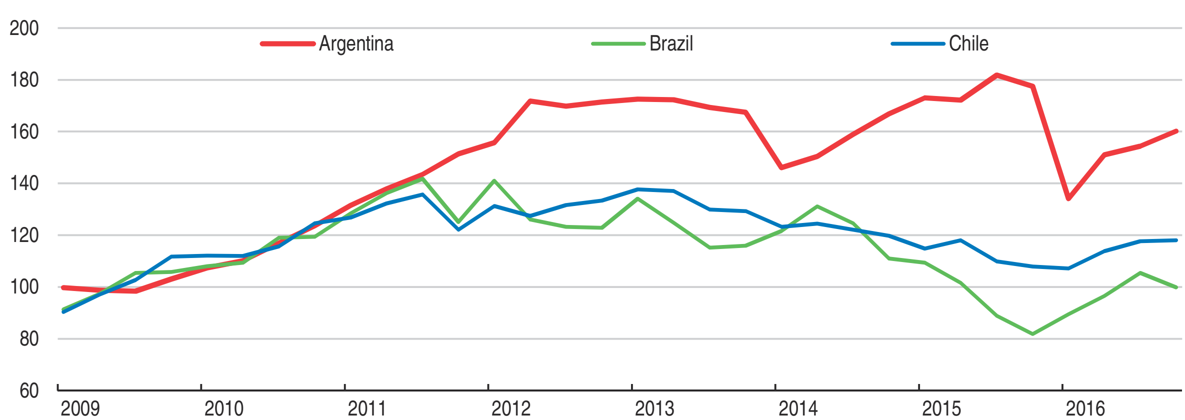
Figure 1.18. **Unit labour costs have increased**

2009 = 100



Source: IMF.

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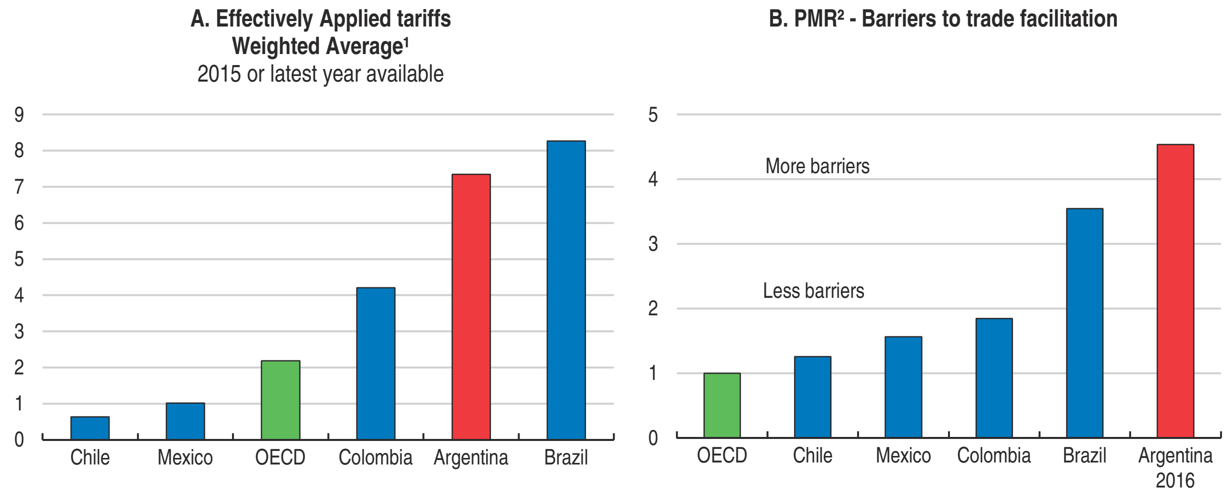
Figure 1.19. **Barriers to trade are high**



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.
3. Latin America includes: Brazil, Chile, Colombia, Mexico and Peru.

Source: World Bank World Integrated Trade Solution and OECD.

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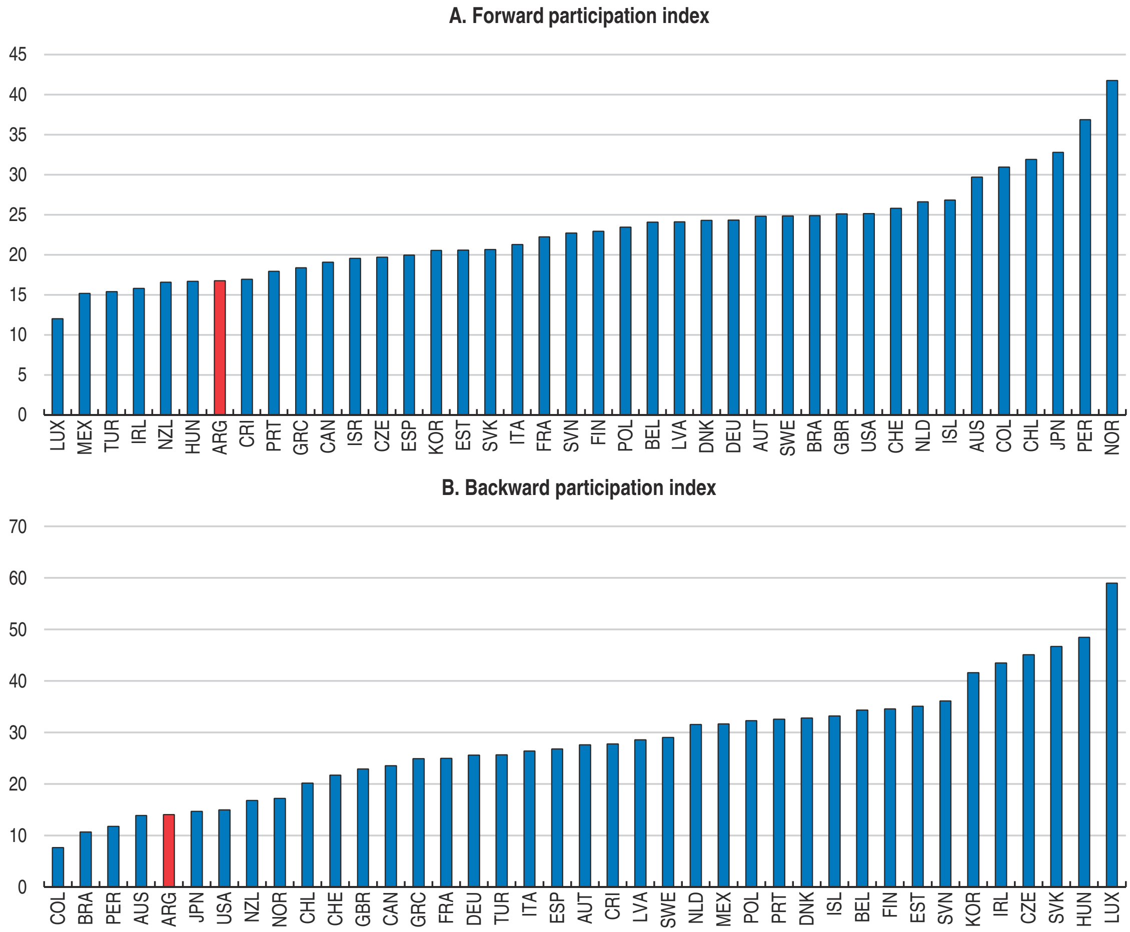
Argentina is poorly integrated into global value chains (Figure 1.20), but it is the world's largest exporter of soybean meal. Food and agriculture products account for half of exports (Table 1.3). Soybean derivatives (meal and oil), soybeans, and corn are the top exports. Motor vehicles account for 12% of exports. Machinery is the largest import item, accounting for 30% of all imports, followed by transportation goods (17%) and chemical products (16%). Brazil is Argentina's main trading partner, accounting for 18% of all exports and 21% of all imports (Figure 21). China and the European Union are also important trading partners. By contrast, Argentina trades relatively little with other Latin American countries, beyond Brazil. This may reflect a lack of bilateral agreements with other countries in the region and infrastructure weaknesses (more below).

Integrating Argentina stronger into global markets is a key priority. First steps into this direction have been taken recently. Foreign exchange controls and quantitative export restrictions on agricultural products were removed and export taxes were eliminated, with the exception of soybean and soy derivatives, for which they were reduced and are being phased out gradually. This is likely to improve Argentina's export performance, but much more remains to be done for exports to become an engine of growth. Boosting export performance would also open up opportunities for Argentinians to access better-paid jobs, since Argentinian exporters pay 31% higher wages than non-exporters (Bambrilla et al., 2016). Good recent export performances in services (Box 1.2) and in the wine sector (Artopoulus et al., 2013) illustrate Argentina's potential to tap successfully international markets.

Figure 1.20. **Argentina is not well integrated into global value chains**



Source: OECD-WTO Trade in Value Added database.

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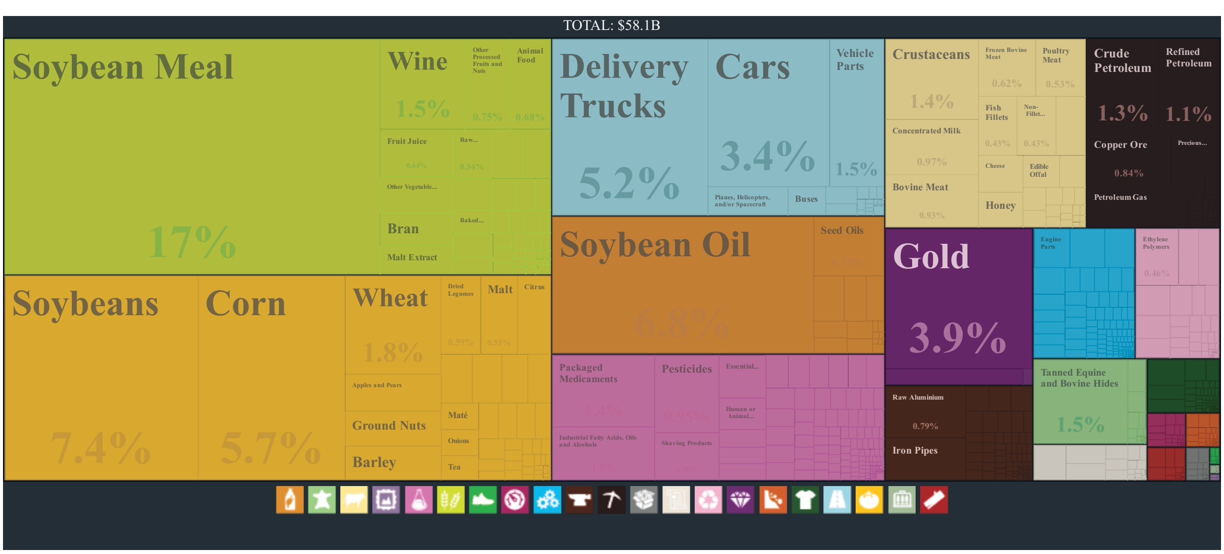
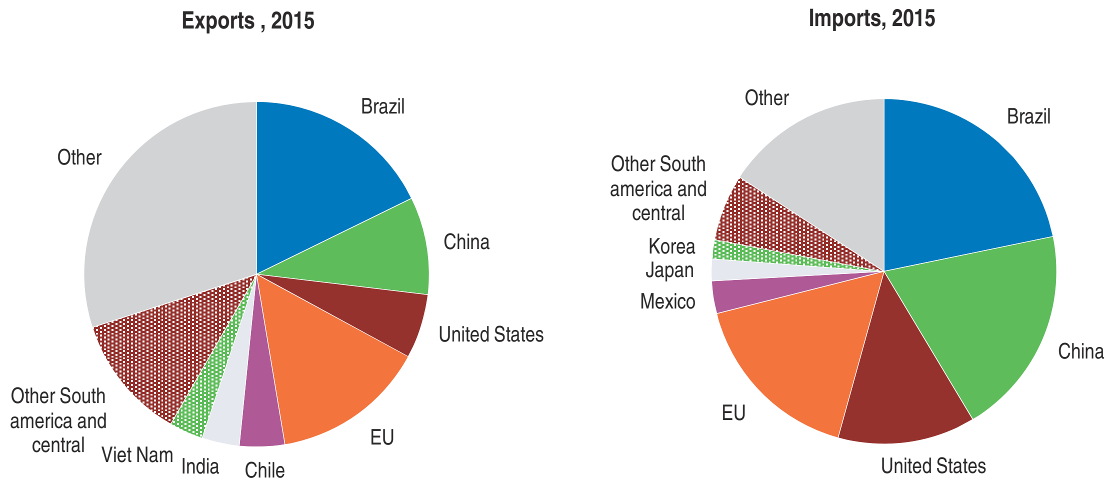
Table 1.3. **Which goods does Argentina export? (2015)**



Source: Observatory of Economic Complexity.

Figure 1.21. **Brazil, China and the European Union are Argentina's main trading partners**



Source: UNCTAD secretariat calculations, based on UN COMTRADE; IMF, Direction of Trade Statistics; UNCTAD, UNCTADstat Merchandise Trade Indices and Total Merchandise Trade.

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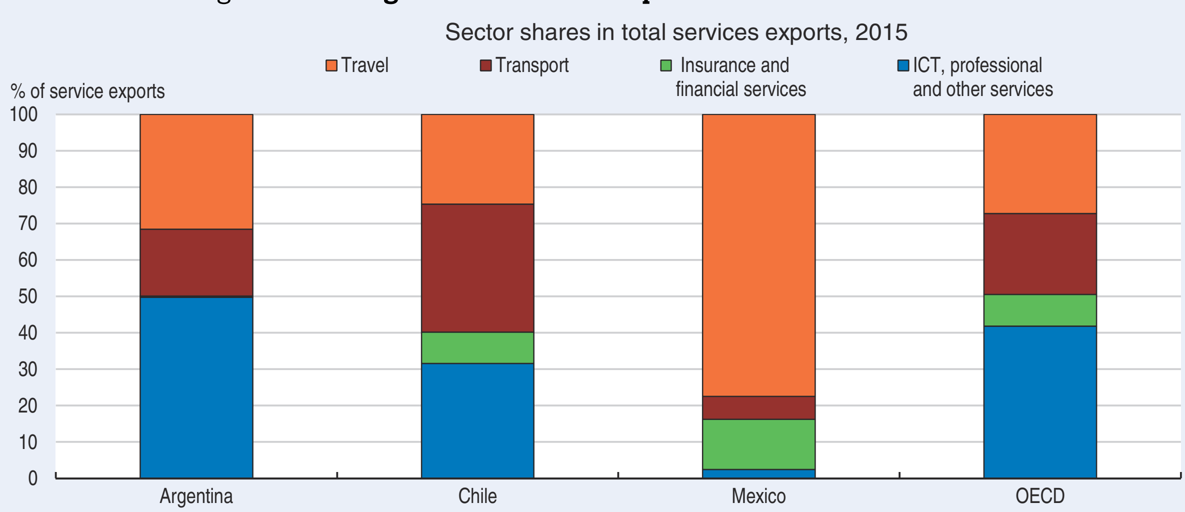
Box 1.2. **Service exports: A success story with good prospects**

Service exports have outperformed goods exports in the past couple of decades. At USD 14 billion in 2015, services exports are around a fifth of the value of total exports, a relatively high proportion by Latin American standards; the corresponding share for Mexico, for example, is 5%. The services trade mix is fairly well-diversified from a sector perspective (Figure 1.22), with a relatively strong performance in knowledge intensive sectors, such as professional and information and communication technology (ICT) services.

Figure 1.22. **Argentina's service export mix is well-diversified**



Source: World Band World Development Indicators database.

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ICT services, which accounts for 11% of the total, have recently increased notably. With clusters in Buenos Aires, Rosario and Cordoba, the sector has benefited from promotion measures by provincial and central governments, with a special focus on key technological cities in the United States, where sales increased by 150 percent in the last decade (Cicomra, 2016).

Box 1.2. **Service exports: A success story with good prospects** *(cont.)*

Other services sectors showing robust exports performance are legal, accounting, management and consulting services, where Argentina has benefited from the increasing business processes outsourcing, and television, where Argentina has successfully created new televisions formats resulting in a significant increase in audio-visual service exports (Artopoulus et al., 2013).

Service exports have also successfully tapped into rising demand in fast-growing emerging markets, with the value of service exports to China rising from close to zero in 2000 to over USD 1 billion by 2015. Hence, looking ahead, both the structure of geographic markets to which Argentina exports its services, with an increasing weight on relatively fast-growing emerging countries, and the product structure, focused on relatively fast growing activities, such as knowledge intensive sectors, will have a positive impact on service exports performance.

Reducing tariffs

Reducing barriers to import can help to expand exports. For example, with expanded access to modern technology embodied in foreign inputs, local companies can become more productive and competitive in export markets (Amiti and Konings, 2007, Johansson and Olaberría, 2014). Empirical evidence confirms that the availability of foreign intermediate goods, through input-tariff cuts, enhances firms' performance in export markets (Bas, 2012). Consumers also stand to gain from lower barriers to trade, as this would reduce the significant price gap in consumer items between Argentina and more open economies, including neighbouring Chile.

The authorities are planning to remove tariff barriers gradually. The current strategy has focused first on sectors with wide ramifications across the economy and comparatively low adjustment costs, such as the zeroing of a 12% tariff on imports of computer components and a 35% tariff on laptops and tablets in early 2017. For sectors with more employment at stake, including textiles and garments, the removal of barriers will be more gradual and has not started yet. The authorities have initiated an intense dialogue with several economic sectors to encourage them to prepare for a more open economy, and to identify further policy areas where reforms could support competitiveness. While the pace can be adapted to the circumstances in individual industries, it is important to establish and communicate a clear and credible time line for phasing out trade barriers. This encourages firms to upgrade their technologies and become more competitive before protection is removed. At the same time it is also important that in sectors providing key intermediate inputs to other parts of the economy, tariffs are removed promptly to avoid harming the competitiveness of sectors that can benefit from imported inputs.

It is important to acknowledge that opening up to trade, even gradually, will involve adjustment costs, as jobs will be lost in some sectors and created in others. Such reallocation enables capital and labour to move to more productive sectors where new firms will be created, or existing ones will expand, creating new jobs. But in the transition process, policies can go a long way to reduce the burden of adjustment for poor and vulnerable households. The design of such policies should put the emphasis on supporting workers rather than on protecting economic sectors or firms (Flanagan and Khor, 2012). Scaling up active labour market policies and providing training opportunities is a key policy lever in this context. Training can help workers to get ready for new jobs in expanding sectors, and even enhance their chances of accessing better paying jobs. Unemployment benefits or other social safety nets can also protect incomes during temporary unemployment spells.

Trade facilitation measures

Trade facilitation measures can also play an important role to stimulate trade, for example by reducing costs. Administrative burdens on exports and imports have been high in Argentina, who ranks below regional partners such as Brazil, Chile or Mexico in terms of efficiency of customs and border clearance, according to World Bank's Logistics Performance Index. Harmonizing procedures into a single electronic document and consolidating information and certifications from various authorities, such as customs or health and agriculture, can significantly increase efficiency in customs and reduce associated costs (Sarmiento et al., 2010).

To reduce administrative burdens, Argentina has established a one-stop mechanism (called *Ventana Unica de Comercio Exterior* - VUCE). A pilot exercise is initially covering wine and soy exports and it is expected that in five years' time the new one-stop shop will cover all export and import operations. Continuing to modernise and simplify customs procedures is fundamental, as cross-country evidence signals that it improves the capacity to export and import high-quality inputs (Moïse and Sorescu, 2013). It will also contribute to reduce the scope for corruption in the customs sector, especially if online procedures are introduced. Progress has also been achieved in terms of improving imports licencing, where automatic licencing has been established for many product lines. Nevertheless, non-automatic import licenses remain for around 1 500 tariff lines, amounting to 17% of import volumes. Reducing the scope of these non-automatic licenses would be a priority.

Engaging in mutual recognition agreements would be an additional measure that can facilitate trade. According to OECD's Product Market Indicators, there is room to pursue such agreements in areas such as construction, distribution, banking, insurance or hotels and administration. Likewise, requiring regulators to use internationally harmonised standards and certification procedures would also facilitate trade. Manufacturing, construction and professional services such as legal, engineering or architecture, are areas where harmonisation is currently lacking.

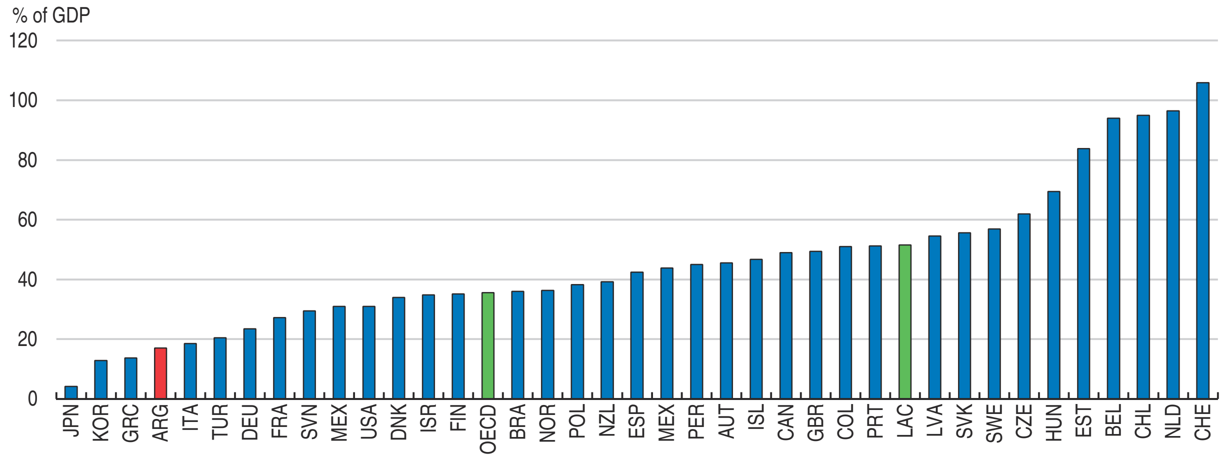
Trade policy can also contribute to boost export performance by providing wider market access and facilitate integration into global value chains. Argentina, as a member of the MERCOSUR customs union, has been less active than other countries in the region in getting access to new export markets. Given political developments in Brazil, new opportunities for MERCOSUR to seek more bilateral trade agreements are likely to come up. In particular, strengthening the links with the Pacific Alliance and moving forward on negotiations with the European Union 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

Foreign direct investment (FDI) inflows are well below those observed in other Latin American countries, such as Mexico or Brazil (Figure 1.23). FDI can contribute to stronger productivity performance, for example, via technology transfer, through supply chains or through the diffusion of better management practices (Blalock and Gertler, 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 and employment (Barrientos,

Figure 1.23. **Argentina attracts little direct investment**

Stock of FDI, 2015



Source: CEPAL; and OECD FDI main aggregates database.

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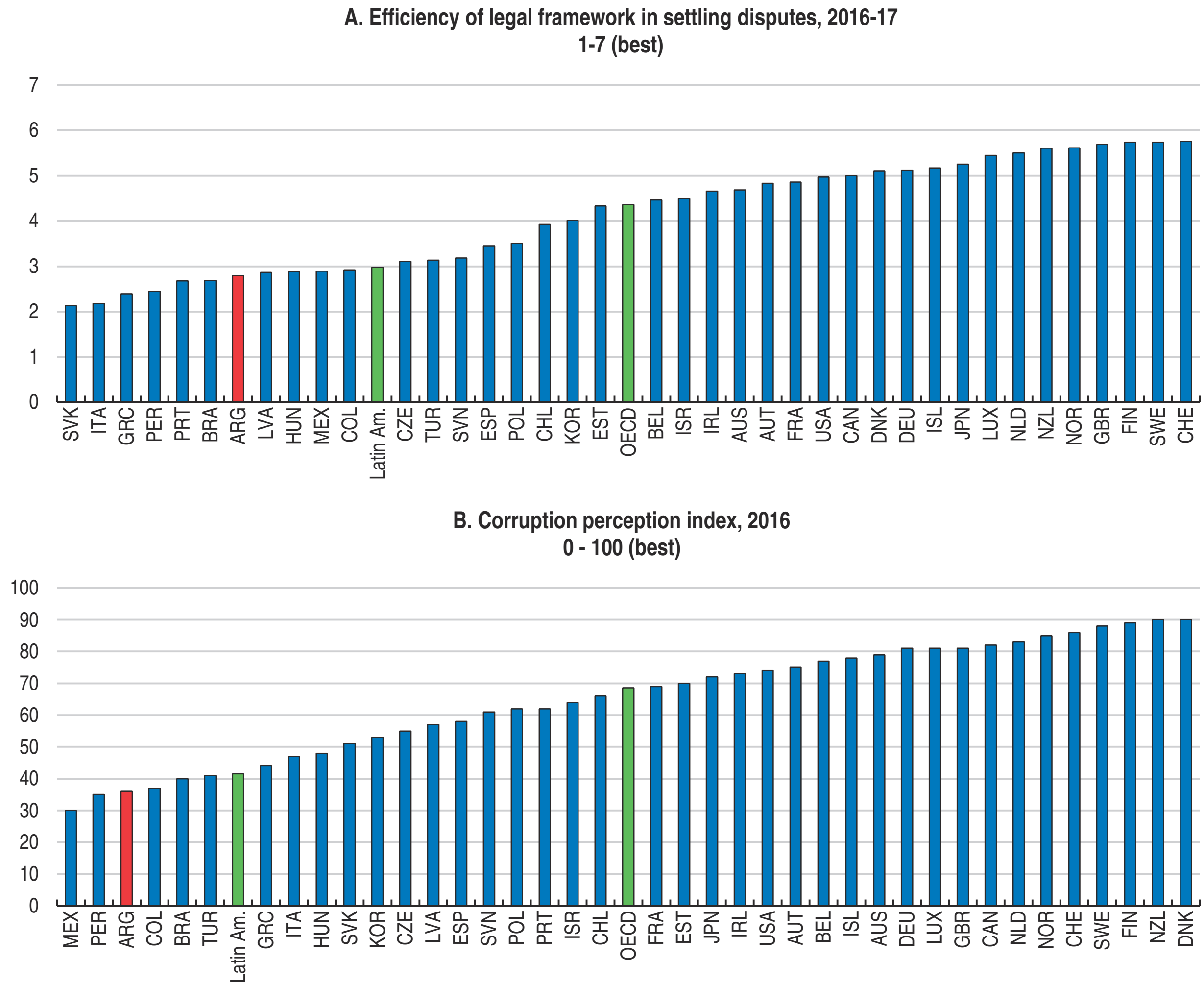
Gereffi and Rossi, 2011). Argentina has the potential to become a very attractive FDI destination, including for efficiency-seeking FDI. A convenient time zone with respect to US or Europe, which is convenient for companies requiring real time communications with customers or headquarters, and good English language skills among tertiary graduates are strategic advantages not fully exploited so far.

Attracting more and higher quality FDI requires adopting a comprehensive and coherent approach to investment climate reforms, including, addressing challenges related to infrastructure and human capital development, as proposed in this chapter. Such an approach would help Argentina to benefit more from its already open regime to FDI (Thomsen and Mistura, 2017). Remaining restrictions to FDI are concentrated in only a few sectors, notably media, transport (international road transportation) and agriculture (rural land ownership restrictions), making Argentina a very open economy to FDI according to the OECD FDI Regulatory Restrictiveness Index (OECD, 2017f). Notwithstanding this, further FDI reforms could potentially contribute to create economy-wide productivity gains. Both transport and agriculture sectors are important for Argentina's participation in global value chains, and existing limitations to foreign participation and competition in these sectors may be preventing potential productivity growth opportunities.

Argentina has had a relatively large number of disputes with investors due to a lack of proper implementation of existing laws and legislations. This created reputational damage and hampered the attraction of foreign investment, which must now be reversed. Legislative changes since December 2015 sent a clear signal of the renewed impetus to attract FDI and reignited international business confidence. A new investment promotion agency has recently been set up and should play a key role in translating the regained business confidence into actual investment. These efforts should be complemented with a strong and decisive commitment to strengthen the rule of law, as this continues to be signalled by investors as an important impediment to do business, in particular as concerns the efficiency of the legal and judicial systems to settle disputes (Figure 1.24, Panel A). Argentina ranks 129 out of 138 countries in terms of judicial independence, according to last edition of

Figure 1.24. **There is room to improving the rule of law and reduce corruption**



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

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the World Economic Forum competitiveness indexes (WEF, 2017). 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, which could also be pursued in Argentina.

Argentina is also perceived, both by national and international investors, as a county that faces significant corruption challenges (Figure 1.24, Panel B). Improving trust in government institutions can contribute to attract direct investment as corrupt practices and weak institutions create barriers to invest and innovate and allow vested interests to capture political and administrative decision-making processes against the interest of the wider public. Argentina ranks among the last ten of 140 countries in favouritism of government officials, ethics and corruption, according to World Economic Forum data (WEF, 2017). The authorities have taken steps since 2016 to strengthen anti-corruption controls such as revamping the anti-corruption office, but a more systematic approach, including a risk-based integrity system, could lead to further progress.

Separating the preventive and investigative powers of the recently revamped anti-corruption agency would be a way to enhance its effectiveness. At the same time, the capacities and de facto independence of the bodies responsible for the investigation of corruption should be strengthened. Those 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, 2016h).

Success in this area, 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 reiterated its 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.

Boosting innovation

Innovation and investment in knowledge-based capital are important engines of growth and productivity. Based on standard innovation indicators, such as patents applications, Argentina's performance is relatively low, below regional peers such as Chile and OECD standards. This general weak performance contrasts with remarkable success cases. For example, Argentina is a top world performer in the aerospace sector, being at the vanguard in the satellite industry and in drone development. The agriculture sector is also at the innovation frontier in terms of farming techniques and use of biotechnology (World Bank, 2015), with INTA (*Instituto Nacional de Tecnología Agropecuaria*, National Agricultural Technology Institute) playing a key role in generating and promoting the diffusion of technologies. These examples are suggestive of high potential to become a top innovation performer.

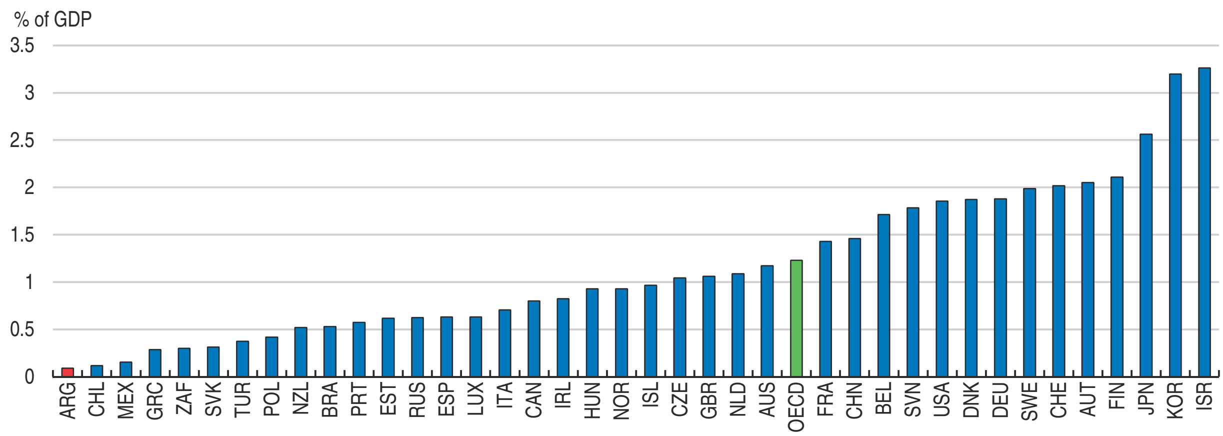
Spending on research and innovation is relatively low, amounting to 0.61 % of GDP, which is about half of Brazil and one fourth of the OECD average of 2.4%. The gap is especially pronounced for business R&D (Figure 1.25), with Argentina spending 0.1% of GDP, versus 0.5% in Brazil or 1.2% in OECD on average. Acknowledging that innovation is a key pillar for the new economic model, the authorities aim at increasing R&D spending to 1.5 % of GDP, with a strong emphasis on raising business investment.

The lack of competitive pressure on product markets curtails incentives for engaging in innovation activities and to adopt new technologies and practices. Entry or the threat of entry has been found to stimulate innovation by incumbent firms (Aghion et al., 2005; Aghion and Bessonova, 2006). When the incentive to get a competitive edge over others is missing because competitive pressures are low, firms do not consider innovation a priority. Moreover, where competition does not drive less efficient firms out of the market to free their resources, much of the public support for research and development may be absorbed in prices and wages rather than in the quantity of R&D (Acemoglu et al., 2013). Therefore, progress to strengthen domestic and foreign competition, as discussed above, would likely lead to more innovation.

There is also room to improve specific innovation policies. A key tool to foster R&D innovation by firms is the R&D tax credit, which aims at alleviating difficulties by firms to

Figure 1.25. **Business innovation is very low**

Business enterprise expenditure in Research and Development
2015 or latest year availabe



Source: OECD Research and Development Statistics database; and Brazil Ministry of Science.

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fully appropriate the returns to their investment and to find external finance, in particular for small or young firms (Appelt et al., 2016). Argentina has an R&D tax credit based on a competitive allocation system with a budget of 0.002 % of GDP. The tax credit is applicable against tax obligations in the gross turnover tax. The R&D tax credit is therefore less favourable than in other jurisdictions, especially as concerns its role in facilitating the financing of innovation and supporting small or young firms. The competitive allocation system, together with the limited budget allocation, introduces a strong degree of uncertainty about the eventual availability of the credit, and thus does not significantly alleviate the difficulties that firms face to raise finance for innovation activities.

In addition, the design of the credit puts young innovative firms at a disadvantage. More innovative start-ups, focused on developing new products and technologies, usually have little sales initially, as the first commercialised forms of new innovations tend to fail (Agarwal and Bayus, 2002). Hence, the more innovative young firms are less likely to benefit from the tax credit under its current design. International evidence show that to support these type of firms, the tax credit should include provisions such as the possibility for tax credits to be converted into cash refunds or into reductions in social security and payroll taxes or include carry forward provisions (Appelt et al., 2016).

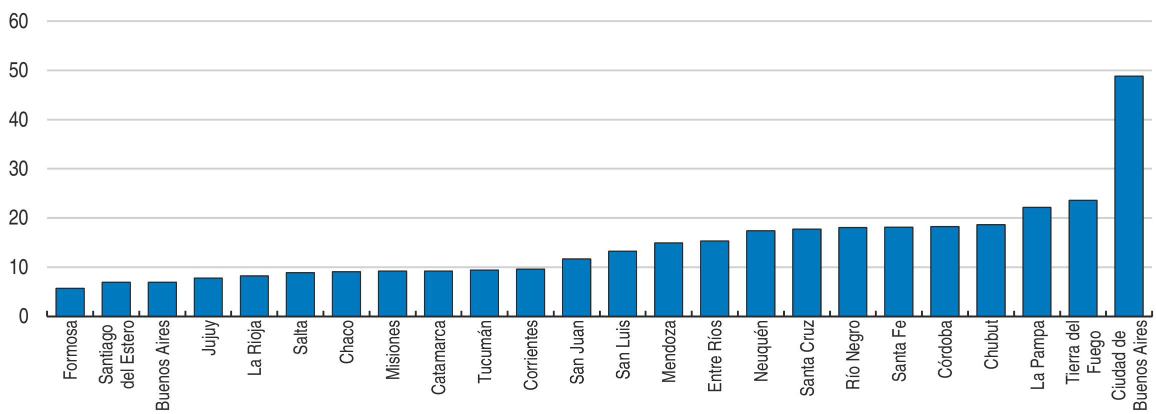
Moving into that direction would optimise the support given to young and innovative firms, although it would also reduce public revenues. A sound evaluation of the scheme may be a useful starting point for reform, as tax credits may unintendedly give an edge to incumbent companies to the detriment of start-ups (OECD, 2013b). In most OECD countries, the R&D tax credit is deductible from the corporate tax liabilities instead of from turnover tax liabilities. Hence, given the recommendation to phase the provincial turnover tax, Argentina could also make the R&D tax credit applicable against corporate income tax obligations.

Improving infrastructure to boost productivity and reduce regional disparities

Better infrastructure can contribute to higher productivity growth through various channels. First, it can boost the productivity of private inputs because of complementarities with labour and the private capital stock. The resulting higher productivity of the private capital stock would boost private investment (Agénor and Moreno-Dodson, 2006). Second, better infrastructure can boost growth in an inclusive way by making it easier for low-income people in remote and isolated areas to get access to jobs. Third, solving infrastructure bottlenecks, such as those in transport, can also reduce carbon emissions. Last, improving infrastructure would facilitate both internal and external trade and contribute to reduce existing regional economic disparities, with central provinces displaying significantly higher economic dynamism than Northern ones (Figure 1.26). Economic activity is concentrated around the province of Buenos Aires, which account for more than half of national GDP. Improving infrastructure would help second tier cities, such as Santa Fe, Cordoba or Mendoza, and also rural areas, by decreasing logistics costs for exports and by connecting them to new economic opportunities in more advanced regions.

Figure 1.26. **Economic disparities across provinces are large**

Number of enterprises per 1000 inhabitants



Source: OECD computations based on *Ministerio de Trabajo, Empleo y Seguridad Social* and INDEC's CENSO 2010.

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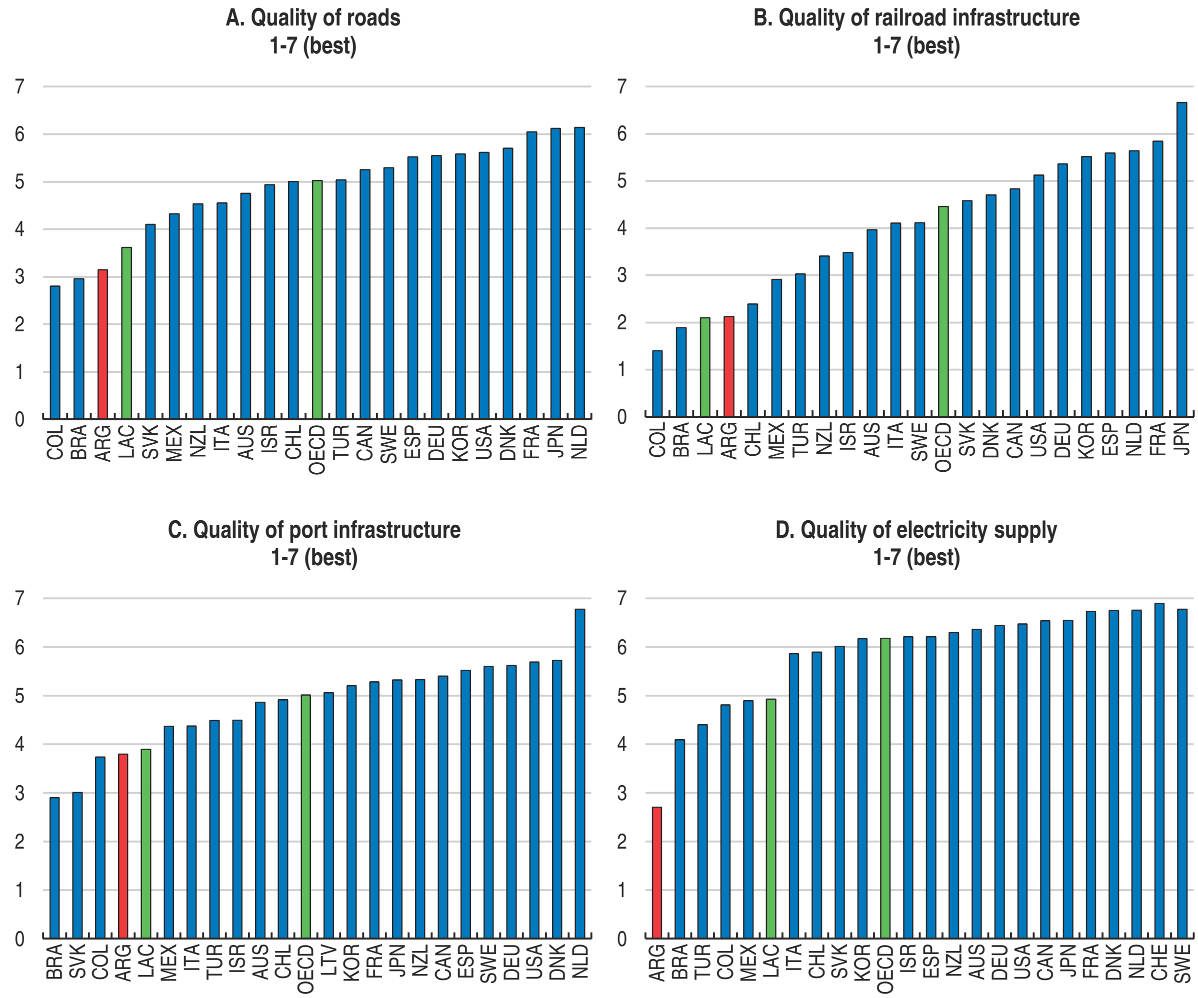
Survey data on the perceived quality of infrastructure rank Argentina 109rd worldwide (World Bank, 2017). Infrastructure quality has been declining steadily over the past years. The quality of roads and railroads is below the Latin America average (Figure 1.27). The quality is slightly above Latin American standards in ports and air transport, but has declined substantially in both sectors. The quality of electricity supply is also very low, and below Latin American standards (Figure 1.27, Panel D). Conversely Argentina ranks relatively well in terms of access to telephone connections, both fixed lines and mobile subscriptions. The decline in infrastructure quality can be attributed to low public investment, as other type of spending such as subsidies to energy and transportation, have been prioritised, and also to declining private investment (World Bank, 2017).

Challenges in infrastructure also depend on territorial specifies. In addition to transport, needs in less-connected rural areas are also geared towards basic services such as electricity or water (OECD, 2016i). Meeting those needs would increase productivity, well-being and reduce territorial disparities. Taking account of the territorial dimension is also important to design sound public governance mechanisms that help to optimise the impact of infrastructure investment (OECD, 2013c). This is particularly important in Argentina, a highly decentralised country, where subnational governments are responsible for 66% of public investment. In particular, Argentina should adopt mechanisms to improve co-ordinating

Figure 1.27. **The quality of infrastructure is relatively low**



Source: World economic forum, Global Competitiveness Indicator database.

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across national and sub-national levels of government. Co-ordination is necessary to identify investment opportunities and bottlenecks, to manage joint policy competencies and to ensure adequate resources and capacity to undertake investment (OECD, 2014b).

Improving rail transport will reduce logistic costs

The deteriorating quality of Argentinian infrastructure contributes to high logistic costs. For example, Argentinian firms pay USD 2 943 on inland transportation costs to import a container, while Brazilian firms pay USD 1 191 and Chileans pay USD 1500. Similar gaps exist in port and airport supply chains. Freight road transport is concentrated in the central areas, where traffic doubled between 2003 and 2014, creating important constraints despite same recent efforts to expand the capacity of some roads (World Bank, 2015). Transport costs are even higher in the Northern regions, where there is no alternative to road transport. This highlights that the transport mix is highly unbalanced. The proportion of rail in total freight transport is only 5% and road accounts for 93% of all freight transport. This compares with 25% of railroad transport in Brazil or 55% in countries with a similar production matrix.

Improving rail transport would offer the double dividend of reducing road congestion in the central area and of decreasing export costs for firms located in the northern region, enabling them to access domestic and export markets. It would also help to boost trade with other Latin America countries. Improving rail transport will require rehabilitating deteriorated infrastructure and developing and implementing a sound regulatory framework. Improvements in rail transport would be more effective in curbing logistic costs if they are undertaken within a multi-modal vision of transport infrastructure, which so far has been lacking. For example, there is a need to improve freight terminals in airports and rail and road access to ports (World Bank, 2015). That would help to improve Argentinian's ports efficiency, which is low in comparison with other ports (Morales Sarriera et al., 2013). In particular, the port of Buenos Aires displays larger container ship turnaround times and higher costs than other container ports in the region (Merk, 2017).

To respond to infrastructure challenges, public investment in infrastructure projects, both at the federal and provincial levels, will be boosted in the second half of 2017, following a review of all ongoing projects. This is welcome, as public investment in infrastructure boosts demand in the short-run and can also crowd-in private investment (OECD, 2016a), supporting the ongoing recovery. However, the fiscal room for further expansions of public spending on infrastructure is limited. Therefore there is a need to optimise public investment and to improve the institutional and legal framework for private sector participation in infrastructure projects. Progress have been achieved in the electricity sector, where the government aims at doubling the supply in the next decade and at covering 25% of energy needs with renewable sources. To that end, two public auctions have been completed and attracted significant interest, partly due to very high returns offered. Progress is also ongoing to open up the air transport sector, which has so far remained underdeveloped in comparison with neighbouring countries such as Chile, Brazil, Ecuador or Bolivia. Removing existing minimum pricing rules for air tickets would be key to foster competition in the sector and allow business and individuals to benefit from lower prices.

To attract private participation in financing and execution of infrastructure projects, both concessions, with which Argentina has experience, and public-private partners (PPP), for which a new framework law has been passed recently, can be useful models. In the case of PPPs, projects should be chosen when they represent good value for money. The literature and international experience suggest a number of factors that can ensure that a PPP is the right delivery model and maximises value for money. These include specifying contracts in terms of outputs instead of inputs to maximise benefits of private sector technical expertise and management skills; an *ex-ante* evaluation of PPP versus public-sector comparators to identify the best way of contracting projects; and proper fiscal accounting of PPPs, including recording them as contingent liabilities in the budget (OECD, 2012a). The latter is particularly important to avoid the build-up of off-balance liabilities, which may end up jeopardising public finances, as experienced in several OECD countries. In that sense, it is crucial that the assessment and accounting of the budgetary implications of PPPs is timely and transparent and covers their whole life-cycle.

In line with international best practices, Argentina is setting up a technical unit of around 20 experts in the office of the Cabinet of Ministers to advise on PPP projects. The unit will also be in charge of elaborating a report explaining the rationale for choosing the PPP model over other financing alternatives, including an economic and environmental impact assessment. This is welcome, since a lack of specialised expertise has been internationally signalled as a key constraint to get the most out of the PPP model. Similar units exist in some OECD countries and its location in the office of the Cabinet of Ministers may help to spread knowledge and advice through all ministers in a co-ordinated way.

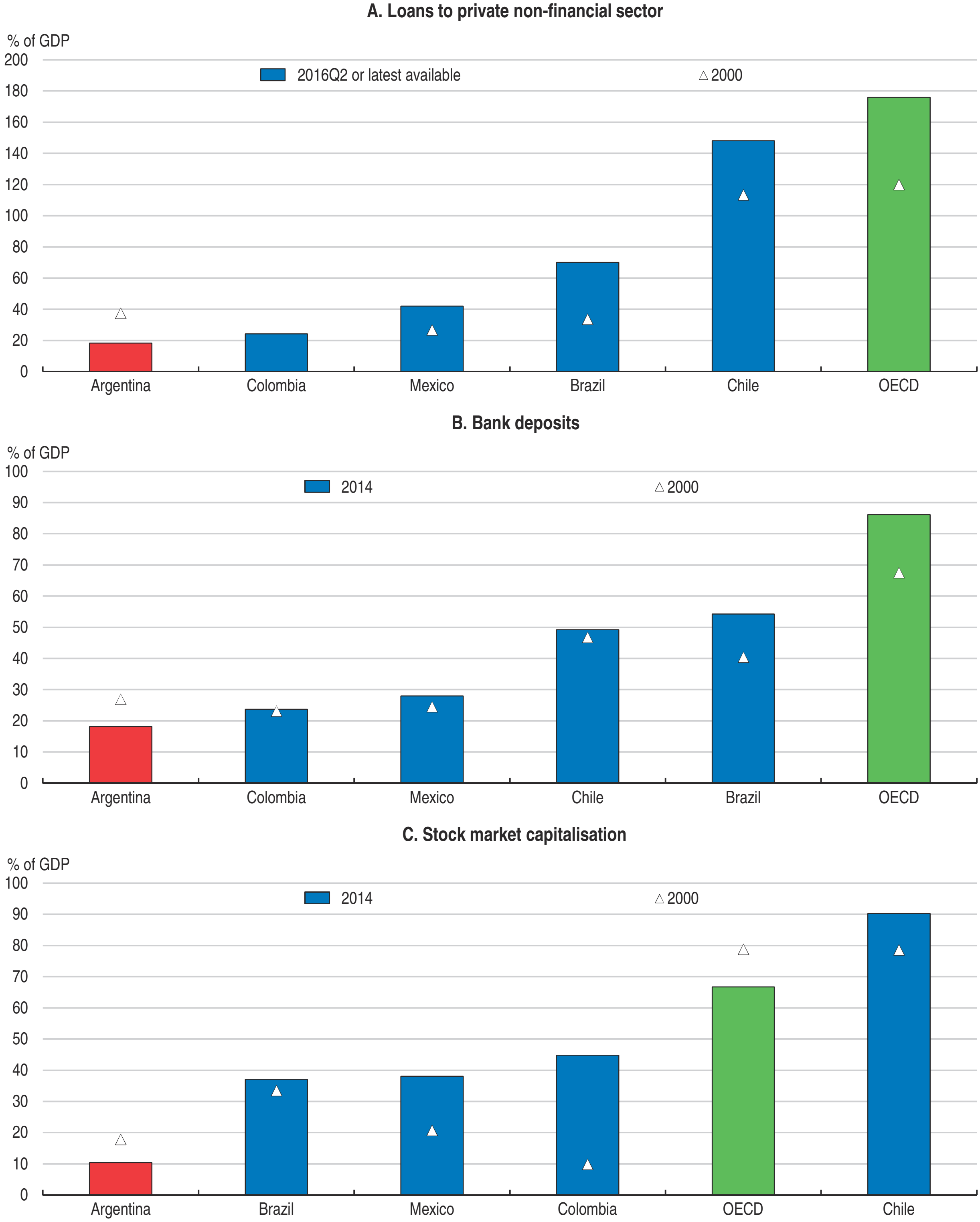
A major weakness of PPP programs implemented in the Latin America region concerns renegotiations, whose high incidence (Bitran et al., 2013) tends to erode significantly the expected benefits of the programmes. Experience of Latin American countries, such as Chile, Colombia and Peru, offers key principles to address renegotiations. Thus, the financial equation of the winning offer should always be the reference point. If the contract is to be modified, the outcome should have a zero impact on the net present value of the benefits, and the contract modifications should not change the original risk allocation matrix. Additionally, the PPP operator should be held responsible for its offer and for the risks accepted in the contract. Renegotiation must not be used to correct errors in the bid or excessively risky or aggressive bids (Guash et al., 2014). Obtaining planning and environmental permissions in advance of tender is a key to avoid renegotiations and delays.

Developing access to finance

Access to finance is very difficult. The financial system is small, mostly transactional and has shrunk relative to its size in 2000 (Figure 1.28, Panel A and B). Both bank credit to the private sector and stock market capitalisation (Figure 1.28, Panel C) are well below levels of OECD and other Latin American countries. SMEs are particularly hard struck and rely mostly on retained earnings. The mortgage market was largely undeveloped until 2017 and there are no institutional investors such as mutual funds, pension funds or insurance companies. This implies that long-term finance is almost non-existent, constraining investment and growth. Moreover, the lack of financial instruments implies that that there is little room to smooth consumption and investment, which exacerbates macroeconomic volatility. While some studies have highlighted that there may be too much finance from a certain point of financial development onward (Cournede and Denk, 2015), Argentina is certainly far below that point. Better financial development would boost growth by providing more domestic financing to investment projects and would also strengthen the monetary transmission channel, thus making monetary policy more effective in taming inflation. Financial development also enhances trade, particularly in goods whose production is highly dependent on external finance (Johansson and Olaberría, 2014). Last, including a greater share of the population into the financial system would improve well-being by providing better opportunities for consumption smoothing.

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, but 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 a recent tax amnesty, which led to the declaration of almost 20% of GDP in previously undeclared assets held by residents, are also likely to support the expansion of the financial sector. A recent initiative by the Central Bank to create an inflation-indexed accounting unit for credit contracts, which was mostly designed for establishing a mortgage market, can be a useful tool in the transition, until rising confidence has made indexed instruments obsolete. With this accounting unit, the real value of credit instalments is kept constant, as has effectively been the case with most rents. This preserves the real values of the instalments paid towards the end of the credit period and therefore allows up to 3 times

Figure 1.28. **Financial markets are hardly developed**



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

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lower initial instalments. As a result, a wider range of households can afford to access mortgage loans. At the same time, however, indexed loans increase financial risk as they transfer risks to borrowers. The Central Bank, who is in 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.

In the past, high inflation and negative real rates on deposits have guaranteed almost automatic returns to banks. As this has changed, banks will have to adapt their business models. Pressures to improve cost-efficiency, including through consolidation, are likely to become stronger. There appears to be significant room for cutting costs through simplifying administrative procedures and adopting digital technologies. The level of administrative expenses of banks is high and increasing, both in private and public institutions. They account for 7.7% of total assets (IEF, 2016), while they are in the 2-3% range for banks in other countries in the region such as Chile or Colombia.

Beyond banks, steps have been taken to enhance the prospects for corporate bond and equity financing. In particular, a draft proposal to modify the Capital Markets Law (*ley del Mercado de capitales)* was sent to Congress in 2017, with a view towards modernising the regulatory framework. Improved corporate governance is one aspect of the draft law, as it intends to limit arbitrary interference of the securities regulator in operational decisions of publicly traded companies. Conversely, the securities regulator will get power to initiate administrative procedures in the case of anti-competitive behaviour. A more developed stock market would also be able to enhance financing options and boost growth (Lanteri, 2013). Plans to create a unified stock exchange are likely to increase liquidity, lower transactions costs, facilitating both domestic and foreign investment in Argentinian equities.

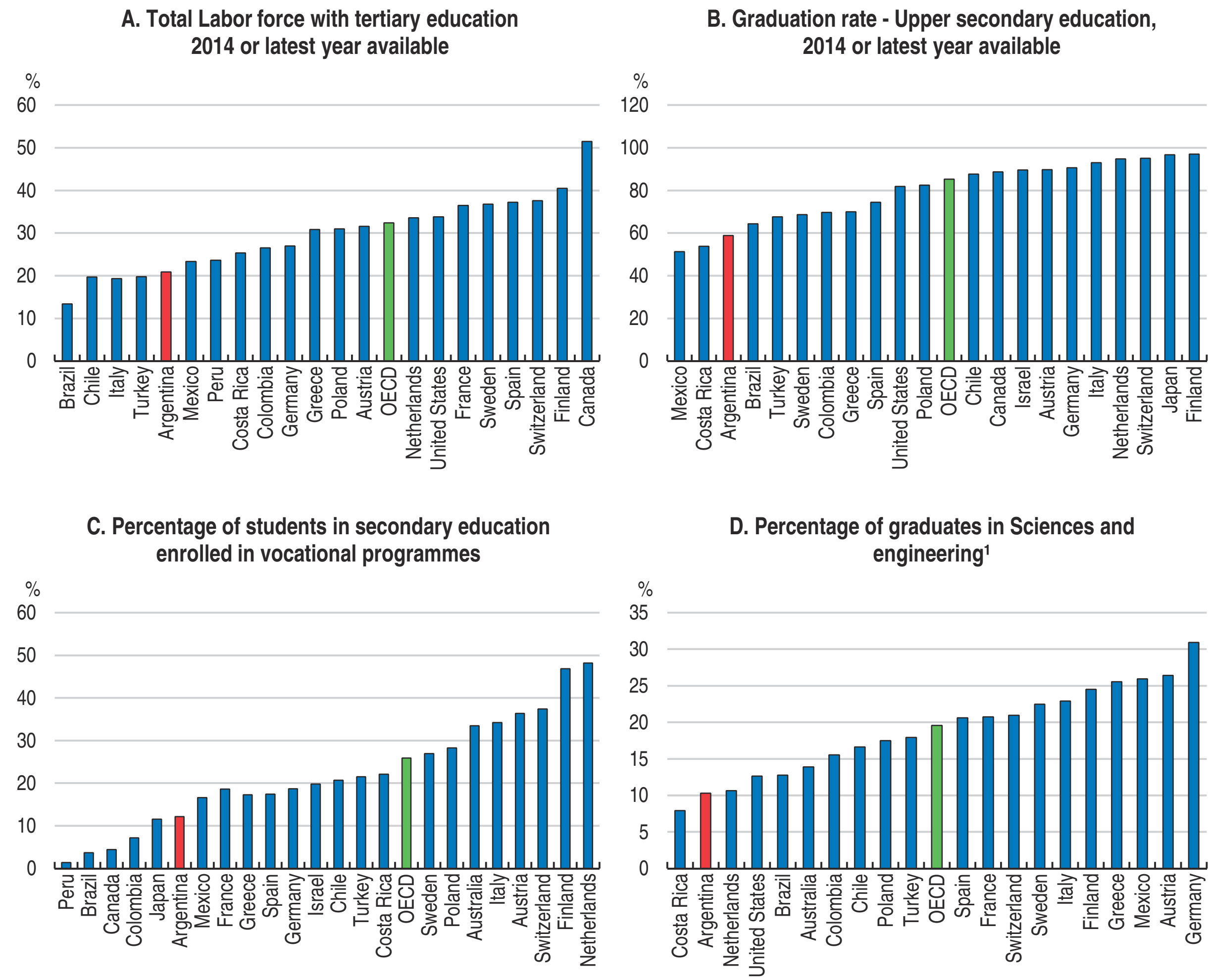
Facilitating the transition from cash payments into bank or electronic payments would also foster financial development and also help to reduce informality (Rogoff, 2016). Policy options include banning cash for transactions above a certain threshold, as done recently by France, Spain and Italy, or taxing cash transactions as opposed to transactions through banks or electronic platforms. South Korea illustrates the potential of using the tax system with that purpose, as it introduced a tax incentive for electronically traceable payments, which succeeded in reducing cash transactions, increased financial inclusion and tax revenues and reduced income inequality (Sung et al., 2017).

There is also a large potential to increase financial development by extending banking services to a greater share of the population. Positives steps have recently been being taken in that direction, such as the simplification of procedures for opening bank accounts and increasing the information on fees. Mobile banking systems also present unused opportunities in this context, as Argentina lags behinds neighbouring countries such as Colombia or Uruguay in this area, although most of the population, including those in low to medium income brackets, own a mobile phone (Tuesta et al., 2015). Some regulatory hurdles have recently been removed as the Central Bank approved a regulation allowing all banks to open mobile bank branches.

Providing better skills will boost productivity and employment

Improving educational achievements is likely to support productivity, investment and job creation. Better skills are crucial for individuals to access quality jobs and for the economy to compete in an increasingly knowledge-based world (OECD, 2012b). The share of the labour force with tertiary education in Argentina is larger than in Brazil or Chile, but a sizeable gap remains with respect to the OECD average (Figure 1.29, Panel A). Moreover, tertiary attainment is currently falling across generations (see Assessment and Recommendations). The graduation rate in secondary education is low (Figure 1.29, Panel B) and there is also a large room to improve its quality, as reflected in PISA rankings (see chapter 2). This indicates that many Argentinians are currently leaving the education system with relatively low levels of skills.

Figure 1.29. **Skill gaps are significant**



1. This includes all the tertiary graduates in the fields of Engineering, Manufacturing, Construction, Natural Sciences, Mathematics and Statistics.

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

StatLink http://dx.doi.org/10.1787/888933542745

Vocational education and training (VET) remains underutilised, below levels observed in OECD countries and in Chile or Mexico (Figure 1.29, Panel C). At the same time, survey results suggest that employers are finding it particularly hard to find technicians, skilled trades and engineers (INET, 2016). Thus, expanding and enhancing the effectiveness of VET can be particularly useful to address these skill mismatches and to raise workers employability. In addition, offering VET as a less academic path in secondary education can reduce the high-dropout rates in secondary education (see Chapter 2). International experience suggests that workplace training and involving employers in the design and delivery of the training are key elements for a successful development of VET. Currently training institutions are the dominant players of the VET system. Giving employers a more central role, both in the design of courses and in the delivery of workplace training, would bring the VET system closer to international standards.

As in many OECD countries, there is also scope for a better alignment of university curriculums to the type of occupations prevailing on the labour market (OECD, 2017a). Digitalisation, globalisation, demographic shifts and other changes in work organisation are constantly reshaping skill needs, creating challenges for the education system, in particular universities, to update curriculums regularly (OECD, 2016j). The tertiary education system produces relatively few graduates in science, technology, engineering and mathematics. Sciences and Engineering account for 10% of graduates, below levels observed in other countries (Figure 1.29, Panel D). At the same time, the system is biased towards social sciences and humanities.

Increasing flexibility and ability to equip tertiary students with job-relevant skills are thus vital and recommended. For that, curricula should be updated regularly, intelligence about future skills needs should be developed and fields with high expected demand, such as engineering, should be promoted. Funding mechanisms can play an important role in this respect, and it is recommended that the funding formula takes into account labour market outcomes and needs. On the demand side, it should be facilitated that students obtain early on in their student life comprehensive information about employment options in the country, as well as wage levels in different industries and about labour market status by degree and university. This would encourage more students to enrol in those institutions offering better employment and earning prospects.

Recommendations to boost growth and living standards in Argentina

Key recommendations

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.

Labour market

- Protect workers with unemployment insurance and training rather than strict labour regulations.
- Introduce out-of-court procedures for labour disputes.

Trade

- Lower import tariffs and further reduce the application of non-automatic import licenses.
- Expand labour market support for affected workers.

Taxes

- Phase out the provincial turnover tax and financial transaction tax.

Skills

- Develop the VET system by increasing the involvement of employers and workplace education.
- Better align tertiary curriculums with jobs.

Recommendations to boost growth and living standards in Argentina *(cont.)*

Rule of law and corruption

- Strengthen the capacities and independence of bodies investigating corruption.
- Reorganise and strengthen courts and enact the corporate liability bill to prosecute bribery.

Other recommendations

Product markets

- Introduce an explicit program to eliminate regulations fragmenting the domestic market.
- Apply the OECD's Competition Assessment toolkit to refine laws and regulations and submit new laws likely to affect competition to a regulatory impact assessment.
- Improve the governance of state-owned enterprises by adopting the OECD Guidelines on Corporate Governance of State-owned enterprises.

Infrastructure

- Improve the regulatory framework for rail transport and rehabilitate deteriorated infrastructure.
- Assess the full implications for the budget position of PPPs over their whole life-cycle and fully record arising contingent liabilities in the budget.

Entrepreneurship

- Evaluate the effects of the entrepreneurship and SMEs laws on firm creation and on improving access to finance by young and innovative firms.
- Promote gender diversity in leadership positions by using gender quotas or targets and information campaigns.

Innovation

- Consider making tax credits for research and development refundable or introducing more generous loss carry-forward provisions.

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ANNEX 1.1

A landmark programme of reforms has been initiated

Table 4. **A landmark programme of reforms has been initiated**

Reform	Purpose/nature of the reform	Status
	Financial	
Resolution of outstanding external debt disputes	An agreement was reached with "holdout" creditors. Subsequently, Argentina successfully returned to international bond markets.	Completed
Elimination of foreign exchange controls	Foreign currencies can now be bought and sold without restrictions, after years of strict and arbitrary interference in exchange markets.	Completed
Capital markets law	Aim at developing financial markets in Argentina and improving corporate governance.	Initial stage
	Trade	
Elimination of export restrictions on agriculture	Exports on agriculture products were highly restricted, discouraging production and investment in the farming sector.	Completed
Elimination of import restrictions	Almost all imports were subject to authorization, which was issued on a discretionary non-transparent manner.	In progress
Elimination of export taxes	Until December 2015, exports in nearly all sectors were taxed. Export duties were eliminated in January 2017, except those on soybean and soy products, which were reduced by 5 percentage points.	In progress
	Fiscal	
Reduction of government subsidies on prices of public services	Subsides were large and untargeted, distorting relative prices, encouraging excess consumption and widening the budget deficit.	In progress
Tax amnesty	Tax amnesty for undeclared funds.	Completed
	Social	
Increase in child benefits	Expansion of beneficiaries to encompass also children of those under a specific tax regimen (*monotributistas*)	Completed
Increase in unemployment benefits	Increase of benefits for some unemployed individuals (from AR$ 400 per month to AR$ 3000)	Completed
Pension package	Retroactive payments and increase in pensions of litigating pensioners. Introduction of universal pensions (equivalent to 80% of the minimum pension)	Completed
	Other	
Argentina productive plan	An all-encompassing plan aimed at increasing productivity and creating 200000 new jobs in the private sector.	In progress
Promotion of renewable energy	Legislation to require use of increasing proportions of energy from renewable sources has been approved. PPP tenders have been completed.	In progress
Plan Belgrano	Plan to address multiple infrastructure gaps affecting the northern provinces of Argentina.	Initial stage
Ley PYME	Law aimed at reducing some taxes for SMEs and improving its financing.	Approved

ANNEX 1.2

Simulating the impact of structural reforms on growth

This quantification of structural reforms is based on the OECD's *Going for Growth* framework of policy indicators and empirical estimates of the relationship between policy and economic outcomes.

The quantification is based on three inputs:

1. A numerical indicator for Argentina of the ***policy stance*** in each area. Namely:
   a) Product markets reforms: the indicator used is the Product Market Regulations (PMR) Index, in particular the sub-indexes related to "Barriers to Entrepreneurship", "Governance of States Owned enterprises" and "Use of command and control regulation".
   b) Trade reforms: the sub-indexes "Tariff barriers" and "Barriers to Trade facilitation" of the PMR index are considered.
   c) Labour market reforms: two indicators are considered: i) OECD's Employment Protection Legislation (EPL) index; ii) Excess coverage of wage bargaining, computed as described in Gal and Theising (2015).
   d) Tax reforms: the share of corporate and property tax revenues in total revenue.
   e) R&D: the spending by the business sector on R&D.
2. A ***policy shock*** to the indicator reflecting reforms. Two shocks are considered: i) the one resulting from moving from Argentina's settings to the OECD average one; ii) the one resulting from closing the gap with selected peer Latin American countries, namely Chile, Colombia and México.
3. An estimate of the impact of changes in the indicator on output growth after 10 years. This is based on the extensive cross-country research programme developed over many years at the OECD to understand the relationships between policy stances and economic outcomes.

Effects of product market reform reforms

Product market reforms impact long-term growth via multi-factor productivity (MFP). The framework used is based on Bourlès *et al.* (2010), column (4), Table 1.

Effects of labour market reforms

Labour market reforms are assumed to impact long-term growth via employment (EPL and excess coverages reform) and investment (EPL reform). The framework used is Égert and Gal (2017). The quantification is based on estimated cross-country effects as reported in Table A6.3.

Effects of tax reforms

Tax reforms impact long-term growth via multi-factor productivity (MFP). The framework used is Arnold et al. (2011). The quantification is based on estimated cross-country effects of the tax mix on long-run GDP per capita as reported in table 1. The scenario of convergence towards the OECD average assumes that the share of corporate income taxes in the tax mix falls, and that revenue neutrality is achieved by adjusting property and consumption taxes. For the scenario of convergence towards Latin America average, it is assumed an increase in property taxes also implemented in a revenue neutral manner.

Effects of R&D policies

Labour market reforms impact long-term growth via multi-factor productivity (MFP). The framework used is Égert and Gal (2017). The quantification is based on estimated cross-country effects as reported in Table A6.3.

Estimates in Bourlès et al. (2010), Égert and Gal (2017) and Arnold et al. (2011) are based on within estimates, as country fixed effects take out the cross-country variation in the data. This implies that the estimates reflect relationships based on the average variations over time. Setting-up best practice scenarios, as those presented in this chapter, imply using larger variations in the data.

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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.

Commodity-led economic growth and expanded social policies served as powerful instruments for reducing poverty, increasing equality and improving the quality of life in Argentina during 2003-11. As family earnings improved, the middle class surpassed the number of poor people, which had increased both in the 1990s and especially around the economic crisis of 2001. On average, these middle-class individuals are more educated than those less well off. They also are more likely to participate in the labour force, especially women, and work in formal sector jobs (Ferreira et al., 2013). These achievements came under threat after 2011 due to increasingly inconsistent economic policies that led to zero growth.

One third of Argentinians are poor, representing the country's main social challenge. Additionally, between them and the middle class lies an emerging group of people who make enough not to be considered poor but who lack the middle class' economic security. This group, making up one-fifth of the population, 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. Supporting this group of people at risk of falling into poverty through social policies, and especially through incentives, is essential for further consolidating the poverty reduction gains of the previous decade, ensuring that the middle class continues expanding, raising productivity, and ultimately promoting greater equality of income, wealth and well-being in the long term.

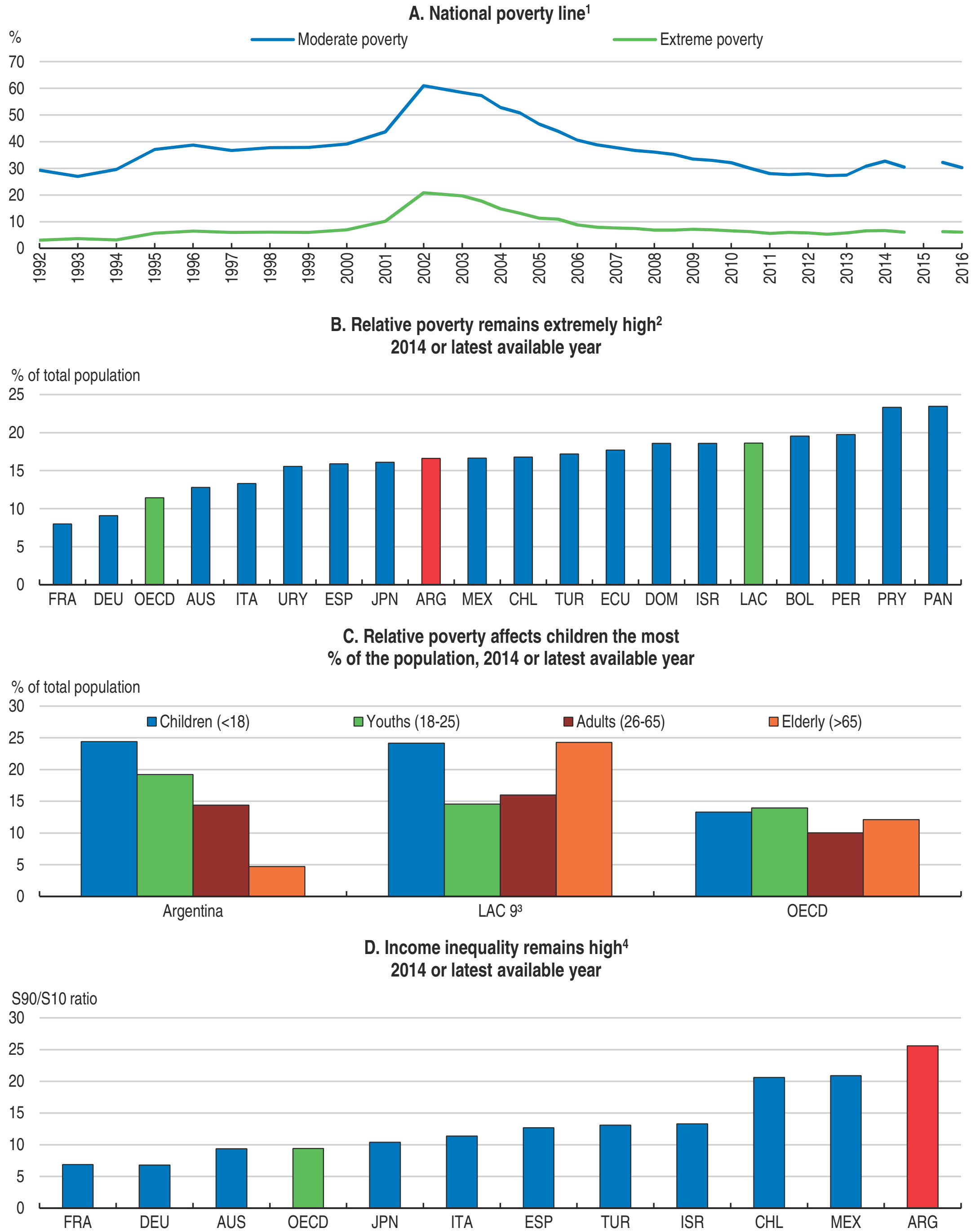
The chapter begins with an overview of income and poverty patterns in the past decades, before going on to examine the main drivers of inequality and poverty in Argentina. Particularly, it looks at the role of income redistribution, education and skills, and job quality with a focus on regional differences. Assessing these drivers is key to strong, sustainable and inclusive growth that improves the lives of all Argentinians.

Reducing poverty, improving equity and strengthening the middle class

Poverty and inequality have declined but remain high

Poverty has fallen considerably since 2003, experiencing as slight upturn since 2013 (Figure 2.1, Panel A). Estimates produced by the *Centro de Estudios Distributivos Laborales y Sociales* (CEDLAS) at the Universidad Nacional de La Plata based on the *Encuesta Permanente de Hogares* (EPH) and the national poverty line suggest that poverty (i.e. the share of people living on sufficient income to afford a set of basic goods) has been almost cut in half since 2003 to 30.3% of the population and to 21.5% of the households (CEDLAS, 2017a). This decline in poverty implies that almost 9 million Argentinians escaped poverty since 2003, returning to poverty levels similar to those in the early nineties. Likewise, extreme poverty (indigence) fell by one-third to 6.1%. Analysing only the extremes of the period 2003 to 2016 as well as not comparing it to other countries in the region does not provide a full picture of what happened (see Box 2.1). Building the foundations for a long and uninterrupted period of growth is a precondition for raising living standards and reducing inequality. However, the benefits for the population at large will depend crucially on the nature of this growth and how its fruits are shared.

Figure 2.1. **Poverty has declined but inequality is large**



1. The series is estimated by CEDLAS using the Permanent Household Survey (EPH), the official price index till 2006 and the Buenos Aires City price index for 2007-15. Poverty lines are calculated on the basis of the current methodology used by the INDEC. The first semester of 2016 only includes the second quarter 2016. No data were collected for the second semester of 2015.
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.
3. Data for Argentina are from the third quarter of 2016 and are representative of urban centres of more than 100 000 inhabitants. LAC 9: Argentina, Bolivia, Chile, Dominican Republic, Ecuador, Mexico, Peru, Paraguay and Panama.
4. 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%.

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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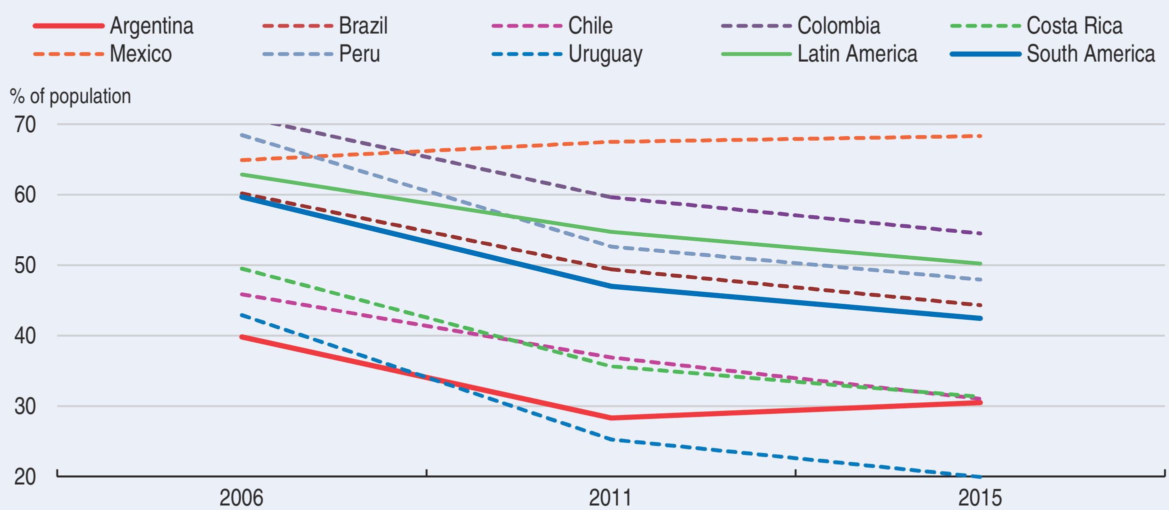
Box 2.1. **Argentina's poverty reduction in context**

International poverty lines are the standard for cross-country poverty comparisons due to their simplicity and despite their technical limitations. Although crucial for harmonising data across countries and time as well as adjusting poverty lines locally, international poverty lines are overly sensitive to measurements of PPP exchange rates and domestic consumer price indexes. This is especially true for countries with high inflation and a volatile exchange rate such as Argentina. Moreover, PPP exchange rates are calculated based on average national prices and might be unsuitable for assessing the income levels of the most poor (Deaton, 2006 and Deaton and Dupriez, 2011).

Given these caveats, poverty in Argentina -both defined as the share of the population living on less than USD 4 PPP a day (World Bank Latin America international threshold; Ferreira et al., 2013) and as the share of the population living on less than USD 9.8 PPP (international threshold for Argentina's national poverty line; CEDLAC, 2017b) – declined dramatically between 2003 and 2006, after rising sharply with the 2001 crisis (Figure 2.2).

Figure 2.2. **The share of the population living on less than 9.8 USD PPP a day has declined at a slower pace in Argentina than in other Latin American countries**



Note: Data for Argentina are from 2016 and are representative of urban centres of more than 100 000 inhabitants.
Source: CEDLAS (2017b)

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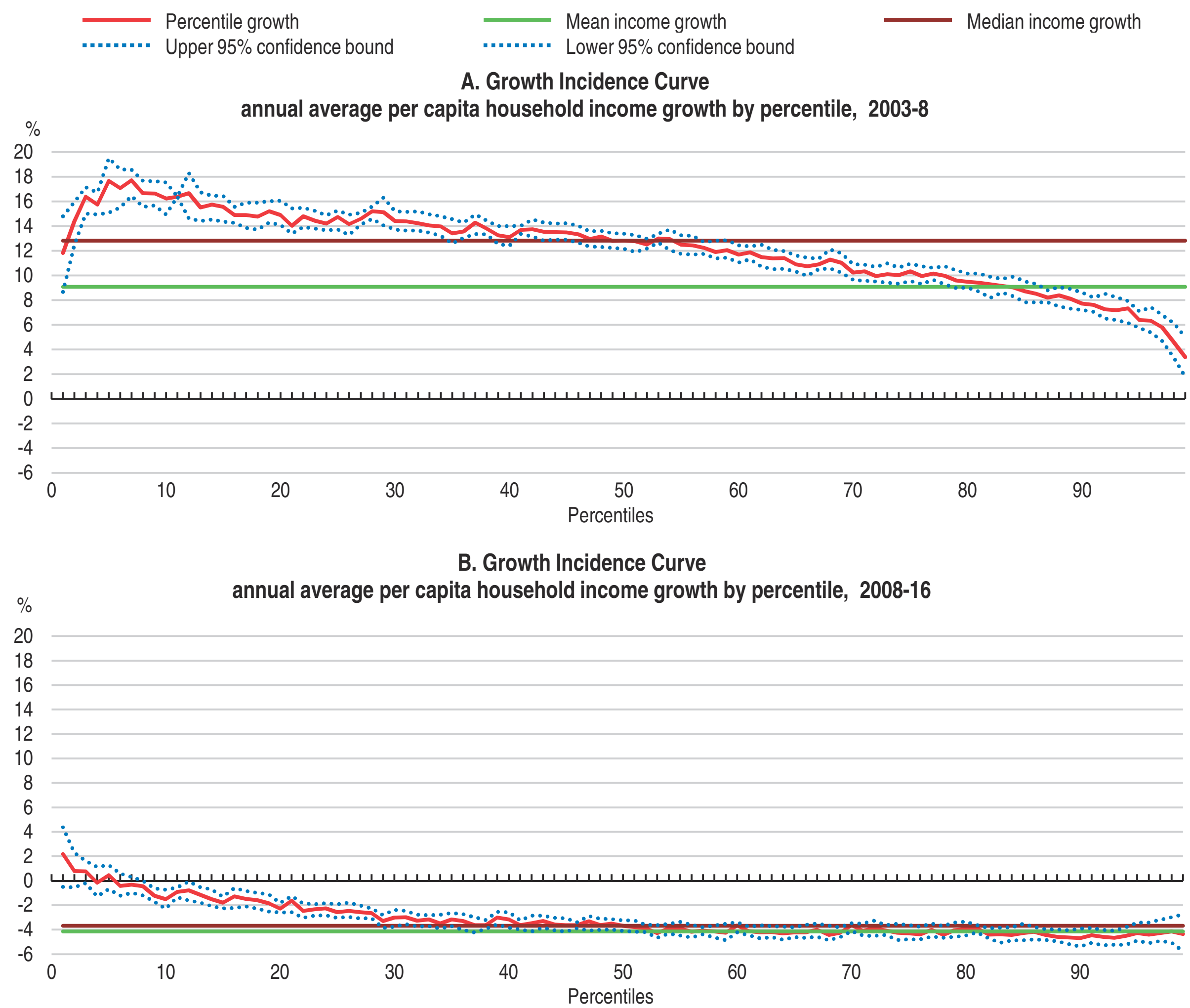
Overall, the reduction of the share of population living on less than 9.8 USD PPP a day in Argentina followed a slower pace than the regional average during the last decade. While in Argentina the share of this population dropped by 9.3 percentage points, the share fell by an average of 12.7 points across Latin American countries and 17.2 points across South America countries. Only El Salvador, Guatemala, Honduras and Mexico experienced slower performance than Argentina during this period (CEDLAS, 2017b).

Yet, two clearly distinct stages can be identified in Argentina's poverty reduction path from 2006 to 2015, with the turning point in 2011 (Figure 2.2). First, from 2006 to 2011, the share of the population living on less than 9.8 USD PPP a day declined on par with regional levels. In fact, the share of this population dropped by 11.5 percentage points in Argentina, similar to the South American country average of 12.7 percentage points and the Latin American country average of 8.2 percentage points. Second, from 2011 to 2015, social progress decelerated in Argentina but was sustained across most countries in the region. Whereas in Argentina the share of the population living on less than USD 9.8 PPP dropped by only 2.2 percentage points from 2011 to 2015, the share of this population shrank by about 4.5 percentage points on average in both Latin American and South America countries. The only country performing worse than Argentina during this period was Honduras (CEDLAS, 2017b).

The less well-off households benefited the most from Argentina's recent period of growth (2003-11). Poverty can decline as a result of growth: if growth affects all people equally, then relative poverty would remain stable while absolute poverty decreases. Poverty can also decline as a result of changes in the distribution of income amongst people. In Argentina's case, both phenomena happened at the same time. As the country experienced a period of growth, the income of the households at the bottom of the income distribution grew significantly faster than those at the top of the income distribution between 2003 and 2008, albeit starting from low income levels, contributing to the reduction of poverty and inequality (Figure 2.3). However, as of 2009, annual average per capita household income growth was negative for households above the 5th percentile of the income distribution threatening the gains of the previous period.

Figure 2.3. **Income growth benefited the less well-off the most**



1. Data are representative of urban centres of more than 100 000 inhabitants.

Source: Encuesta Permanente de Hogares (EPH) for the third quarter of 2016, and EPH for the third quarter of 2008 and EPH for the third quarter of 2003 (INDEC).

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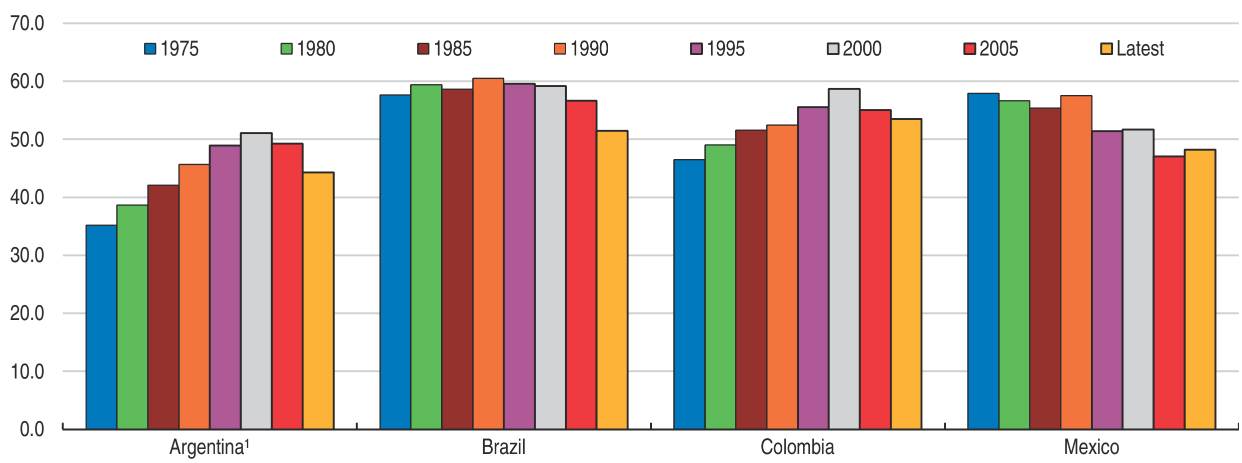
Relative poverty (i.e. households with incomes less than half of median incomes) in Argentina decreased by almost 7 percentage points between 2000 and 2016, placing the country below the average of the region but still above OECD countries (Figure 2.1, Panel B).

Almost 17% of Argentinians are poor as defined by the OECD definition relative poverty, with children among the most affected, rather than the elderly as in the case in most Latin American countries (Figure 2.1, Panel C).The gap between the trends in absolute and relative poverty measures can be clarified by untangling the effects of growth and distribution on poverty. While the income of the poor grew faster than that of the richer, it is still significantly lower than the median of the population.

Despite these advances, income inequality remains high. The Gini coefficient of disposable income inequality in Argentina was 0.46 in 2016 (Figure 2.4) (World Bank, 2017). Income inequality in Argentina increased both in the 1990s and after the debt crisis in 2001, and then subsequently declined. The Gini coefficient has dropped 7.5 percentage points since 2003. This decrease is around the average for Latin American countries (Tsounta and Osueke, 2014). Still, the ratio of disposable income of the 10% of people with highest disposable income to that of the poorest 10% places Argentina slightly above other Latin American countries and significantly above OECD countries (Figure 2.1, Panel D).

Figure 2.4. **Inequality has declined, but it is still large**

Gini index



1. Latest data for Argentina are for 2016 and are representative of urban centres of more than 100.000 inhabitants. Latest data for Brazil, Colombia and Mexico are for 2014.

Source: Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC) and World Bank World Development Indicators database.

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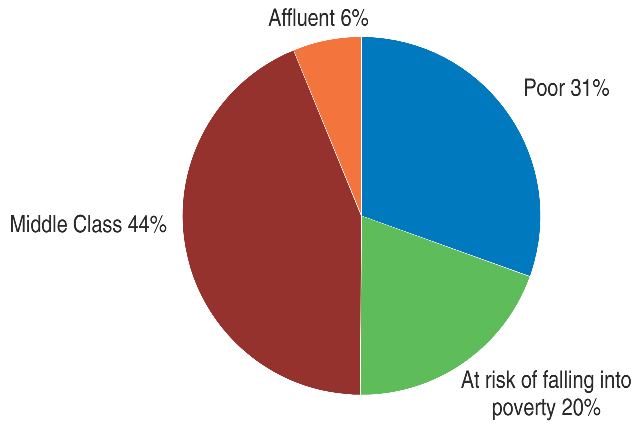
As household incomes increased, especially for poor families, and inequality edged downward, Argentina's middle class grew from less than 2 out of ten Argentinians in 2003 to more than four out of ten Argentinians in 2016 (INDEC, 2003; INDEC, 2016). The middle class is defined as the population living in households with a daily per capita income between USD 15 PPP and USD 50 PPP. This definition is based on the notion of economic security (i.e. having enough income to absolve socks and formal job). Today, 19 million people live in middle-class households (Figure 2.5). As a result, Argentina is third to Chile and Uruguay in the size of its middle class and among the few countries of the Latin American region where most people belong to the middle class (CEDLAS and the World Bank, 2014).

Still, most of the poor who moved up did not join the middle class but rather joined a group in between the poor and the middle class ("vulnerable" according to Ferreira et al., 2013). These are individuals living in households with a daily per capita income between USD 9.8 PPP (equivalent to Argentina's national poverty line – CEDLAS, 2017b) and USD 15 PPP,

Figure 2.5. **A large share of the population is poor or at risk of falling into poverty**



Note: Data are representative of urban centres of more than 100 000 inhabitants. Socio-economic classes are defined using the following classification: "Poor" = individuals with a daily per capita income of USD 9.8 or lower. "Population at risk of falling into poverty" = individuals with a daily per capita income of USD 9.8-15. "Middle class" = individuals with a daily per capita income of USD 15-50. "Affluent": individuals with a daily per capita income higher than USD 50. Poverty lines and incomes are expressed in 2011 USD PPP per day (PPP = purchasing power parity).
Source: Encuesta Permanente de Hogares (EPH) for the second and third quarter of 2016.

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which exposes them to a relative probability of experiencing spells of poverty in the future. This report will call them "at risk of falling into poverty". One out of five people in Argentina stand right above the poverty line, but are at risk of falling into poverty owing to substantial vulnerabilities, such as low labour income, insufficient skills, informal employment and poor access to quality public services. Supporting this vulnerable population is key for the welfare and growth of the country as a whole. Any risk of changes in income may constrain households and decrease their investments in productive assets and in human capital. Such risk could also force households to diversify their income sources even at the cost of lower returns.

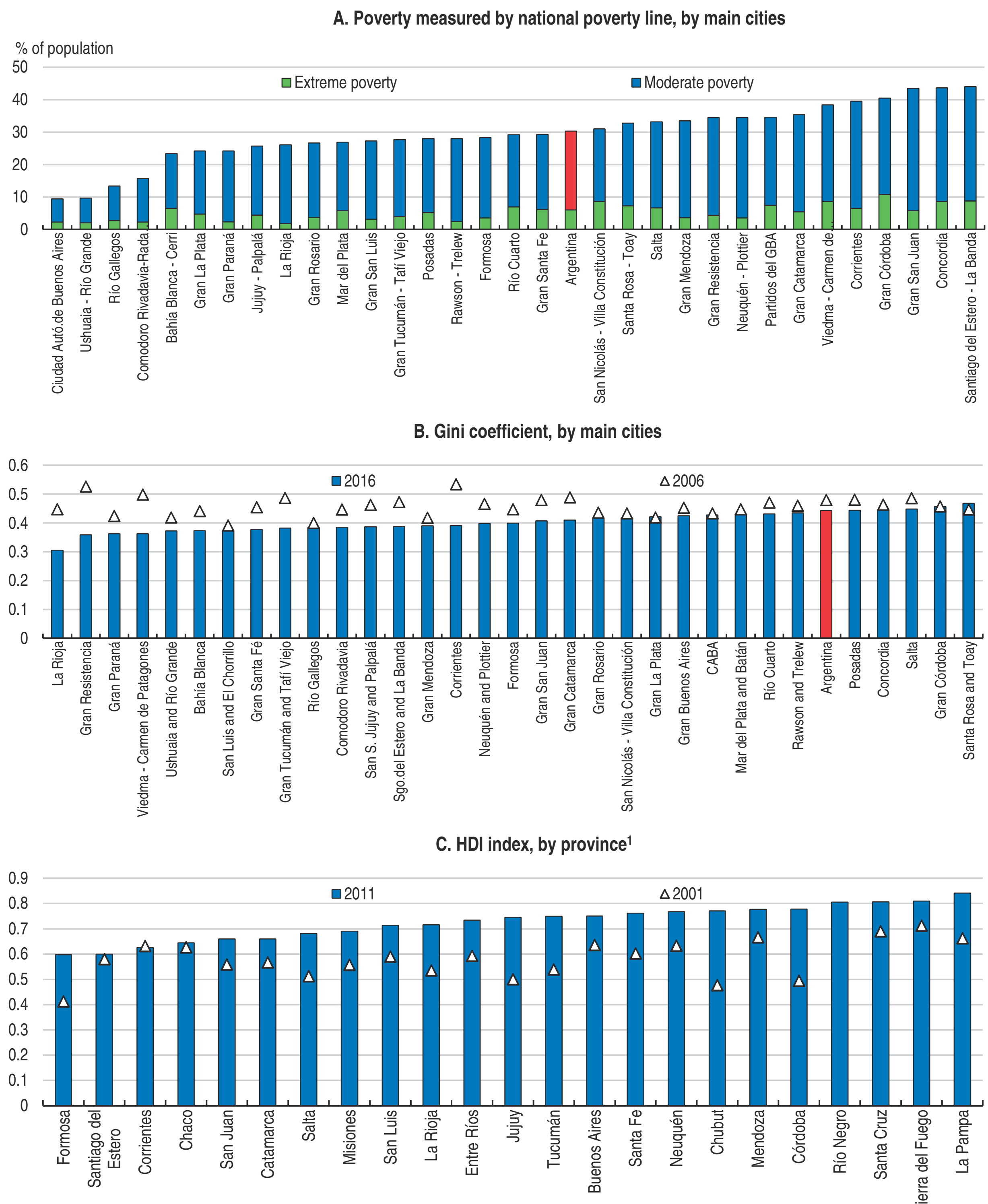
Territorial inequalities challenge inclusive growth

Improvements in living standards and reductions in inequality and poverty levels over the past decade have not benefited all provinces equally. Regional disparities are high, with poverty rates above 40% in the Northern provinces (Figure 2.6, Panel A). Disparities within and among provinces and cities are large (OECD, 2016a), particularly in the City of Buenos Aires and its metropolitan area (Gran Buenos Aires) (Figure 2.6, Panel B). The causes are complex. High inequalities among provinces and cities relate to high informality rates, lack of quality jobs, low skills and poor public services.

In terms of well-being, and particularly material and living conditions, a great divergence is observed between provinces. The performance of the City of Buenos Aires on the Human Development Index is far above the national average, while provinces such as San Juan, Catamarca, Chaco, Corrientes, Santiago del Estero and Formosa do not perform so well (UNDP, 2014) (Figure 2.6, Panel C). Likewise, almost a quarter of the population of Santiago del Estero, Chaco, Salta and Formosa had unmet basic needs (UBN Index) compared with only 6% in the province of La Pampa and 7% in the City of Buenos Aires (INDEC, 2010a).

Access to public infrastructure and public service provision of water, sanitation, electricity, education and health care differ substantially across provinces, contributing to discrepancies in well-being. For example, people living in the Northern provinces have a larger risk of not having access to drinkable water in their dwellings than people living in

Figure 2.6. **Territorial differences are large**



1. Data correspond to the amplified version of the Human Development Index (HDI).

Source: Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC) and UNDP (2014), Argentina National Development Report 2013.

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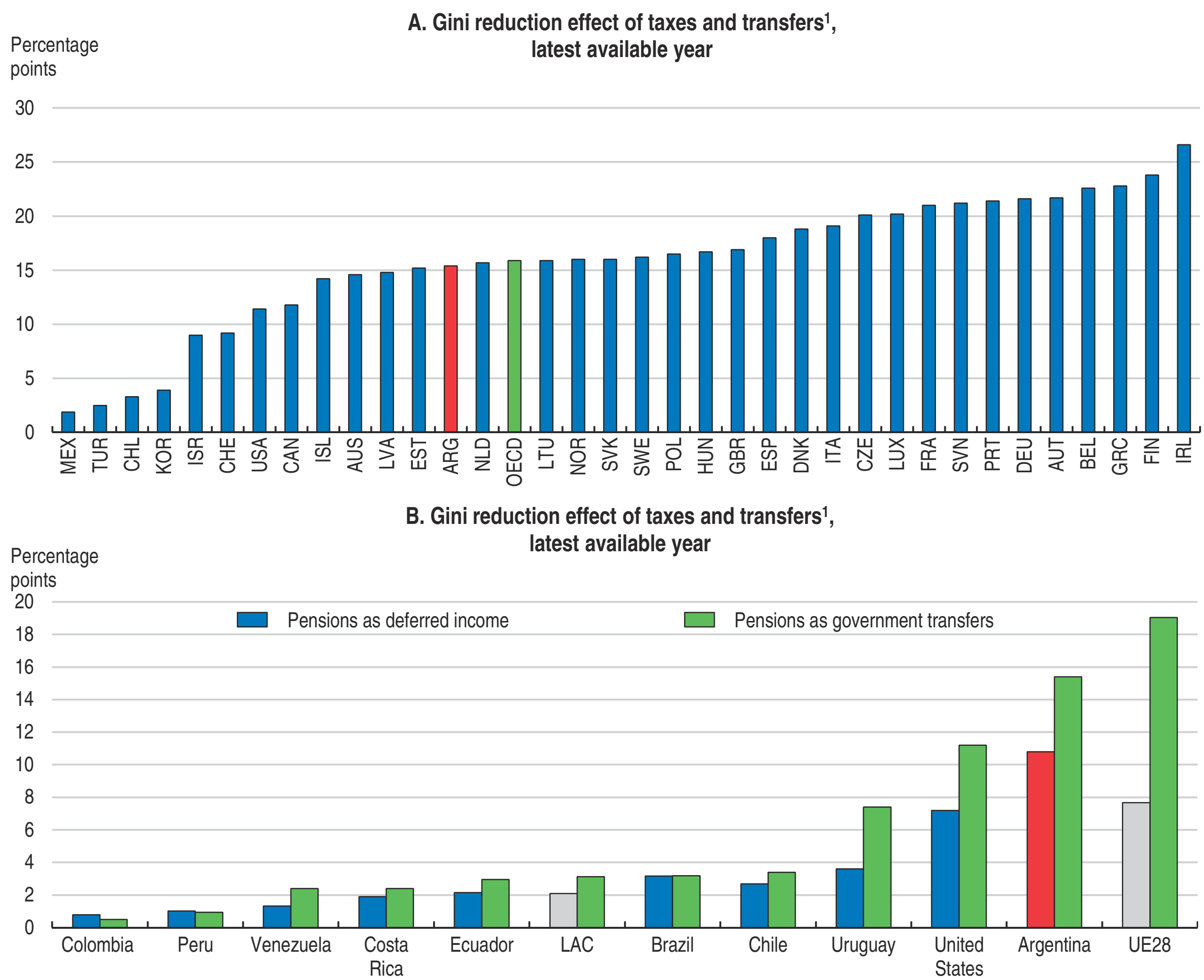
the southern provinces or the City of Buenos Aires. The most recently available data from the 2010 census show that in the provinces of Misiones and Chaco only 19% and 26% of households, respectively, had access to improved sanitation facilities, compared to 98% in the City of Buenos Aires (INDEC, 2010b).

Taxes and transfers reduce inequalities

Taxes and transfers play a significant role in shaping the income distribution in Argentina. Income inequality and poverty would be higher without redistribution through taxes and transfers. The Commitment to Equity Institute (CEQ) analysis shows that the impact of direct taxes and direct transfers combined has an equalising income effect and reduces poverty. Under a scenario where contributory pensions are considered direct government transfers, direct taxes and transfers reduce the Gini index by 15.4 percentage points. This reduction is higher than in other Latin American countries with similar pre-tax levels of inequality and similar the OECD average (Figure 2.7).

Figure 2.7. **Transfers and taxes alleviate inequalities**



1. Data for Argentina are representative of urban centres of more than 100.000 inhabitants.

Source: OECD Income Distribution Database, OECD calculations based on the Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC), and Lustig (2017).

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Most of this impact on inequality is explained by transfers rather than taxes. More than two thirds of the Gini reduction can be attributed to direct transfers. Most direct cash transfers are progressive in absolute terms, since they benefit the less well-off households. After direct transfers, the income Gini declines 10.8 percentage points. A large share of this reduction comes from the contributory pension and the effectively non-contributory pension introduced by the *Moratoria Previsional* (Social Security Moratorium) (Annex: Table 1). Likewise, direct taxes are progressive, especially the Personal Income Tax that is only paid by the richest 10% of the population, as are social security contributions if they are borne by the employee. Direct taxes decrease the Gini coefficient by 4.6 percentage points.

The redistributive effect of taxes and transfers is highly concentrated amongst the lowest and highest deciles, and not on the population at risk of falling into poverty. The highest decile of the market income distribution is the one that bears the highest proportion of direct taxes. Conversely, the lowest market income deciles receive the highest proportion of transfers. The effect is exceptionally high for the lowest deciles of income distribution when pensions are considered a government transfer. This impact is markedly higher than if pensions are considered differed market income (Annex: Table 2). As a result, after government intervention, the first decile receives a net government transfer of 7.4% of total disposable income (they concentrated no income before the intervention), and the richest decile concentrates 25.7% of total disposable income (compared to 39.1% before the intervention). In contrast, the effects of taxes and transfers amount to between 1 and 5 percentage points of total disposable income in the lower-middle part of the income distribution (i.e. the 2nd to 5th lowest deciles). In other words, redistributive effects are very large for the lowest income decile, but relatively small for households at risk of falling into poverty.

The redistributive effects of transfers are much milder when pensions are treated as deferred market income. After direct transfers, the income Gini declines 6.4 percentage points, while direct taxes decrease the Gini coefficient by 4.4 percentage points. Moreover, although the lowest market income deciles receive the highest proportion of transfers, after government intervention, the first decile only concentrates 3.2% of total disposable income (compared to 0.4% before the intervention), and the richest decile concentrates 27.1% of total disposable income (compared to 35.3% before the intervention) (Annex: Table 2). The effects of taxes and transfers amount to between 0.7 and 1.6 percentage points of total disposable income in the lower-middle part of the income distribution (i.e. the 2nd to 5th lowest deciles). Although the redistributive effects of transfers are much milder when pensions are treated as deferred market income, the overall results are similar to the scenario where pensions are considered a government transfer: redistribution is large for the lowest income decile, but relatively small for households at risk of falling into poverty.

Conversely, indirect taxes tend to increase moderate poverty. Transfers received compensate the effect of indirect taxes paid only for the lowest decile, while the opposite is the case for all other deciles. The CEQ analysis of indirect taxes shows that the three lowest market income deciles pay a higher proportion of their market income in taxes than the rest deciles. Moreover, low-income consumers, except for the first decile, pay more in indirect taxes than what they receive in direct subsidies other than pensions (Rossignolo, 2016).

Improving the sustainability of redistribution policies

The sustainability of social policies (both social assistance and insurance programs) is key for continuing poverty and inequality reduction in Argentina. Public spending increased from 27% of GDP in 2007 to almost 41% in 2015 (IMF, 2017). A large portion of the spending increase was the result of three policies: the *Moratoria Previsional* (Social Security Moratorium) adopted in 2005 to promote a special pension subsidy regime designed to include workers who had insufficient years of contributions into the pension system; the Educational Financing Law adopted in 2006 that increased education spending to 6% of GDP, and the creation of the *Asignación Universal por Hijo* (AUH) in 2009 that extended the family benefits allowance to the children of non-registered workers and the unemployed. Moreover, in 2016 the AUH was extended, pensions were adjusted to current prices through the *Reparación Histórica a Jubilados y Pensionados* law sanctioned in June and the *Pensión Universal para el Adulto Mayor* (social pension) was created, all of them expanding Argentina's social public spending. Additionally, strengthening active labour market policies, and possibly unemployment benefits, may require further increases in social spending.

Social protection programmes, subsidies and transfers can be rendered more efficient by creating a true social protection system with shared tools and registries. Social protection in Argentina has a large number of policies and programmes offered both at national and provincial levels by the *Administración Nacional de la Seguridad Social* (ANSES – National Social Security Agency), Ministry of Education, Ministry of Social Development, Ministry of Labour, Employment and Social Security, and Ministry of Health. Integrating and co-ordinating the provision of services could significantly increase the effectiveness of social protection and the efficiency of social spending (World Bank, 2015). The creation of shared targeting instruments for multiple programmes, such as a unique social registry and one-stop processing centres for social benefits, should make Argentina's social protection system more efficient by reducing programme duplicity, lowering administrative costs, and simplifying the bureaucracy burden and payments.

Likewise, room for improvement exists in targeting indirect subsidies on transportation, electricity, water and gas. With a few exceptions, transportation, electricity, water and gas subsidies benefit the most affluent since spending is evenly distributed among poor and rich households. As a result, the richest households receive a higher benefit in absolute terms than low-income individuals transferring a significant portion of fiscal resources to the non-poor (Puig and Salinardi, 2015). As such, room remains to reduce subsidies, while protecting the poor and those at risk of falling into poverty that rely heavily on these subsidies.

Additionally, a pension reform is needed to increase pension adequacy and fiscal sustainability. The pension system, which combines contributory and non-contributory elements, significantly reduces inequality and poverty. Even before the introduction of the non-contribution pension (PUAM) for all people aged 65 and above, whose benefits are set at 80% of the minimum contributory pension benefit 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). In the contributory system, 70% of beneficiaries get the minimum pension of approximately 80% of the minimum wage and 54% of the average wage. Benefits are capped at around six times the minimum wage. Replacement rates, which link benefits to the last wage, are about 72% for an average wage, compared with 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 currently amount to around 8% of GDP, which is high for a country with Argentina's age profile. They are expected to rise to around 12% of GDP by 2050 (OECD, 2015c).

In terms of coverage, the starting point is relatively solid with high coverage rates both in the active (contributors) and passive (pensioners) sides. Policies to protect old-age vulnerability compensate for extensive informality, especially among women. In combination with the PUAM, Argentina's pension system has achieved almost universal coverage.

However, demographic developments, combined with high informality rates, will raise long-term sustainability issues for the pension system. A package revising the level of benefits and retirement age, incorporating incentives for formality especially for the middle and lower-middle classes, and reinforcing the institutions and rules governing the recently implemented non-contributory pensions would be a step forward.

Pension benefits are comparatively high relative to working age earnings. 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). OECD countries typically adjust pension benefits by consumer prices, wages or a mixture of the two. In light of demographic developments and high replacement rates, a prudent choice for Argentina would be to adjust pension benefits by consumer prices, preserving 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, 2016).

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. They accord lower retirement ages and higher benefits. For those beneficiaries of the special pension regimes who are sufficiently far away from retirement, the conditions could be brought in line with the general pension system.

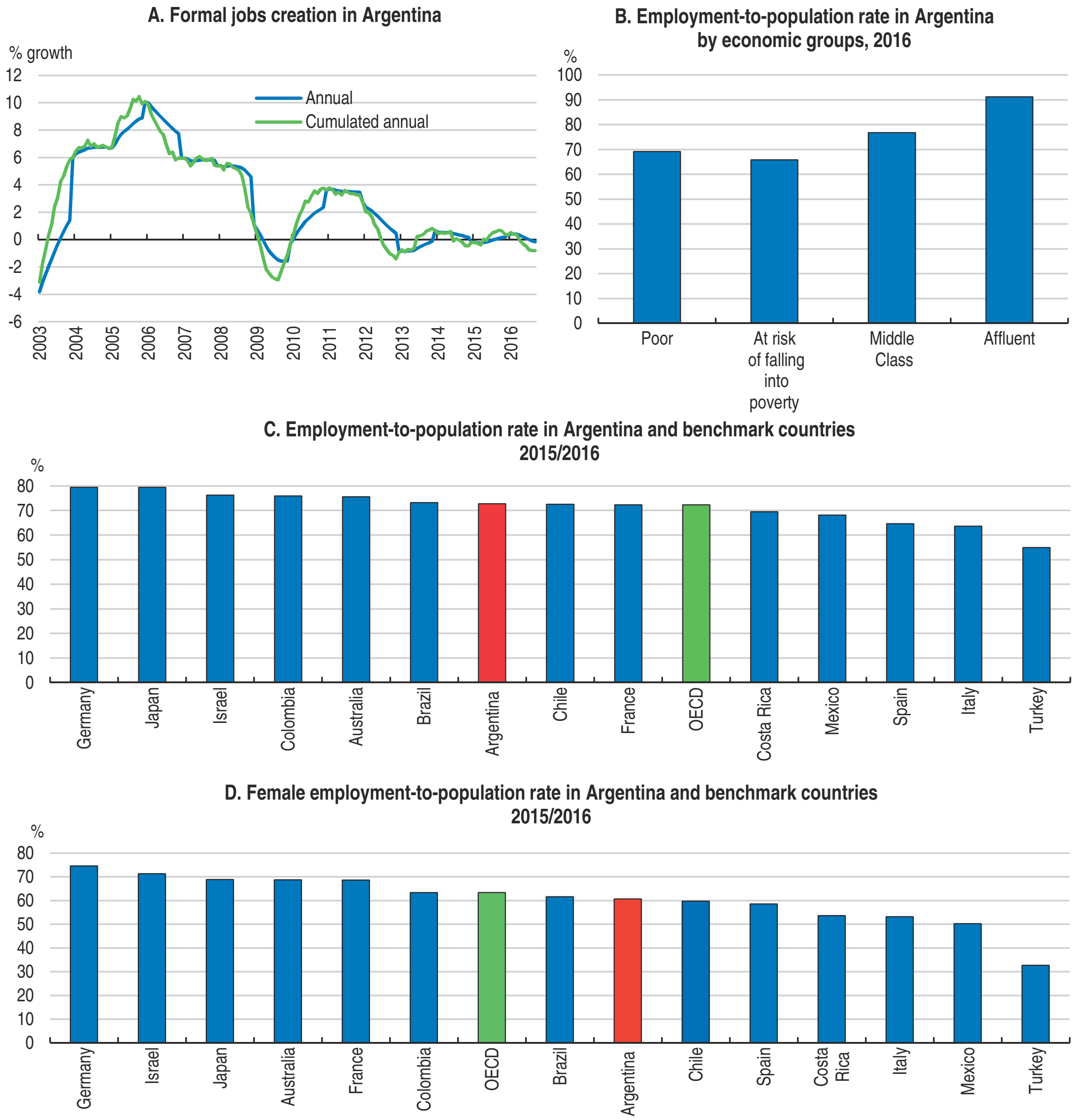
Creating better jobs to improve productivity and equity

Many working-age Argentinians encounter labour-market difficulties. Employability barriers are related to insufficient work-related capabilities, lack of financial incentives to look for a job (such as low potential pay and bad quality jobs) and scarce job opportunities.

Improving job quality, reducing informality and increasing employment levels, especially for women and youth, remain key challenges (Battistón et al., 2014). Additionally, a recurrent problem is the lack of appropriate educational and professional skills. More than half of the out-of-work have not completed secondary education (compared with 35% of the working population), highlighting the need for skills upgrading (CEDLAS, 2016).

The economic slowdown cut short the period of rising formal employment creation which began in 2004 and continued, with the exception of 2009, until 2012. Argentina's employment rate slightly decreased from 2013 to 2016, down to 72.7% from 73.7% (population aged 25 to 64) as a result of weakening labour demand and the subsequent drop in the number of new, salaried jobs created (Ministry of Labour, Employment and Social Security, 2016; ECLAC/ILO, 2016). Since 2012, the low job creation (Figure 2.8, Panel A) has been driven mainly by the public sector where employment grew on average by 4.2% per year compared with the formal private sector where it only grew by 0.5% annually (Ministry of Labour, Employment and Social Security, 2016). This slowdown is also reflected in the rising unemployment rate (9.2% in the first quarter of 2017).Yet employment has been rising since mid-2016 and is expected to improve further.

Figure 2.8. **Formal job creation slowed down specially affecting those at risk of falling into poverty**



Note: In Panel C and Panel D data for Argentina are for 2016 and for Brazil are for 2014. Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: Ministry of Labour, Employment and Social Security 2016), OECD (LFS - Sex and Age Indicators), Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC) for Argentina.

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Argentina needs a comprehensive policy package to make its labour market more inclusive. First, it should put in place policies to facilitate the acquisition of skills for the large share of low-skilled workers. Second, it should implement policies supporting youth and women to participate in the labour market. And third, it should improve incentives for employers and workers to stay in or move to the formal economy. Although informality serves as an important source of jobs and livelihood for many, it hampers productivity, growth and equity (Binell, 2016; Amarante and Arim, 2015a; Maurizio, 2014; Gasparini et al., 2014).

Participation rates are low, especially for youth and women

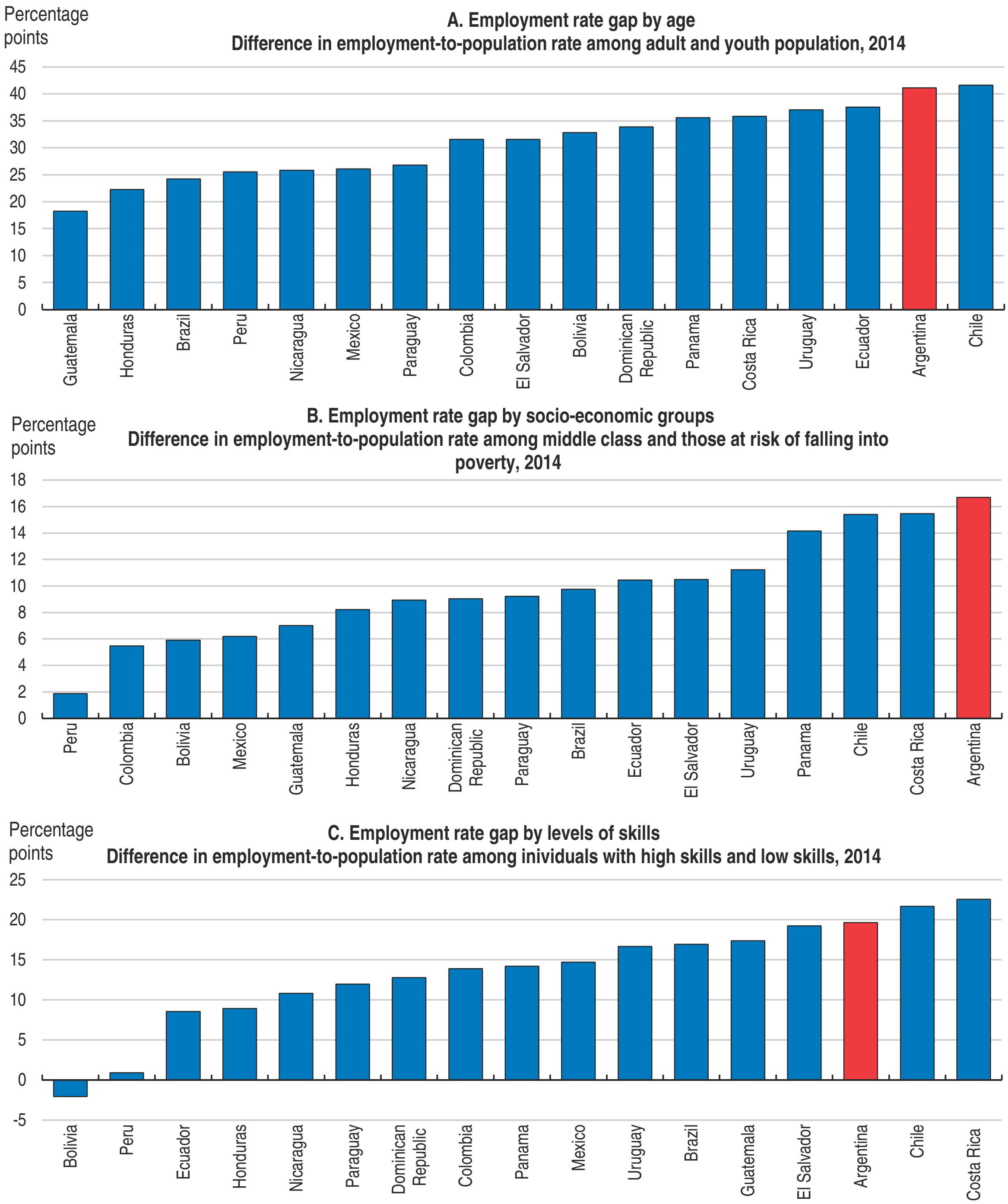
The scarcity of employment opportunities is one of the obstacles to making the labour market more inclusive, displaying significant variations across income levels and regions. Labour market participation gaps across different socio-economic groups are large (Figure 2.8, Panel B). 53% of those in the bottom decile are employed compared with 93% in the highest decile of the income distribution (INDEC, 2016), while only 63% of the population at risk of falling into poverty are employed. Furthermore, employment varies across provinces, with several northern cities among the ones with the lowest share of employed population. In the city of Buenos Aires, the richest in the country, 82% of the population aged 25 to 64 are employed, while 65% or less are employed in Gran San Juan, Gran Resistencia, Formosa, San Nicolás and Villa Constitución. Regional labour marked differences mainly reflect the experience of youth and women. The differential in participation rates between socio-economic groups, workers with different skills level and youth is higher in Argentina than in other countries in the region, which highlights the need to put in place targeted policies to make the labour market more inclusive (Figure 2.9).

Only two out of ten young Argentinians participate in the formal labour market. Youth labour force participation has slightly decreased from 48% in 2003 to 39% in 2016 (SEDLAC, 2016; INDEC, 2016). Lower employment may translate into better employment opportunities in the future if lower participation is reflected in higher school enrolments or training. Unfortunately, only a small part of the fall in participation rates reflects higher enrolments in education and training. One-fifth of youth aged 15 to 29 years old living in Argentine urban areas are not engaged in employment, education or training (NEET) (Figure 2.10, Panel C) and almost 15% are employed in informal jobs. On the other hand, 18% of Argentinian youth are formal workers and almost 50% are students. These poor employment opportunities, which are even worse for young women, the poor and those at risk of falling into poverty, result in lower well-being and reinforce the belief of many youth that they can never get ahead of a pattern of self-reinforcing aspiration gaps (OECD/CAF/ECLAC 2016).

Youth inactivity is a problem since it contributes to the intergenerational persistence of inequality, and it prevents Argentina from exploiting an emerging demographic window of opportunity. All 25 Argentine provinces and the City of Buenos Aires will benefit from the "demographic dividend" until around 2040 (De Hoyos, Halsey and Székely, 2016). Although fertility rates have declined, children under age 15 still account for almost 20% of the population in 2016, and young people aged 15 to 29 account for almost 25% (Figure 2.10, Panel A). Supporting a successful start to a professional life is crucial for youth, since their later careers depend highly on the first steps (IDB, 2015). Lack of good employment opportunities is one of the most significant factors hindering the inclusion of youth in Argentina.

The challenge of NEETs is concentrated among young adults, while most teens in Argentina attend school. NEET rates increase between the ages of 20 and 29. A substantial part of it is explained by young women choosing not to combine raising a family with paid work. In fact, there is a 13 percentage points gender gap in the NEET rate in Argentina. Almost three out of ten young women (aged 15-29) are NEET, and two of them are engaged in unpaid domestic work and caregiving. Youth who left secondary school before completion and are neither working nor improving their skills are of particular concern. More than one-half of NEETs aged 15-29 years are early school leavers and likely to face limited career prospects (OECD/CAF/ECLAC 2016).

Figure 2.9. **Argentina's labour market needs to be more inclusive**



Notes: Employment rate for population of 30 to 64. Youth is defined by the population aged 15-29. An individuals have "low skill level" if have completed 8 years of education or less, and "high skilled level" if completed 13 years of education or more. Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: SEDLAS (2016) and OECD and World Bank tabulations of SEDLAC (2016).

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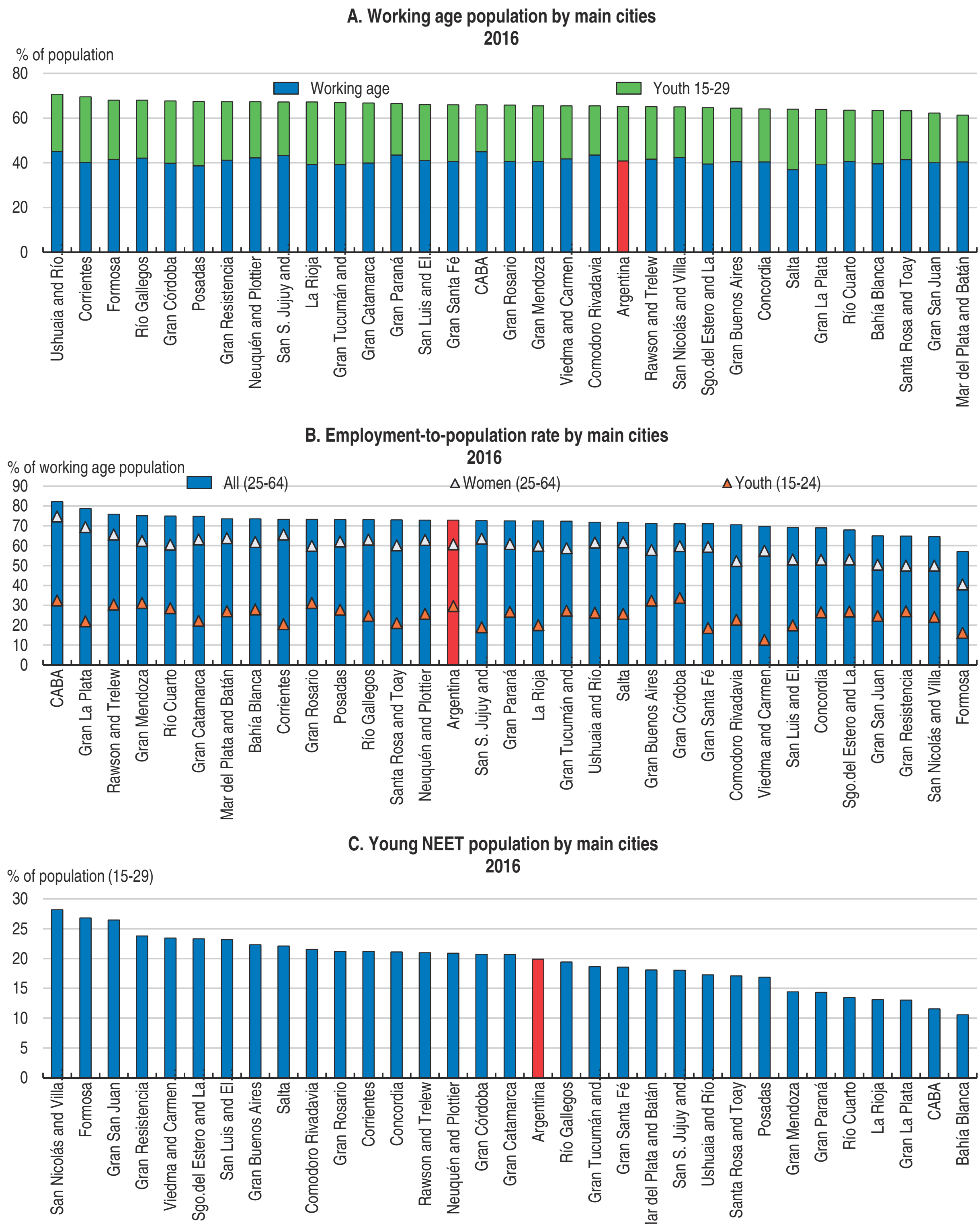
Participation rates for Argentinian women are low compared with OECD economies (Figure 2.8, Panel D), being especially low in the smallest cities and the Greater Buenos Aires area where non-participation rates are higher than 40% (Figure 2.10, Panel B). Most affected

Figure 2.10. **Too many young and women in Argentina do not work**



Source: Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC).

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are the most vulnerable women; i.e. those with low education, living in small cities, with children or married to low-earning spouses (Gasparini and Marchionni, 2015). This trend suggests the emergence of a dual scenario. On the one hand, skilled higher-income women living in large cities have labour participation levels similar to those of developed countries; and, on the other, low-skilled vulnerable women living in smaller cities with poorer services have substantially lower levels, leading to increasing inequality and poverty cycles (Gasparini and Marchionni, 2015; OECD/CAF/ECLAC, 2016).

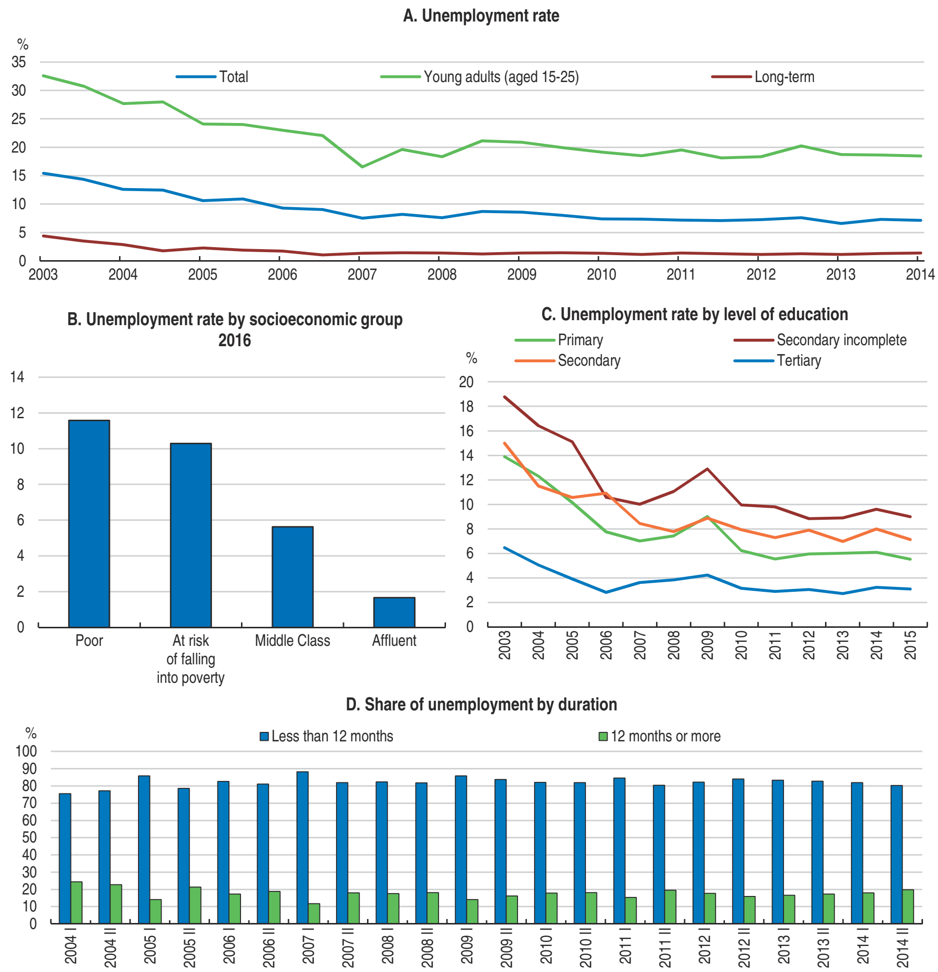
Although progress in female participation has been made over the past decades, advances have slowed recently. From 2012 to 2015, the gender gap remained constant at around 28% (OECD, 2015b). Unless Argentina implements policies to promote the participation of women in the labour force, the country will not reduce the gender labour force participation gap by the G20 commitment of 25% by 2025.

The availability of affordable, high-quality childcare is a key factor explaining cross-country differences in women's labour market participation (OECD, 2012a). Only 36% of Argentine three year-olds are enrolled in formal childcare, lower than in Mexico (40%), Brazil (49%) and Chile (54%), and significantly lower than the OECD average of 68% (CAF, 2016; OECD, 2015a) and advanced economies such as France (99%), Germany (93%) and Israel (97%). Moreover, only 25% of 3-year-olds from households in the lowest decile of the income distribution attend school, while 81% of their peers in the highest decile do so (SEDLAC, 2016).

Active labour market policies, quality of education, job flexibility and affordable childcare facilities are needed to support further increases of women labour force participation. Designing employment initiatives for groups with less attractive job prospects and more predisposed to exit are needed, given the significant slowdown of labour participation among vulnerable women. Active labour market policies (ALPMs) interventions such as training, employment services and incentives to small business development, protected employment and direct employment generation through public employment programmes can improve employment prospects for women and better prepare them for the world of work. Closing the gender gaps in education, starting from childhood, is essential to better integrate women in the world of work. According to the OECD *Programme for International Student Assessment* (PISA) 2015 data, the City of Buenos Aires ranks among the territories with the largest gender performance gap in mathematics (boys' average score exceeds girls' by more than 15 points, although they have similar performance in science). Additionally, reducing the time-burden women face related to family responsibilities by offering free childcare, free elderly care and job flexibility can help women pursuing a career. Lastly, policy advocacy regarding female stereotypes could help to pursue changes in social attitudes and norms.

Unemployment mainly affects the young, less educated and those living in low-income households (Figure 2.11). Unemployment rates are four times higher for youth than for adults with nearly 24% of the economically active young population being unemployed in 2016 (INDEC, 2016). Low- skilled workers are also hit hard; the rate of unemployment among those with tertiary education is three times lower than that for individuals with incomplete secondary education. Territorial differences are also significant. The unemployment rate of cities with more than 500 000 inhabitants is higher than the national average and twice as high (9.3%) as the unemployment rate in smaller cities (4.6%). Still, spells of unemployment in Argentina are short. On average unemployed workers spend nine-and-a-half months looking for a job and only 20% take more than one year (SEDLAC, 2016).

Figure 2.11. **Unemployment hits the young and the poor the most**



1. Data are representative of urban centres of more than 100 000 inhabitants.

Source: SEDLAC (2016), EPH for the third quarter of 2016 (INDEC), Ministry of Labour, Employment and Social Security based on Encuesta Permanente de Hogares (EPH).

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Box 2.2. **Job Quality in Argentina**

Besides the problems associated with informality, labour earnings are very unequal (Figure 2.12). This is the principal reason why job quality, a multi-dimensional concept capturing several job characteristics that contribute to the well-being of workers, is low in Argentina, even though average hourly wages at purchasing power parity are above those in other Latin American countries (OECD, 2015b).

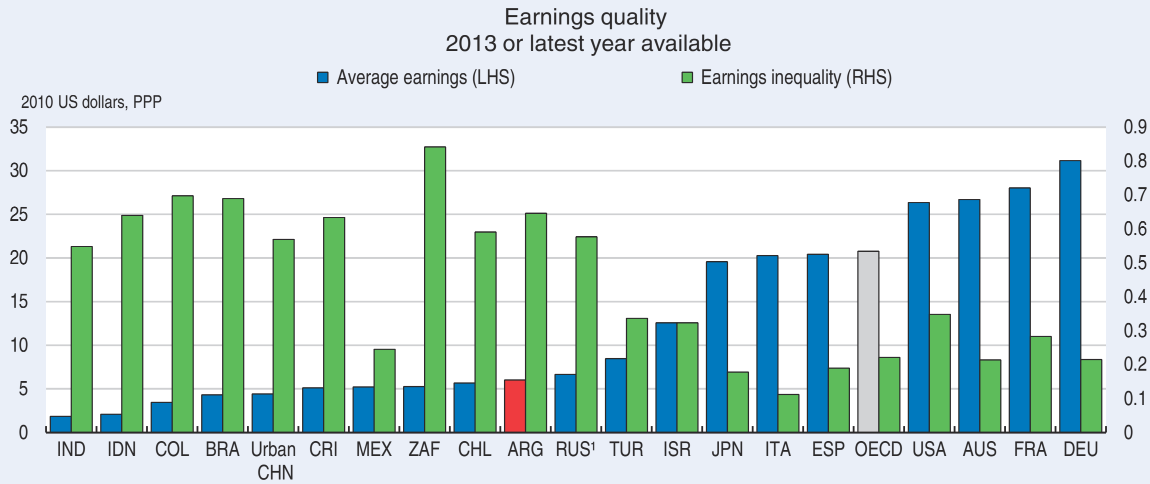
The *OECD Job Quality Framework* is structured around three dimensions that are closely related to people's employment situation: earnings quality (a combination of average earnings and inequality); labour market security (capturing the risk of unemployment and extreme low pay); and the quality of the working environment (measured as the incidence of job strain or very long working hours).

These three dimensions jointly define job quality and should be considered simultaneously, together with job quantity, when assessing labour market performance. The OECD (2015a) has adapted the job quality framework to emerging economies by taking into account their labour market specificities, such as the weakness of social protection (inadequacy of benefits and low coverage of social insurance schemes) and high rates of working poverty, and, at the same time, the more limited data available for these countries.

Box 2.2. **Job Quality in Argentina** *(cont.)*

As in other emerging countries analysed, Argentina's job quality is much lower than the OECD average in all three dimensions. The results show special concern on the incidence of informality and risk of entering extreme low-pay status (OECD, 2015a). More than a fifth of the workers earn less than the minimum wage (INDEC, 2016). Earnings quality is low and inequality large. As in most emerging economies, the levels of earnings inequality are more than twice as high as in OECD countries (Figure 2.12) (OECD, 2015a).

Figure 2.12. **Earnings are lower and more unequal than in OECD economies**



1. The figures for Russia are based on imputed data on households' disposable income from information on income brackets, and therefore include the effect of net transfers. Individual hourly income for two-earner households was calculated using available information on partners' employment status and working hours.

Note: Calculations are based on net hourly earnings and concern 2013 values, except for Brazil (2009), Chile (2009), China (2009), Argentina (2010) and India (2011). The OECD average is a simple cross-country average of earnings quality. Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: OECD (2015a).

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Although the risk of falling into extreme low pay is low compared to other emerging economies such as India, Mexico and Colombia, social transfers are not fully able to reduce this risk which translates into higher levels of overall labour market insecurity than in most OECD countries. Moreover, although unemployment risk[1] is lower than that of the OECD average, the very limited unemployment insurance coverage causes labour market insecurity from unemployment in Argentina to be higher than that in a typical OECD country. The low unemployment risk is likely to reflect unaffordability of unemployment: many workers may need to accept very low quality jobs when better jobs are not available due to lack of social insurance benefits (OECD, 2015a).

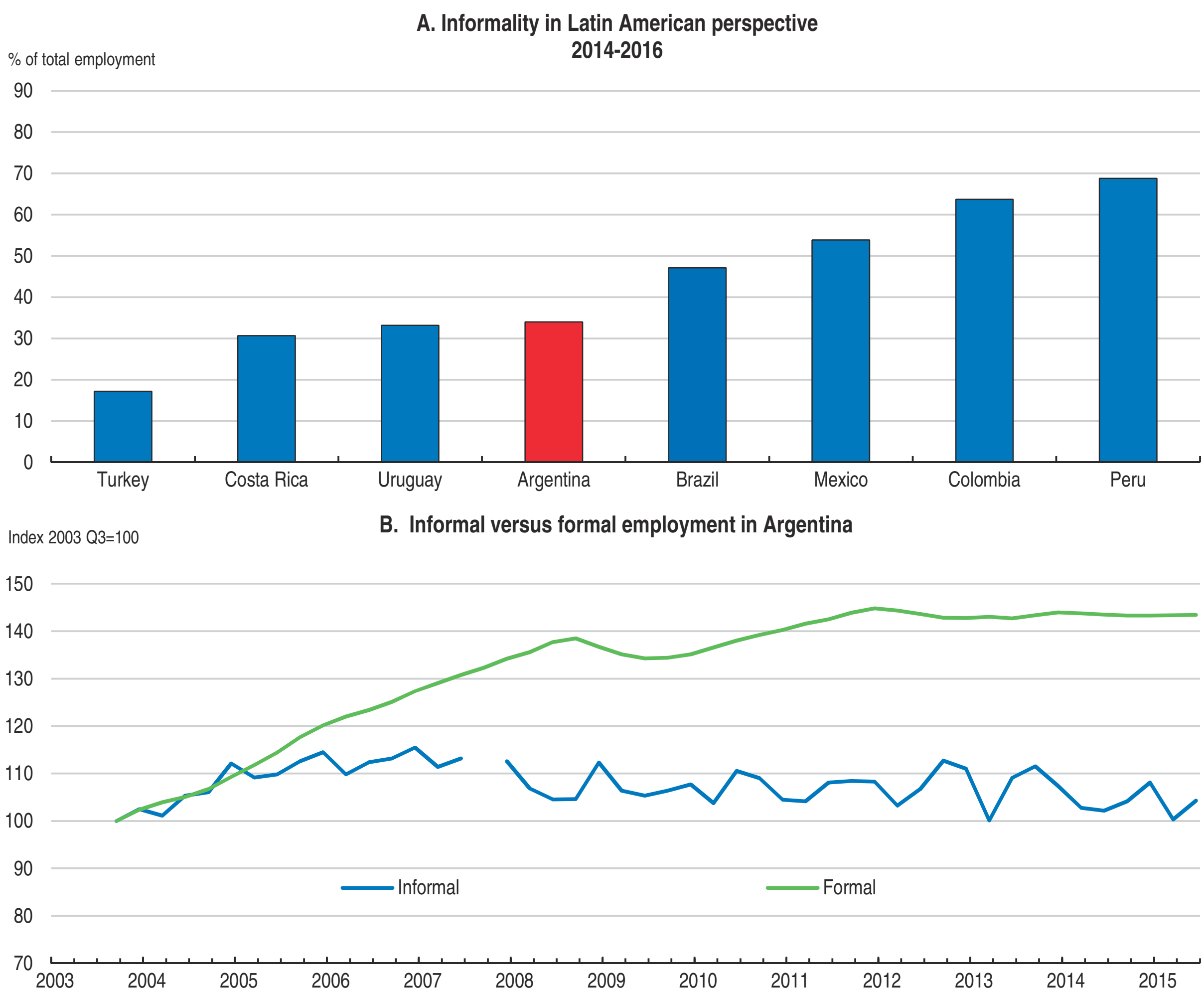
1. Unemployment risk denotes the (scaled transformation of the) probability of becoming unemployed times the expected duration of unemployment, which may be interpreted as the average expected earnings loss associated with unemployment as a share of previous earnings. Unemployment insurance captures the average effective net individual replacement rate of unemployment and social assistance benefits in terms of previous earnings, for the median earner. Labour market insecurity is calculated as unemployment risk times one minus unemployment insurance and may be interpreted as the expected earnings loss associated with unemployment as a share of previous earnings. The risk of unemployment is approximated by the unemployment rate, owing to the lack of satisfactory data to calculate flows into and out of unemployment in the countries analysed. In a steady-state economy with a relatively low level of unemployment, the two approaches yield very similar results. The OECD average is a simple cross-country average of labour market security as calculated in the *Employment Outlook 2014* (OECD, 2015a).

Source: OECD *Employment Outlook 2015*.

High labour market duality and inequality

Another obstacle to making the labour market more inclusive is informality. The informal sector in Argentina is smaller than in most Latin America countries, but large by OECD standards. The stringent employment protection for permanent formal jobs and the large share of unprotected informal jobs have resulted in a dual labour market (Canavire-Bacarreza and Lima, 2007). Informal work, by definition, leaves workers without the social protection and general entitlements of the formal sectors. Like in many other Latin American countries, informality has declined in the past decade (Figure 2.13). In 2016 informal employment accounted for 33.5% of total wage workers, affecting those in the lowest quintiles of the income distribution and especially those at risk of falling into poverty, and thus contributing to inequality. Additionally, informality especially affects youth, the less educated and women. Almost 60% of the working young population do so in the informal sector. Half of the working population with just primary education are employed in unregistered jobs, compared with only 8% of those who attained a tertiary education degree. And a larger share of women hold informal jobs compared with men (Figure 2.13).

Figure 2.13. **The share of informal employment is decreasing**



Notes: A worker is considered informal if not contributing to the pension system. Data for Argentina are for 2016, all other countries for 2014. Data for Argentina are representative of urban centres of more than 100 000 inhabitants and only accounts for wage workers.

Source: World Bank, Ministry of Labour, Employment and Social Security of Argentina Based on EPH (INDEC), and INCED (2016)

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Informality increases wage dispersion, negatively affecting equity. Although earnings inequality is similar among formal and informal workers, formal workers earn, on average, significantly more (Figure 2.14 Panel A, see Box 2.3). In fact, the provinces with the highest median and mean wages are those with lower levels of informality (Figure 2.14, Panel D). Argentina is among the emerging economies with the largest wage gap between formal and informal workers (OECD, 2015a). Lower average earnings for informal workers are consistent with the consensus view that informal jobs are less productive.

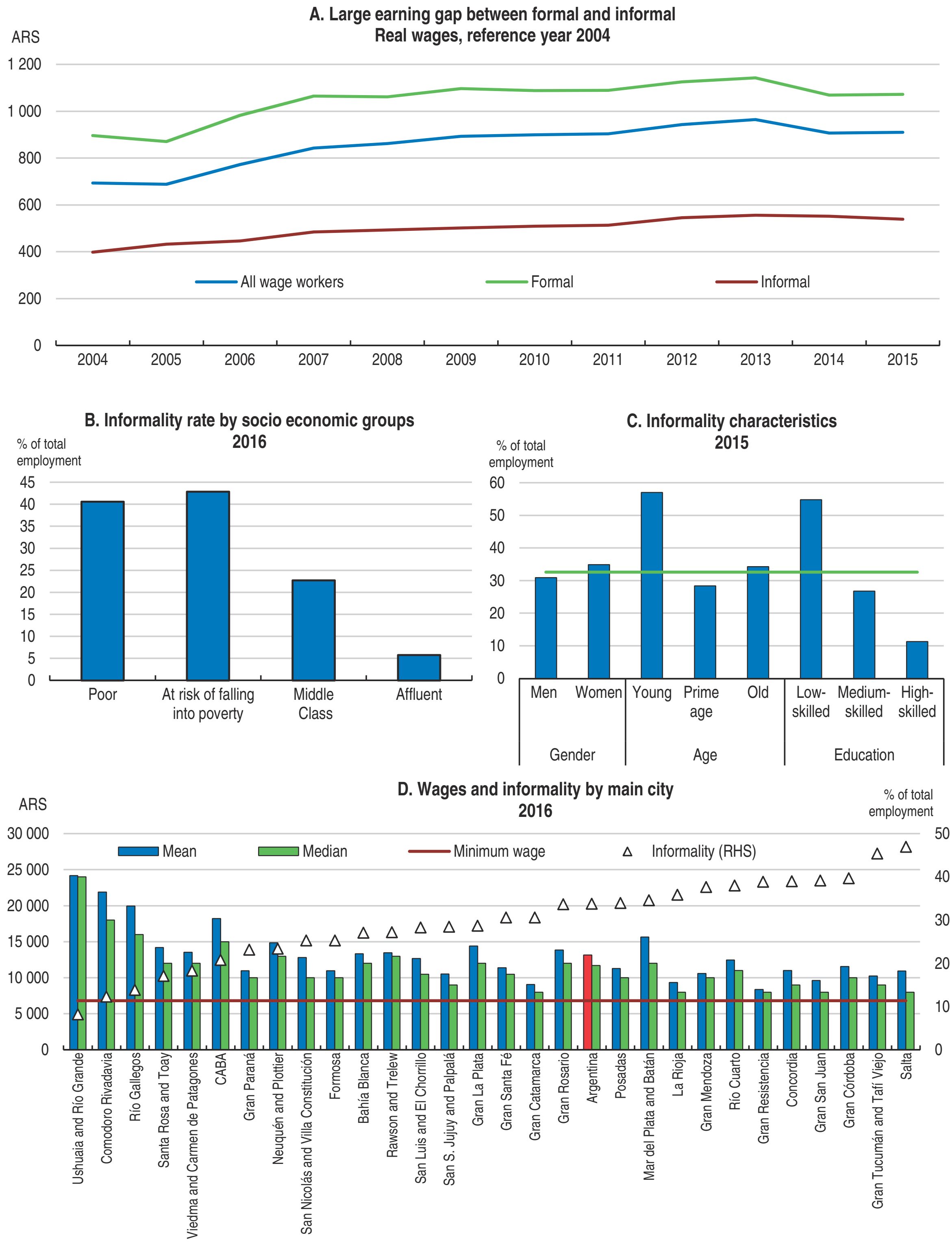
Argentina's labour market exhibits frequent flows between formal "good" jobs and informal "bad" jobs (Bosch, Melguizo and Pages, 2017). Flows out of informal jobs are more common than those out of formal jobs, but a considerable share of informal workers make the transition into formal jobs every year. Panel data capturing the dynamics of how workers aged 30 to 55 move in and out of informal employment in Argentina show that on average 34% of female workers and 30% of male workers who are currently in the informal sector will not remain there for a year (Figure 2.15). Almost 11% of women informal workers will move into formal jobs, and 22% of male will do so. Frequent flows of workers suggest that policies to tackle informality should focus on strengthening the incentives to become formal.

Flows out of the formal sector and into the informal sector are sizeable, stressing the need to place better incentives in the former. On average, 15% of workers who are currently in the formal sector will not be so within a year. Almost 10% will be informal workers a year later (80% of males who exit formal wage work and 50% of the women), compared with 2% who will be unemployed. This raises three labour policy issues in Argentina. First, formal jobs are scarce, and more quality jobs are needed. Second, unemployment benefit might not be generous enough to support the unemployed while they look for quality jobs, forcing them to take lower quality jobs instead. And third, the high cost of formalisation for workers might encourage some of them to prefer informal types of employment.

This pattern of entering and leaving the formal sector is also evidence that those informal jobs are more unstable owing to higher risk of job loss. Informal jobs appear to be associated with a higher probability of making the transition into unemployment or inactivity, particularly among women. Transitions into unemployment do not seem much higher for women than men, while transitions from informality to inactivity are quite high for women: 56% of those women make the transition out of informality compared with 11% for men. Certainly, this can also result from personal choice. Women who are planning to leave the labour force soon for family reasons, for example, may be more likely to look for more flexible work, and thus self-select into informal work (OECD/CAF/ECLAC, 2016). As explained earlier, active labour market policies, quality of education, job flexibility and affordable child care facilities are needed to facilitate the participation of women in formal employment.

Overall, informal jobs seem to be a trap for most workers, particularly for youth, women and low-skilled workers, having long-term adverse effects on equity. While holding an informal job might be a "springboard" for some, it can have scarring effects for workers' employment prospects and future wages. Bosch and Maloney (2010), and Cunningham and Bustos (2011) found that informal salaried work in Argentina may actually act as a preliminary step towards the formal sector. In fact, it might be a standard queue towards formal work, especially for younger workers, which can serve as training time and not necessarily harm an individual's career path. However, Cruces, Ham and Viollaz (2012) found strong and significant scarring effects in Argentina: people exposed to higher levels of

Figure 2.14. **Informality enhances inequality**



Notes: A worker is considered informal if s/he is a wage worker and is not contributing to the pension system. Data are representative of urban centres of more than 100 000 inhabitants.

Source: Ministry of Labour, Employment and Social Security based on Encuesta Permanente de Hogares (EPH), INDEC (2016) and EPH for the third quarter of 2016 (INDEC).

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Box 2.3. **Estimating wage differentials for informal and female workers**

Recent household data from 2016 make it possible to estimate the determinants of wages in Argentina, accounting for a number of specific characteristics of the job, including characteristics of the worker, the employer and also regional differences. Such wage estimations also allow an approximation of the wage differentials that informal workers and women face on labour markets, conditional on other factors. These estimations are presented below.

The estimated coefficient for the indicator variable representing a formal worker, defined by contributing to the social security system, suggests a wage premium of 3 880 ARS (approximately 260 USD at that time). Comparing this with the average wage of workers in the sample suggests that formal workers earn 35% more than informal workers, all else being equal. Similarly, male workers earn a wage premium of 2 614 ARS, equivalent to 24% of average wages. In other words, women with equal personal and job characteristics are paid 24% less on average than men.

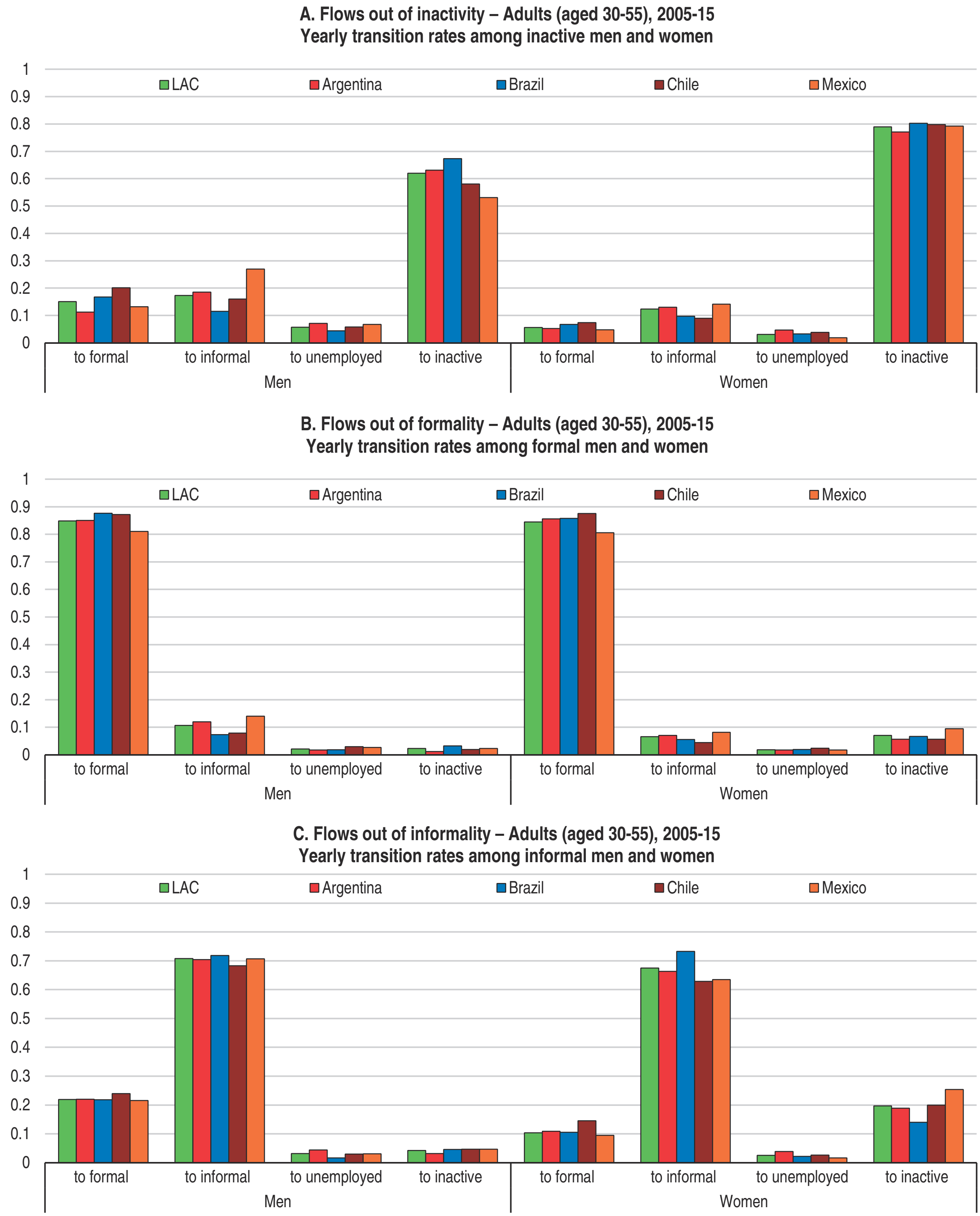
Individual characteristics that the estimations account for include age, approximated by three age groups. Relative to those aged between 25 and 50, youths earn less while older workers earn more. Educational attainments of the individual are accounted for in the estimations through four different categories. Predictably, wages are rising with higher educational attainments. Being born in a foreign country, by contrast, reduces earnings prospects. Public sector jobs appear to be paying less than the private sector, while workers who have been with their current employer for more than five years and those working for large companies earn more. By contrast, domestic employees fetch lower wages, all else being equal.

Table 2.1. **Wage differentials in Argentina**

Industry interaction factor	Coefficient estimate	Standard error
Formal employment	3880.9***	(5.70)
Male	2614.6***	(5.09)
Aged below 25	-1765.4***	(6.84)
Aged between 50 and 60	1213.5***	(6.55)
Aged above 60	1720.0***	(8.51)
Some secondary education	724.6***	(7.70)
Secondary education completed	1846.8***	(7.03)
Some post-secondary education	2844.8***	(8.31)
University education completed	6313.2***	(7.84)
Foreign-born	-382.8***	(10.1)
Public sector employee	-744.5***	(6.06)
More than 5 years with current employer	1789.3***	(5.40)
Working for a company with more than 40 employees	2662.0***	(5.37)
Domestic employee	-1239.6***	(9.11)
Hours worked	27.1***	(0.09)
Constant	6036.7***	(13.9)
Fixed effects for 6 major regions	included	
Number of observations	7 946 210	
R-squared	0.3994	

Note: ***, ** and * denote significance at 10%, 5% and 1% levels, respectively. Heteroskedasticity-robust standard errors in parentheses.
Source: OECD estimates based on microdata from *Encuesta Permanente de Hogares (EPH)* for the third quarter of 2016 (INDEC).

Figure 2.15. **Argentina's labour market is far from being segmented**



Note: Results show yearly transition rates into and out of informality. This analysis is limited to urban populations in four countries (Argentina, Brazil, Mexico, Chile) owing to data limitations. Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: OECD and World Bank tabulations of LABLAC (CEDLAS and the World Bank).

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unemployment and informality in their youth fare systematically worse in labour markets as adults (OECD/CAF/ECLAC, 2016). Additionally, informal firms generally provide workers with fewer opportunities for human capital accumulation and are less productive (La Porta and Schleifer, 2014). All of this might thus pose an additional burden to the most vulnerable earnings and career advancement (OECD/CAF/ECLAC, 2016).

Reducing informality entails policy action on the supply and on the demand of labour. Expanding training programmes to upgrade the skills of informal workers, increasing their productivity, as well as alternative skills certifications that can provide information on the capacities that are developed during informal jobs could increase formality prospects. Tackling business informality and promoting enterprises' registration are equally important since most informal workers are employed by informal firms.

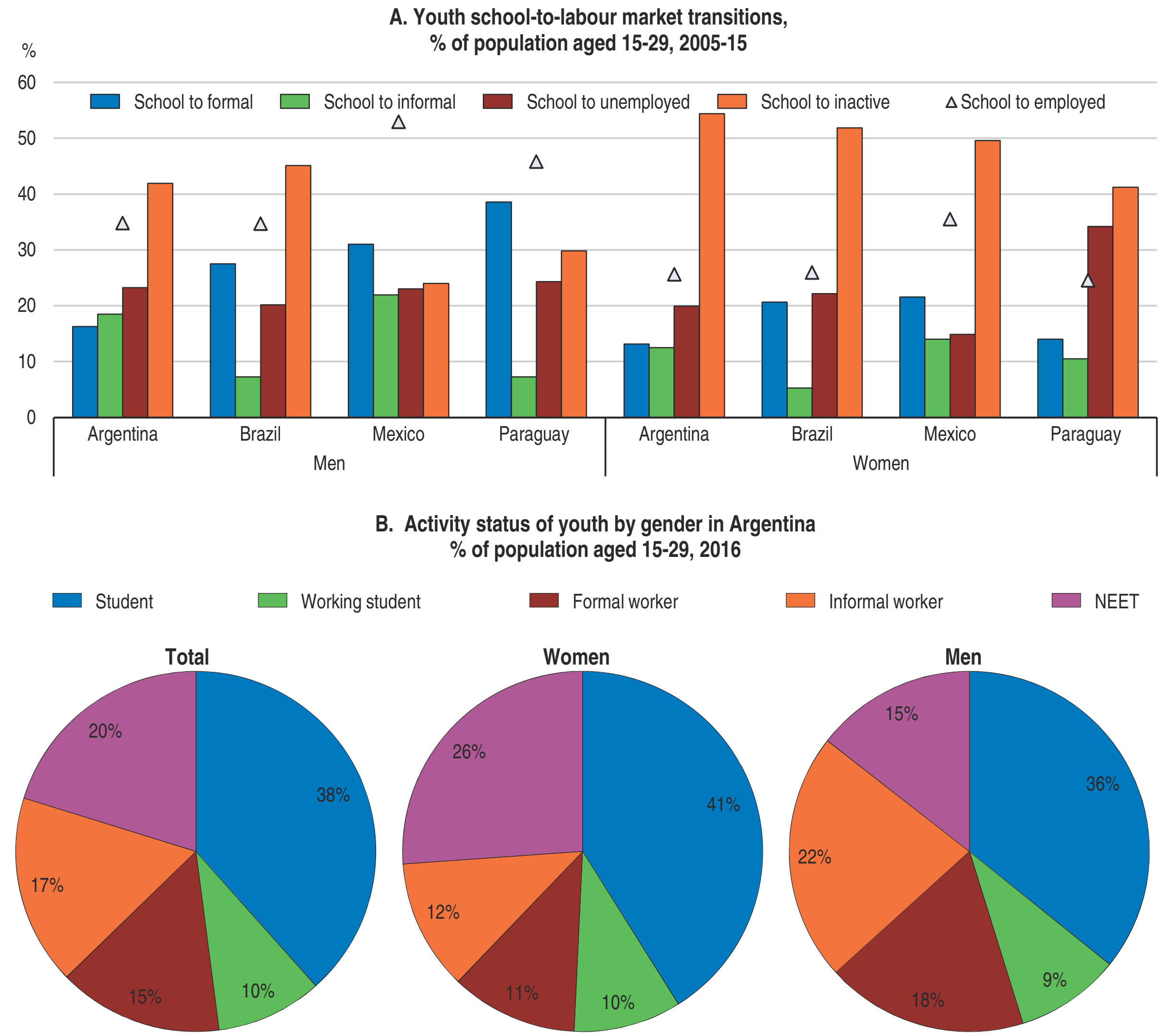
Youth inclusion is a pending challenge

In Argentina many young people struggle to integrate into the labour market. Starting in a low-paying job, or being mismatched early on with the wrong type of employment, would not have severe consequences if youth could move to more productive opportunities. Unfortunately, this does not seem to be the case in Argentina; young people seem to face particular barriers to entering the labour market (Figure 2.16), as can be seen in their lower participation rates, high unemployment rates, precarious jobs, informality rates (Figure 2.14, Panel C) and low income. Argentine youth hold fewer and worse jobs than adults. These difficulties can persist and be costly to mitigate, which is why it is crucial to ensure youth are off to a good start (OECD/CAF/ECLAC, 2016).

Youth entering the labour market in Argentina may have to wait a long time before getting a good quality job. The link between education and employment is one of the keys to social inclusion at this stage of life. Leaving school too early is costly for later productivity. The forgone earnings and the lack of skills accumulation can make it much more difficult to escape poverty as an adult. Figure 2.16 Panel A presents results of yearly transition rates out of school for the pooled period 2005-15 for youth who were enrolled in school in year t-1 and were not in school in year t. In Argentina, while about half of female movers first enter inactivity, this percentage is much lower for men. A high percentage of young men manage to enter into employment, but more than half of them find an informal job. Additionally, around 20% for both men and women ends up in unemployment (OECD/CAF/ECLAC, 2016).

The challenges that young Argentinians face in their path to work are particularly severe among those from disadvantaged socio-economic backgrounds. The transition from school to work explains the poor labour market outcomes experienced by young people in Argentina, especially those from poorer and more vulnerable households. Youth from these households leave school earlier than their peers in better-off households, and when employed they work mainly in informal jobs (Figure 2.17). At age 15, nine out of ten youth living in poor households are in school; at age 29, however, almost three out of ten youth are NEET, four of them work in the informal sector, and only three works in the formal sector. In households at risk of falling into poverty, six out of ten young people aged 29 are working in the informal sector or are NEET. In contrast, remarkable differences are observed among consolidated middle-class households: around 96% of youth are in school at age 15, while 60% are studying or have a job in the formal sector at age 29.

Figure 2.16. **School-to-work transitions are key for youth inclusion**



Note: Results show yearly transition rates out of school for the pooled period 2005-15. Transitions rates are calculated as the ratio between flow of people moving that transitioned from Condition 1 (school) to Condition 2 between time 0 and time 1, over the total stock of people in the population in Condition 1 in time 0 (i.e. in school: only in school and in school and working). The transitions are year to year (from year t to year t+1). This analysis is limited to urban populations due to data limitations. Data for Argentina are representative of urban centres of more than 100.000 inhabitants.
Source: OECD and World Bank tabulations of Labour Database for Latin America and The Caribbean – LABLAC (CEDLAS and the World Bank) and Encuesta Permanente de Hogares (EPH) for the second and third quarter of 2016.

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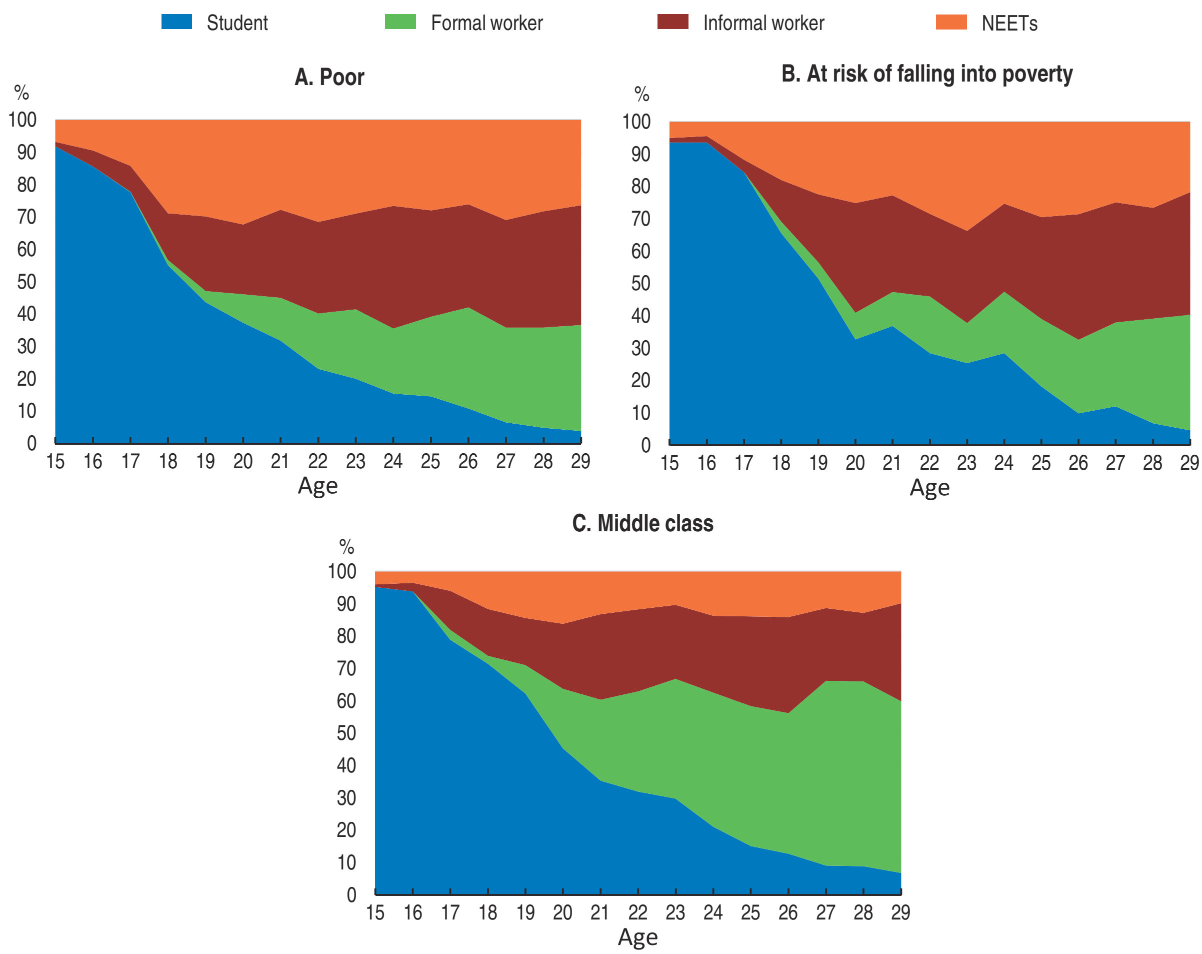
Boosting formal jobs

Reducing informality requires a comprehensive strategy, including actions on education, labour and business regulation, taxation, social protection policies and productive policies. Simplifying some labour market policies, improving training and education, lowering non-wage labour costs, and adapting business registrations procedures to the needs of micro and small firms would help to boost formal employment (Bosch et al., 2017).

Activation policies have the capacity of increasing the employability of workers in a cost-effective manner, making labour markets more inclusive. Argentina has a long history of poverty-targeted labour market and long life learning programmes. Except for youth

Figure 2.17. **Poor and at risk of falling into poverty youth find it harder to find formal jobs**

Youth status by single year of age and socioeconomic status



Note: Data are representative of urban centres of more than 100.000 inhabitants. Socio-economic classes are defined using the following classification: "Poor" = individuals with a daily per capita income of USD 9.8 or lower. "Population at risk of falling into poverty" = individuals with a daily per capita income of USD 9.8-15. "Middle class" = individuals with a daily per capita income of USD 15-50.
Source: Encuesta Permanente de Hogares (EPH) for the second and third quarter of 2016.

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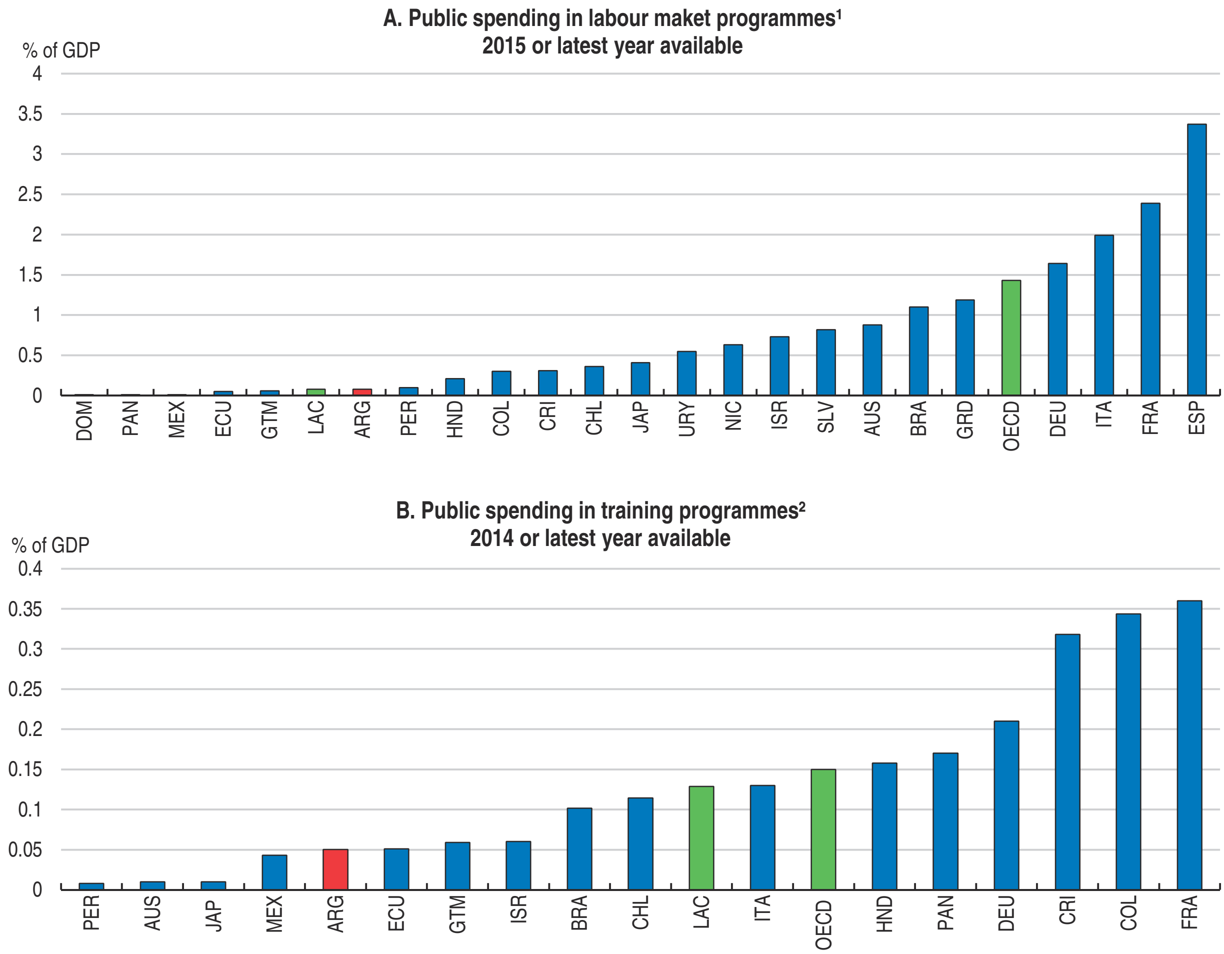
training programmes, relatively few job seekers participate in ALMP. Job training and search measures need to support all jobseekers and informal workers as well as encourage the inactive by improving their employability and helping them find an appropriate job. These programmes should help ensure that those out of work return to employment in the most appropriate job; likewise, they should help informal workers become more productive and find jobs which are a better fit for their skills.

Labour market policies in Argentina should be strengthening financially, made more efficient and spread all across the territory. The first challenge is to raise labour market programmes spending. Argentina's spending on labour market programmes is low compared with that of OECD countries, in particular, in terms of job intermediation and unemployment benefit (Figure 2.18). This partially reflects the limited fiscal space of Argentina. A second challenge is to improve the effectiveness of spending on active labour

Figure 2.18. **Low spending on labour market policies**



1. Includes active, intermediary and passive policies. Data for Costa Rica and Guatemala 2012; Nicaragua from 2013; Panama, and Honduras from 2014. The LAC average includes: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru and Uruguay.
2. Year 2014 for Argentina, Brazil, OECD and Panama, 2013 for Costa Rica, Guatemala, Nicaragua and Peru, 2012 for Dominican Rep, Honduras and Mexico, 2011 for Chile and Ecuador, and 2010 for Colombia. The LAC average includes: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Honduras, Mexico, Panama, and Peru.

Source: World Bank ASPIRE (2016) database and OECD Stats.

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market policies (ALMPs). While fiscal space may remain limited for some time to come, past evidence suggests that improving the spending efficiency can significantly improve outcomes. However, Argentina lacks a practice of systematic assessment of the labour market impact of activation programmes. Evaluating programmes can be difficult given the multiplicity of programmes and that implementation is done at regional level. The third challenge is to implement high quality programmes across the country. To target the neediest, implementation is done at provincial and municipal level replicating the disparities across provincial borders.

Skill-enhancing programmes could be complemented with temporarily lowering employer social security contributions to support employment, while increasing social security contributions ceilings to mitigate revenue losses. Labour supply and demand decisions are affected by taxation. Tax systems might deter employment by either diminishing the after-tax wage of employees, and/or increasing the employer's labour costs (OECD, 2011a). From an employee's perspective, larger net personal tax average rates (NPTA – defined as the tax/benefit proportion of the gross wage an employee pays/receives after taking into account all mandatory income taxes and social security liabilities and cash transfer benefits) and net personal marginal tax rates (NPTM – defined as the proportion of an additional unit of wage-earning income that is paid in respect of taxes and social security contributions net of additional benefits) provide greater incentives to reduce the worker's labour supply and/or entry to the labour market. The latter is especially true for second earners, when the tax unit is the individual, as the loss of tax allowances and credits on the basis of family income can discourage second earners' labour market participation incentives (OECD/IDB/CIAT, 2016).

In Argentina, the NPTA and NPTM rates an employee faces are 17% of an average wage for both indicators. These indicators are high relative to the regional LAC averages, 9.3% of an average wage for both indicators, but low relative to OECD averages (36% and 44.9% respectively). The figures for a secondary earner who enters the labour market are 17% in Argentina and 3% in Latin America and Caribbean (LAC) and 23% in OECD economies. Additional factors beyond marginal rates that might contribute to raise the costs of entering the labour market for secondary earners are in respect of childcare.

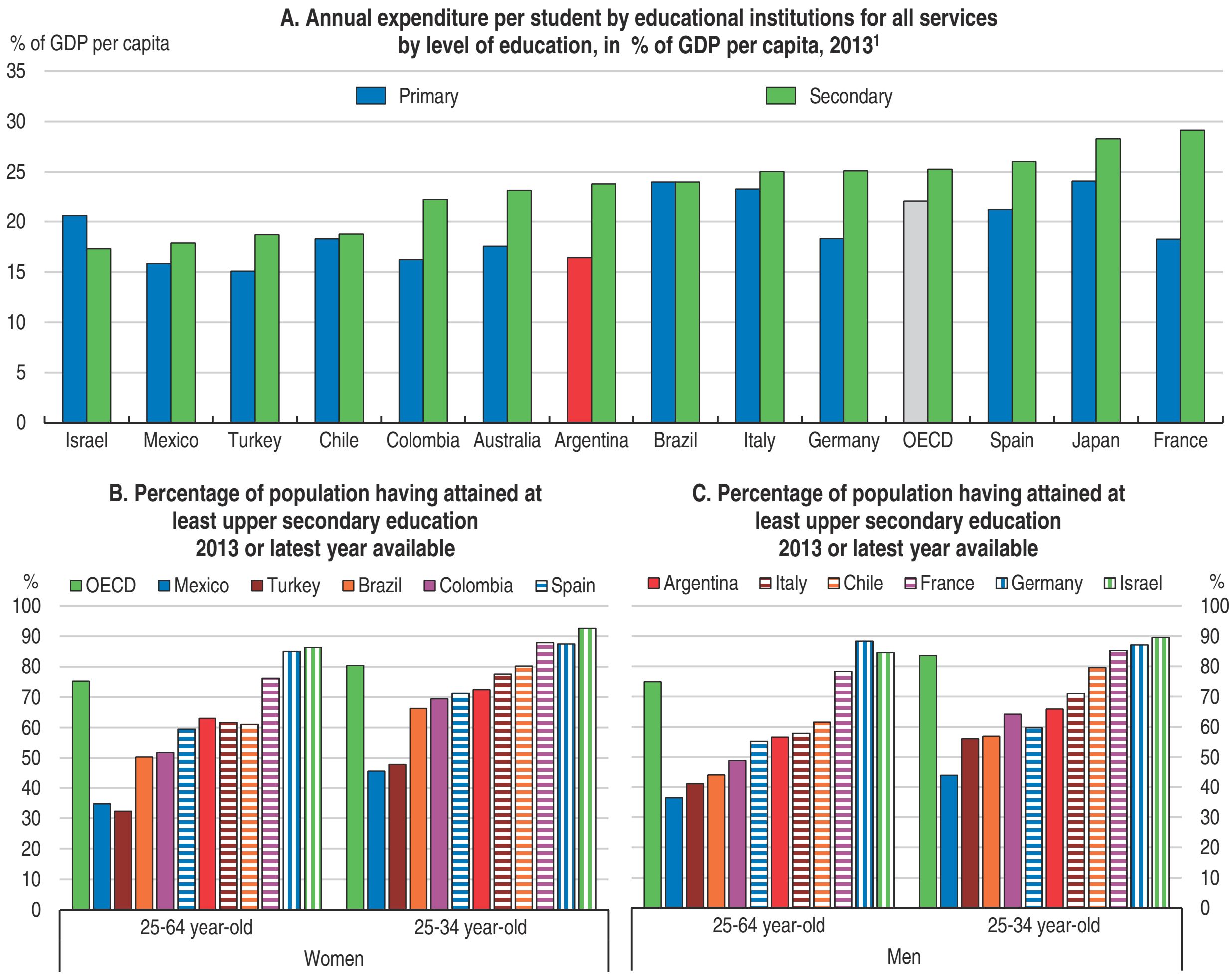
From an employer's perspective, average and marginal social security contributions and payroll taxes rates raise labour costs and thus the worker's required marginal productivity, discouraging labour creation, especially for very low-skilled workers. In Argentina, the average and marginal social security contributions employers pay are 21% of the average labour cost. These are significantly above the OECD and LAC averages, 14.3% and 13.6% of average labour costs respectively. Theory on taxation incidence on employers predicts high taxation will be passed in the form of lower wages to employees up to the point in which the minimum wage becomes binding (González-Páramo and Melguizo, 2012). This might explain the high proportion (35%) of the labour force earning wages at the minimum wage level or below in Argentina.

Strengthening education and skills to raise growth and equity

Argentina is one of the forerunners in free education, universal access to primary schooling and mandatory secondary instruction in Latin America. However, the gap in educational outcomes with respect to OECD countries is large and has persisted across time, directly impacting the well-being of the population (Figure 2.19). Education coverage has expanded through the last decade – especially at pre-primary and secondary level – and public investment in education has increased higher than average spending in OECD countries since 2006, at close to 6% of GDP.

The educational attainment and skills of Argentina's population are low in international comparison. Despite progress at all levels, only 60% of the population aged 25-64 has completed secondary education, in contrast with the OECD average of 80% (INDEC, 2016; OECD, 2016b). The results are not better for recent cohorts, which have lower education attainment than in OECD and other Latin American countries such as Chile, France, Germany, Israel and Italy (Figure 2.19). Moreover, only 21% of the population aged 25-64 has attained a higher education degree. Learning outcomes are also comparatively low according to OECD's PISA tests. Results from the OECD PISA study are only available for the capital City of Buenos Aires (CABA), and results in major urban centres generally tend to be above the

Figure 2.19. **Spending on education is on par with OECD countries but outcomes are low**



1. Chile: year of reference 2014. Brazil and Italy: public institutions only.

Note: Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: UNESCO (2016), *Education* (database); OECD *Education at a Glance 2016* and EPH for the third quarter of 2016 (INDEC).

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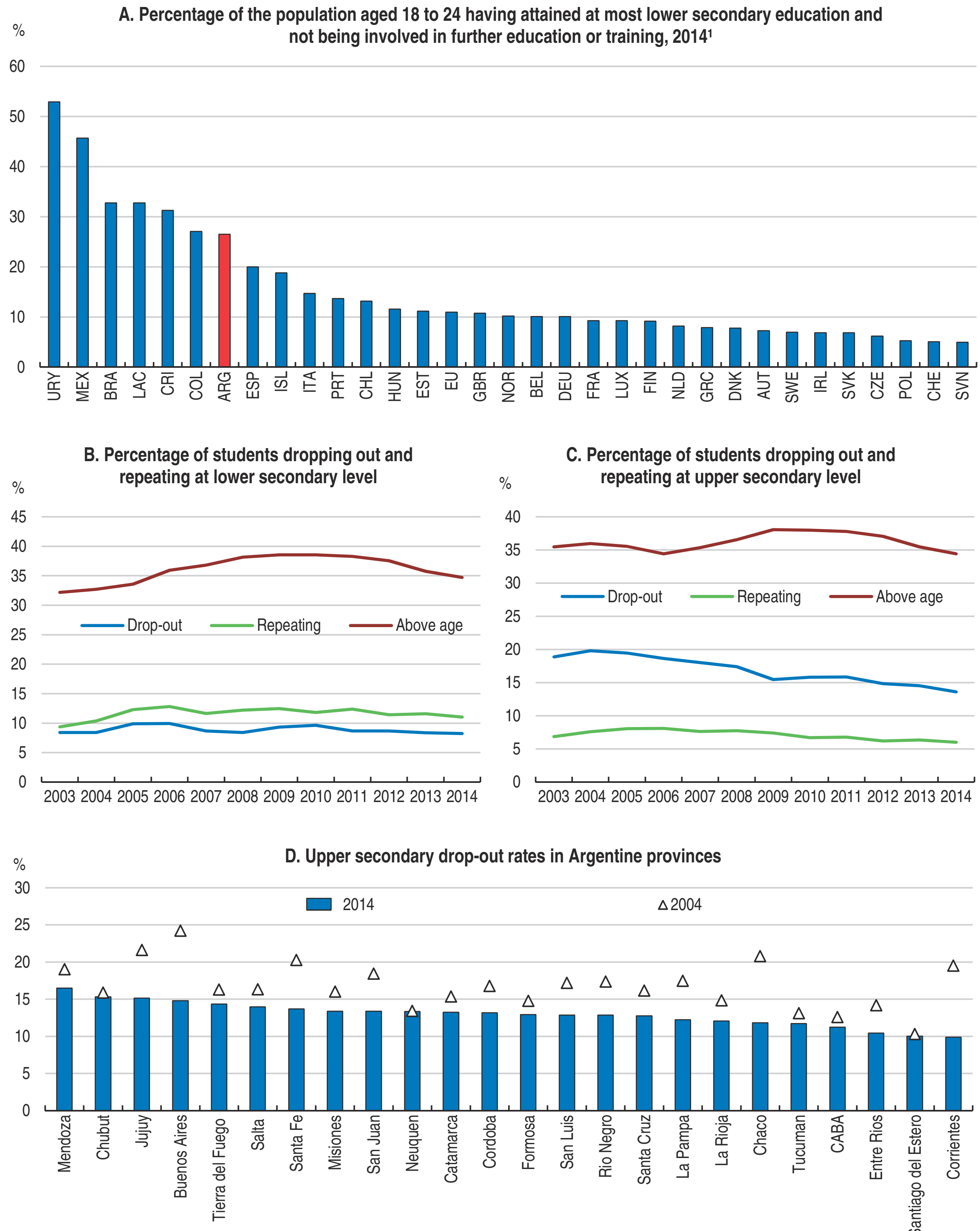
national average. Two-thirds of 15-year-old students in CABA do not have basic-level proficiency in reading, mathematics and science, facing significant disadvantages in their transition into higher education and the labour force (OECD, 2016d).

The main challenge is to spread educational benefits more fairly across the country. Argentina's inequity is a cause and consequence of uneven access to and quality of education and – later in life – labour market participation. Argentina faces several education challenges that need to be addressed urgently. First, reduce high school dropout. Second, improve education quality and teacher training. Third, support disadvantaged students and low achievers. Fourth, expand higher education and technical and vocational education at all levels to better prepare students for the world of work.

Dropout prevents strong skill acquisition

Although inequities in the education system originate at early stages, they become most evident in high school level through high school dropout. Upper secondary dropouts have decreased in the past decade but are still high (Figure 2.20). The last year of high

Figure 2.20. **High school dropout is high**



1. The early school leaving rate for Spain covers "school dropouts". Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: Eurostat Database and European Commission (2014), EPH for the third quarter of 2016 (INDEC) and DiNIECE, Ministry of Education of Argentina (2015).

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school is the most critical with 20% of students leaving school (DiNIECE, 2015). More than 1.5 million Argentinians aged 15-29 living in urban areas (equivalent to 25% of the urban youth population) have not completed secondary education and are not enrolled in school, with almost three out of five being men. By the age of 25 less than half of those who come from poor families or households at risk of falling into poverty will complete high school (OECD/CAF/ECLAC, 2016).

Leaving school before completing secondary education truncates students' path towards higher education, exacerbates inequalities and narrows the skills base of the labour force. Besides improving the overall quality of education, improving school and teacher mechanisms to identify those who are struggling academically and providing them with individualised support should ensure that more students graduate from secondary school. ALMPs to promote employment opportunities and income support for dropouts may turn out to be more costly, more difficult to implement on a large scale and less effective than strengthening efforts to keep students in the education system.

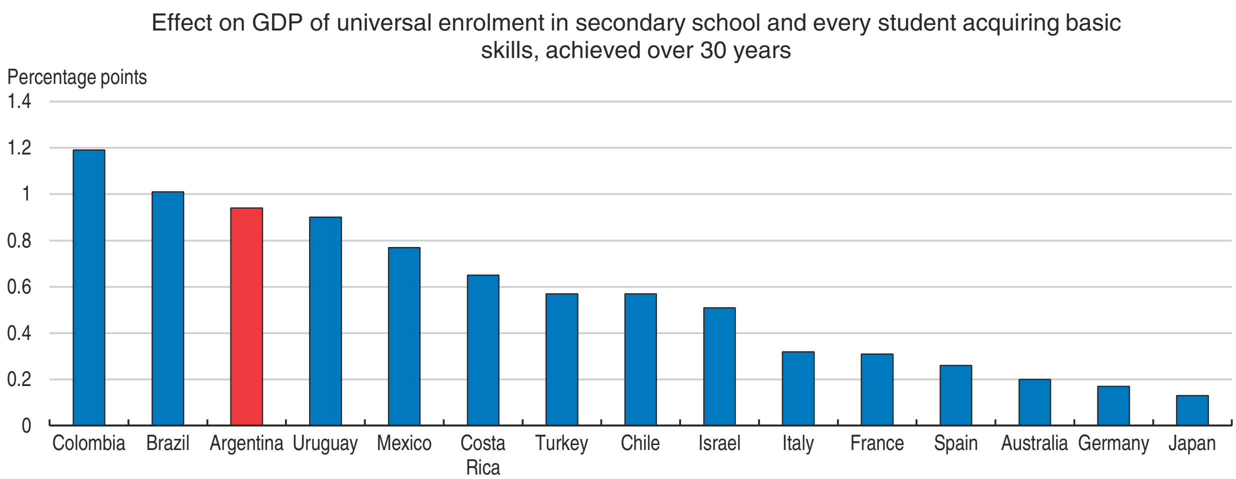
Grade repetition amplifies social and economic disadvantages conducive to disengagement, dropout and school failure. On average, in Argentina disadvantaged students are 1.4 times more likely to repeat a grade than advantaged students who perform at the same level (OECD, 2012b). Grade repetition has not shown clear benefits for the students who were held back or for school systems as a whole (OECD, 2011b). Retained students stay longer in the school system, spend less time in the labour force, and are more likely to drop out. (Roderick, M., 1994; Ferrão, Beltrão and Santos, 2002, 2007; Ferrão, Beltrão and Fernandes, 2003; Lyche, 2010; Manacorda, 2012, OECD, 2013b). Moreover, school systems that extensively use repetition are associated with low levels of educational performance (OECD, 2010). Repetition rates in secondary education are high in Argentina; on average every year one in ten students has to repeat the grade they are enrolled in. The situation is even worse for provinces such as Neuquén, Río Negro, Salta, Santa Cruz and Santa Fe where repetition rates of the first two years of high school are almost 20%. As a result, only 79% of the students enrolled in high school at national level advance to the following year of education or graduate (DiNIECE, 2015).

Finding alternatives to grade repetition, such as extra tutoring time and learning support, should lead to better outcomes. Making a student repeat an educational year is costly both for students and for the school system and often ineffective in raising educational outcomes (OECD, 2013b). More could be done to identify students at risk early on by offer continuous and comprehensive assessment and tackle student underperformance during the school year by providing early, regular and timely individualised support. Likewise, automatic promotion with support and tutoring is often a better option than repetition. This entails supporting students, reinforcing teachers' ability to teach classes with more diverse attainment levels, and extending and intensifying learning opportunities in the specific subjects in which students did not reach a satisfactory level.

Argentina has just started implementing the programme *Asistiré* (I will attend) in the Province of Buenos Aires which holds 25% of the public high school students. The programme aims at identifying students who are at risk of dropping out or who are out of the education system and offer them tailored multi-sector strategies to stay in school such as flexible school trajectories. Looking forward, the programme should be rigorously evaluated to assess its design and implementation strengths and deficiencies, and later scaled-up making the necessary changes.

Ensuring that all children have access to quality schooling can have large economic improvements at both national and individual levels. Achieving universal basic skills for every student in Argentina could have a large impact on long-run growth, higher than in some other Latin American countries such as Chile, Mexico or Uruguay (Figure 2.21). Universal basic skills refer to ensuring that every child not only has access to education but, through that education, acquires at least the baseline level of skills needed to participate fully in society. Improving the skills of low-skilled individuals could also improve the distribution of incomes. Making sure that all members of society have the ability to participate in the modern economy will raise the bottom of the income distribution (Hanushek et al., 2014). Hence, policy makers should focus on skills by improving the quality of schools and not just on the level of education (Hanushek et al., 2014).

Figure 2.21. **Expanding quality education could have large economic gains**



Note: "Long-run growth increase" refers to increase in annual growth rate (in percentage points) once the whole labour force has reached higher level of educational achievement.
Source: OECD/E. Hanushek /L. Woessmann (2015), *Universal Basic Skills: What Countries Stand to Gain.*

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Box 2.4. **Household income shocks and dropouts**

The different evolutions of the school-to-work transitions are driven by different household characteristics and the dissimilar interactions between economic shocks and institutions. Negative shocks to household income can increase the likelihood of dropping out impacting on future human capital development. Evidence shows that in a sample of Latin American countries youth from households whose main earner experienced a negative income shock are more likely to abandon school (Cerutti et al., forthcoming). In particular, in Argentina students belonging to households whose main earner experienced a negative income shock are more than 1 percentage point likely to drop out from school. This finding suggests the existence of real "income" effect, arising from the change in the resources available to the household for investing in schooling.

The effects of shocks are heterogeneous among gender, age and socio-economic groups. Results are stronger for young females who are the ones suffering the most from household income shocks. Likewise, household earnings and parental education are negatively correlated with school exit rates, suggesting youth from richer and more educated households have, on average, lower school exit rates. Moreover, the effect of income shocks tends to increase with age, but results are more significant between the ages of 18 and 20. These ages coincide not only with the end of secondary school, but also with the transition from secondary to tertiary education and with the first few years of tertiary.

Box 2.4. **Household income shocks and dropouts** *(cont.)*

Looking at what happens after dropping out, results confirm the detrimental effect of receiving negative income shock. The experience of a negative shock is associated to a higher probability of ending up not in education, employment, or training (NEET) or in an informal job rather than in a formal job.

Table 2.2. **Exit rates and household shocks (OLS regressions)**

	Argentina	Brazil	Mexico
Negative income shock	0.988***	2.291***	-0.305
	(0.321)	(0.254)	(0.252)
Male dummy	2.727***	2.262***	-0.552*
	(0.497)	(0.283)	(0.301)
Employed dummy	8.542***	3.920***	7.995***
	(0.945)	(0.413)	(0.650)
Income share of main earner	8.942***	3.562***	11.203***
	(2.623)	(0.929)	(1.729)
Labour income per capita	-1.555***	-1.776***	-0.219
	(0.215)	(0.149)	(0.182)
Household members employed	0.203	0.332**	0.711***
	(0.188)	(0.131)	(0.162)
Age main earner	-0.115***	-0.093***	-0.105***
	(0.020)	(0.013)	(0.016)
Female main earner	0.546*	0.300	0.183
	(0.316)	(0.222)	(0.259)
Years of education main earner	-0.881***	-0.690***	-0.707***
	(0.046)	(0.033)	(0.031)
Secondary wage premium	0.015**	0.008	0.001
	(0.007)	(0.006)	(0.006)
Tertiary wage premium	-0.012*	0.001	-0.002
	(0.007)	(0.003)	(0.004)
Constant	22.989***	17.552***	17.914***
	(1.674)	(1.338)	(1.208)
Observations	36,824	75,333	56,112
Adjusted R-squared	0.393	0.561	0.260
School Exit Rate (%)	14.62	20.69	11.12
Shock Rate (%)	32.53	21.51	34.06

Note: This table presents estimates of the correlation between schooling exit rates and household main earner income shock by country. Coefficients were estimated through ordinary least squares (OLS) regressions. All columns control for fixed effects for each year of age, quarter, year, country X year, completion of educational levels (secondary and tertiary) and state. ***, ** and * denote significance at 10%, 5% and 1% levels, respectively. Heteroskedasticity-robust standard errors in parentheses. Regressions include quarterly and yearly fixed effects. The sample restricted to children of household head and households with income generating capacity.
Source: Cerutti et al. (forthcoming), calculations using LABLAC (CEDLAS and the World Bank).

Strengthening primary and general secondary education

Despite some improvement in recent years, learning outcomes are poor and young Argentinians perform poorly in reading, mathematics and science compared with OECD countries. While secondary and tertiary education attainments remain a challenge, low qualifications are not restricted to those who left the education system. The education system is the obvious tool for improving the skills of Argentine citizens. The effectiveness of Argentina's education system has improved slightly over time. Performance in successive rounds of the PISA tests shows a moderate improvement over time in students' learning outcomes. In both, the 2012 PISA evaluation of Argentina and the 2015 PISA evaluation of the City of Buenos Aires, performances were below the OECD average in science, mathematics and reading (Figure 2.22).[1] For example, in mathematics, 15-year-old students in Argentina performed 106 points lower than OECD students (OECD, 2014a) and those in CABA 34 points lower than OECD students (OECD, 2016d). This is equivalent to approximately 2.4 years and 1 year of schooling, respectively.

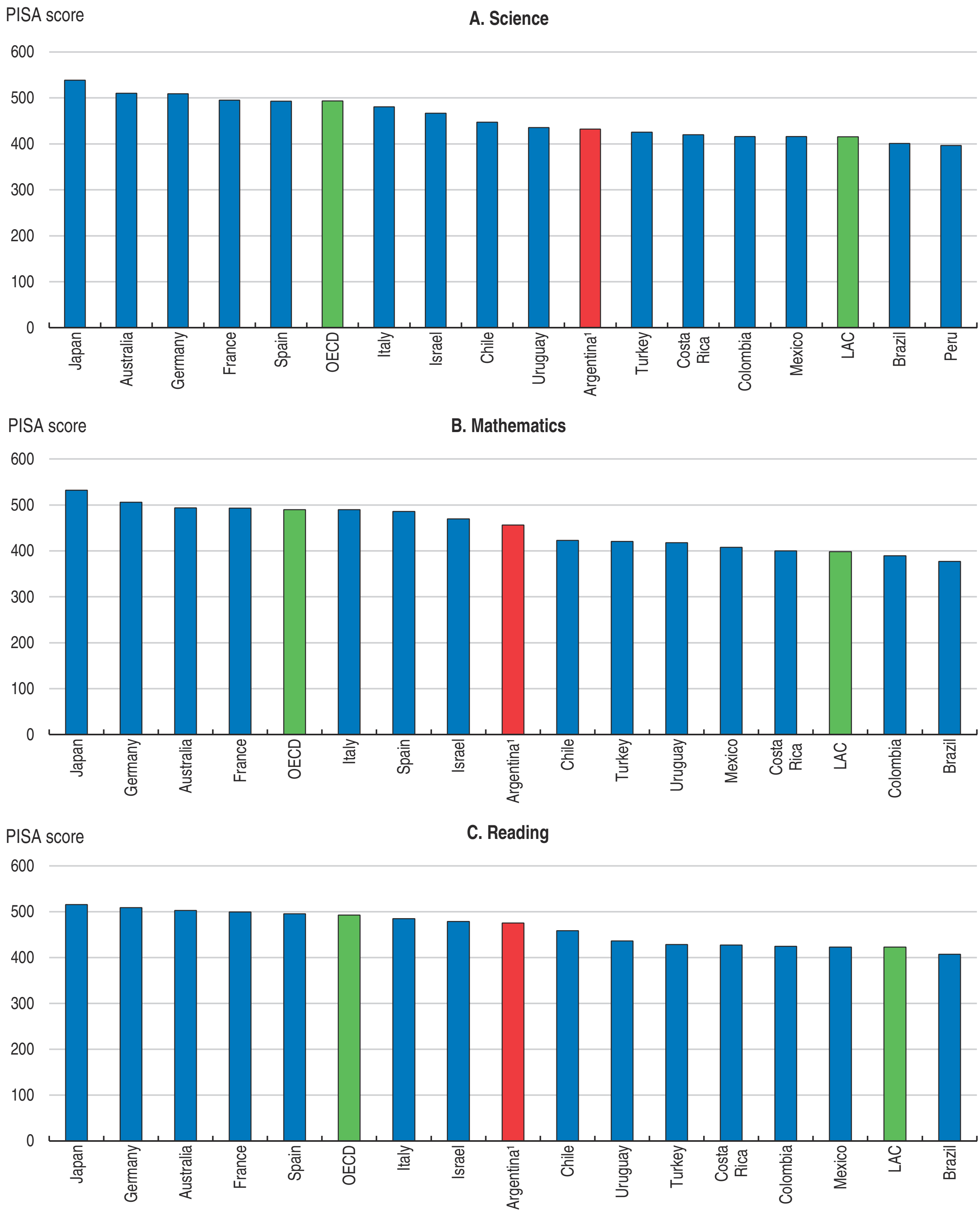
The high level of Argentine youth below a basic level of proficiency constitutes an obstacle to further development of more specific skills. According to PISA 2012 test, almost two-thirds of young Argentinians enrolled in school do not acquire basic-level proficiency in reading, mathematics and science (Figure 2.23). These students often face significant disadvantages in their transition into higher education and the labour force. In the case of OECD economies, this occurs for a quarter of 15-year-old students (OECD, 2014b).

At the same time, the small portion of top performers may hamper innovation and entrepreneurship, limiting productive transformation and upgrading (see Chapter 1). Knowledge-based and skills-based economies increasingly depend upon a broad base of technically skilled individuals, as well as a sizeable share of high performers who can produce new knowledge. Few Argentine students perform at the top levels. According to PISA 2012, less than 1% of Argentinian students perform in the highest two PISA proficiency levels – levels 5 or 6 – in mathematics, reading or science. In contrast, 12% of students in OECD countries perform in the top two levels in mathematics, and 8.5% reach these levels in reading and science.[2] This is a common challenge to all Latin American countries participating in PISA.

Argentina's improvements over time are only slightly visible at the bottom of the score distribution and the share of students with basic skills did not improve substantially. Remarkably, between 2006 and 2012 the share of low performers in mathematics, reading and science decreased as education expanded. However, given the low starting level of Argentine students, the improvements at the bottom of the PISA score distribution took place mainly as a flow of students from below level 1 to level 1. The share of students at level 2 – the level at which students acquire basic skills – did not rise substantially as in most of the LAC region's countries (OECD, 2016d). Additionally the share of top performers decreased (i.e. the share of those students who reached Level 5 or 6 in PISA tests decreased). Ensuring that a large base of the population acquires core literacy and numeracy skills is fundamental for the diffusion of knowledge and innovation that sustains economic growth (Hanushek and Woessmann, 2007). An increase of one standard deviation in cognitive skills (measured using PISA-type exams) is associated with approximately a 2% increase in annual growth of per capita GDP (Hanushek and Woessmann, 2012).

Additionally, poor early basic skills acquisition is detrimental for the later acquisition of labour specific skills. Early performance in mathematics is correlated with job-relevant numeracy skills. The results from the 2012 Survey of Adult Skills (PIAAC) show that countries performing well in PISA tend to display a relatively high performance in PIAAC and vice versa. Students' performance in PISA will be at least partly reflected in their acquisition of job-related skills later in life. Part of the effect will transit through the ability to pursue further education, the quality of post-secondary training in the different countries and the specialisation chosen.

Figure 2.22. **Learning outcomes are low in international comparisons**



1. Argentina results only reflect the results for the City of Buenos Aires. Argentina's results in 2012 were 388 in Mathematics (OECD Average: 494), 396 in Reading (OECD Average: 496) and 406 in Science (OECD Average: 501).

Source: OECD, 2016d.

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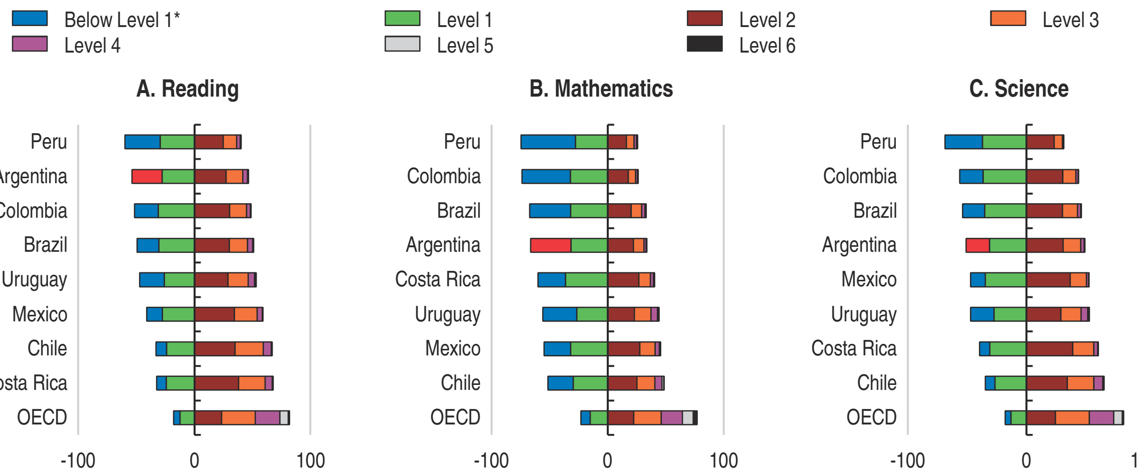
Figure 2.23. **Argentina has large shares of low performers**

% of students at each level of proficiency in reading, mathematics and science (PISA), 2012



Note: Countries and economies are ranked in descending order of the percentage of students at Levels 2, 3, 4, 5 and 6.

Source: OECD, *PISA 2012* (database), *www.oecd.org/pisa/pisaproducts/pisa2012database-downloadabledata.htm*; OECD (2014b), *PISA 2012 Results: What Students Know and Can Do* (Volume I, Revised edition, February 2014).

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Raising teachers' skills to improve the quality of education

Teachers are an important determinant for education quality. Besides teacher attendance and punctuality, teachers' knowledge of the subject they teach and the quality of the instruction time are important determinants of student performance, even stronger than their level of education, experience, qualifications, work status or salaries (Avendano et al., 2016; Hanushek Piopiunik and Wiederhold, 2014; Metzler and Woessmann, 2012; Hanushek and Rivkin, 2006; Palardy and Rumberger, 2008; Allison-Jones and Hirt, 2004). More than 85% of teachers in Argentina are fully certified by the appropriate authority; however, less than one-third of the teachers participate in professional development (OECD, 2016d). Just like practitioners in any other profession, teachers need to keep up-to-date with advances in their field (OECD, 2016e). Teachers' professional development activities are one way in which teachers' knowledge can be strengthened (OECD, 2016e).

In-house professional development activities, particularly those that promote teacher collaboration, can be effective. In countries that performed above the OECD average in PISA 2015's science test, at least 80% of the students are in schools that invite specialists to conduct teacher training or organise in-service workshops for teachers or where teachers co-operate with each other (OECD, 2016f). The Argentine government has recently launched the *Plan Nacional de Formación Docente 2016-2021* (National Teacher Training Plan 2016-2021). The programme aims at providing teachers with periodic instruction in reading comprehension, writing, mathematics, and socio-emotional skills teaching methods, among other activities to improve teacher's performance.

Improving teacher quality through better teacher training is a key challenge and requires a comprehensive policy plan. The country needs to strengthen its education centres, establish clear quality standards for their operation and provide incentives for teachers to participate in regular training sessions to improve the quality of instruction across all schools. Today, the country has more than 1 269 teacher training centres, with a generalised lack of nation-wide quality standards and evaluations. Some 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 centres would reduce conflicts of interest and allow a more professional management of these institutions, including a better use of scale economies. By comparison, France has 38 teacher training institutions for about twice the population. In the context of a forthcoming National Education Review on Argentina, these aspects will be studied with more detail.

The education system needs to do more to reach better outcomes for disadvantaged children

Argentina is subject to strong educational disparities among students of different household income and gender. Inequalities across different education and skills dimensions, related mainly to access and quality, are the remaining major challenges in Argentina. The socio-economic background of students and the geographical location of schools have a marked influence on access to education, performance and completion.

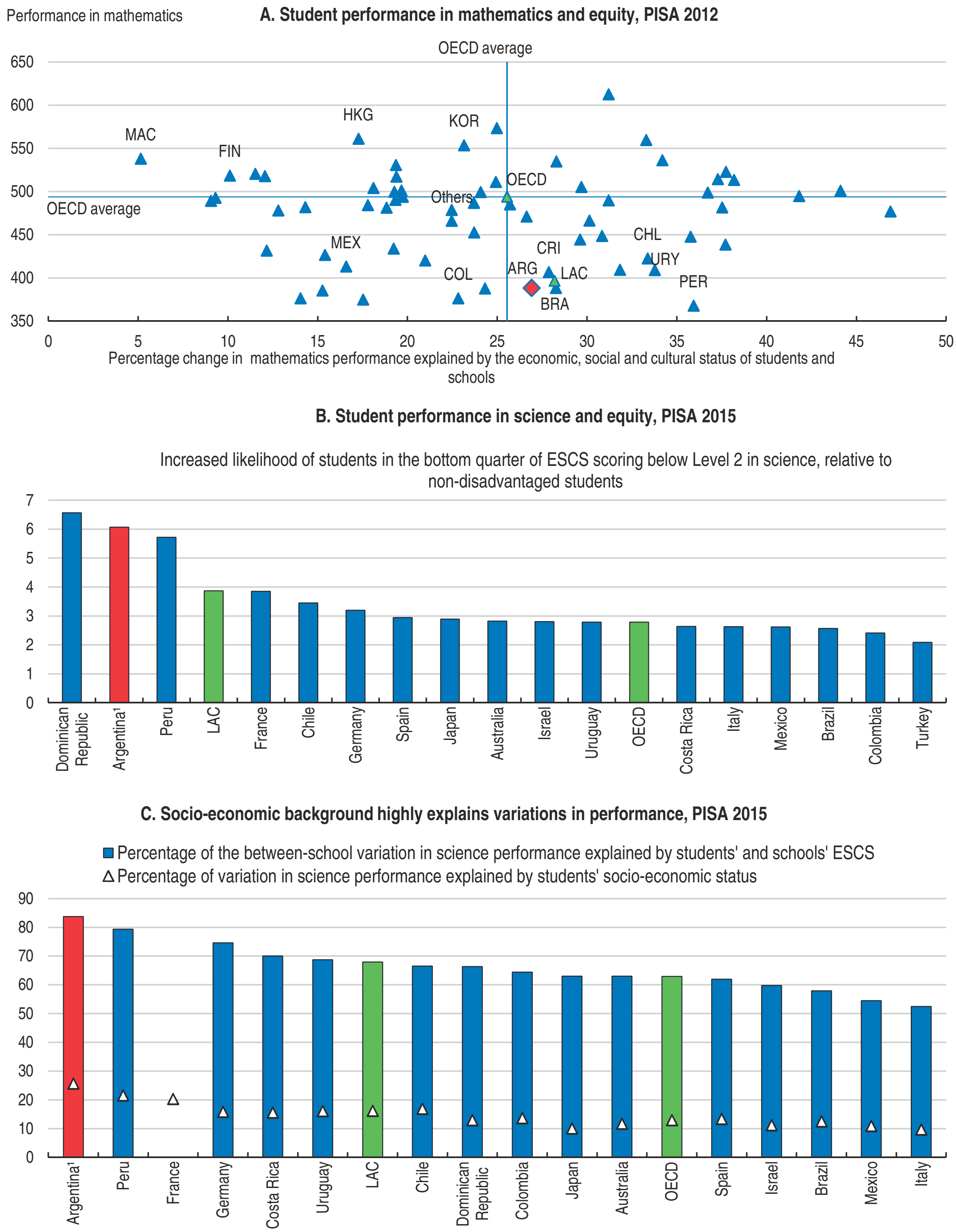
Inequities in education start early: 73% of the children between the ages of 3 and 5 in Argentina are enrolled in education, compared with 86% in OECD countries (INDEC, 2016; OECD, 2016b). While 87% of Argentinian children from households in the highest decile of the income distribution attend school, only 60% of those from the lowest decile do so. This is particularly relevant, as pre-primary education has a long-term impact on student performance: secondary-school performance improves by the equivalent of almost a full school year among those who had pre-primary education (OECD/CAF/ECLAC, 2014). Furthermore, disadvantaged students benefit the most since pre-primary education allows them to "catch up", at least partly, with their peers. The government of Argentina has committed to build 3 000 new pre-primary institutions, or add additional classrooms to existing schools, by 2019, which would expand the number of schools by 15%.

Access to education and completion of secondary education is strongly linked to socio-economic background and geographical location. Although 80% of those in the lowest income quintile attend secondary school, only 18% graduate and continue into tertiary education, compared with 95% and 55%, respectively, for those in the highest income quintile (SEDLAC, 2016).

The socio-economic status of students and schools has a powerful influence on learning outcomes of students in Argentina. The socio-economic status of the student and the school can explain 27% of the performance variation in Argentina in PISA 2012 (Figure 2.24, Panel A) and 25% of the performance variation in the capital city of Buenos Aires in PISA 2015, compared with 13% for OECD economies in PISA 2015 (OECD, 2013a OECD, 2016d). The strength of the socio-economic gradient refers to how well socio-economic status predicts performance and serves as an indication of the extent to which education policies should target socio-economically disadvantaged students specifically. When the relationship is strong, as in Argentina, effective policies would be those aiming to raise the quality and equity of the education system (OECD, 2016d).

Advantaged students generally perform better than disadvantaged students. On average, a one-unit increase in the PISA index of economic, social and cultural status of the student is associated with an increase of 37 score points in the science assessment in CABA regardless of their level of performance (equivalent of almost a full school year). Moreover, students with low socio-economic status are at greater risk of not attaining the baseline

Figure 2.24. **Socio-economic status has a powerful influence on learning outcomes**



1. Data for Argentina represent the City of Buenos Aires.

Note: The Programme for International Student Assessment (PISA) index of Economic, Social and Cultural Status (ESCS) was created on the basis of the following variables: the International Socio-Economic Index of Occupational Status (ISEI); the highest level of education of the student's parents, converted into years of schooling; the PISA index of family wealth; the PISA index of home educational resources; and the PISA index of possessions related to "classical" culture in the family home.

Source: OECD, PISA 2015 Database.

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level of skills in science, the focus of PISA 2015 test. Students from disadvantaged socio-economic backgrounds are more than six times more likely than more advantaged students to not attain the baseline level of proficiency in science (Figure 2.24, Panel B). Similar results are obtained when looking at mathematics and reading performance.

Inequalities among schools are also large. Socio-economic disparities are closely associated with performance differences among schools in the City of Buenos Aires. More than 80% of the between-school variation in performance in science – which in turn is above the OECD average as a share of the overall level of variation– is explained by the socio-economic profile of students and schools. How the variation in performance is distributed between and within schools is often related to the degree of socio-economic diversity across schools. In the City of Buenos Aires, 40% of the variation in students' socio-economic status lies between schools, compared with 23.5% in OECD countries (Figure 2.24, Panel C). This implies that, on average, there tends to be less socio-economic diversity among students attending the same schools than between students attending different schools.

Like the large differences in performance among different groups, the distribution of educational resources appears to be linked to the socio-economic background of students. High-performing countries, such as Finland, Germany and Korea, tend to allocate resources more equitably across socio-economically advantaged and disadvantaged schools. This is not the case in Argentina where principals of disadvantaged schools reported more shortage or inadequacy of educational resources than principals of advantaged schools did (OECD, 2013b). In fact, the correlation between the school mean socio-economic background and the index of educational resources (including the share of certified teachers, books, instructional material and laboratories) in Argentina (0.32 in 2012) is considerably higher than in OECD economies (0.21 in 2012) (OECD/CAF/ECLAC, 2015). Moreover, principals of schools located in rural areas reported more shortages or inadequacy than did principals of schools in towns (OECD, 2013b). In the long run, improving the distribution of educational resources is an important challenge for improving both performance and equity in Argentina's educational systems. While in the short run, educational resources need to be allocated for the purpose of reducing inequalities, by targeting students from poorer socio-economic backgrounds.

Argentina also stands out for its gender performance gap. Boys outperform girls in mathematics by 15 score points – placing Argentina among the countries with the largest gender performance gap in PISA 2015 – and the share of top performers in science is larger among boys than among girls (OECD, 2016b). Although a larger share of women graduate from both secondary and higher education, women represent 37% of the secondary graduates in applied science and technology (DiNIECE, 2015) and one- third of the engineering, manufacturing and construction tertiary education graduates (UNESCO, 2016). This bias of women towards the humanities and social sciences might lead into career paths with lower demand and lower pay than those in fields related to science, technology, engineering and mathematics (STEM).

The reduction of inequalities in the access to good quality education across different socioeconomic groups should be mainstreamed as part of a comprehensive education strategy. A good starting point is to promote the expansion of good quality pre-primary education, so as to ensure that all children have a strong start in their education cycle. This is particularly relevant in view of the strong impact of an additional year of pre-primary schooling in the performance of students in later stages of life. Likewise, ensuring better teacher training, including a teacher career with clear incentives, can be instrumental in improving the quality of learning all across students from different socioeconomic backgrounds. Improving school infrastructure and school resources can also have a pivotal role in reducing inequalities in levels of quality across schools. Finally, the curriculum can also be adapted to incorporate into teaching local idiosyncrasies and promote local capacities, in order to promote lagging school from rural areas or small cities (OECD/CAF/ECLAC, 2014; OECD, 2016b). The scope and specificities of an education strategy to improve quality and reduce inequalities will be the subject of a forthcoming OECD National Education Review on Argentina.

Ensuring equal access to tertiary education

The potential for tertiary education remains unrealised in Argentina. Only 33% of the population aged 25-64 began tertiary education and 21% completed it**.** Argentina is proud to have a gross enrolment rate on a par with OECD countries; however, net enrolment rates are low and few students graduate from tertiary education. In more than one-third of all public universities drop-out rates are above 80% representing a challenge for the structural economic transformation of Argentina (Rabossi, 2013).

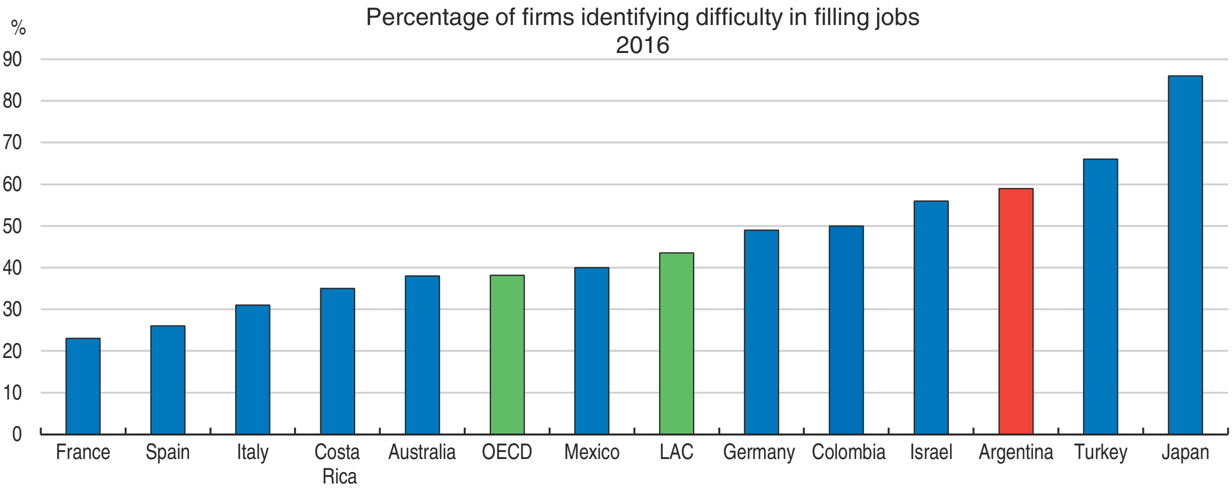
The strong marks of students' socio-economic background are most evident in tertiary education, which is particularly unequal in Argentina. Only 17% of the young individuals in the poorest quintile of the income distribution are enrolled in tertiary education, compared with 55% of those from the highest quintile of the income distribution (SEDLAC, 2016). Likewise, only 4% of the population aged 25 to 64 in the poorest quintile of the income distribution attained a tertiary degree compared with 48% from the highest quintile of the income distribution.

Higher education inefficiencies are large, especially in the university system. There is in fact strong socio-economic selectivity evident in the progression from first to subsequent years of most university degree programmes (Rabossi, 2013). Poorly prepared students find it hard to advance; institutions offer little out-of-class support or tutoring, and almost no programme or degree change flexibility. As a result, tertiary education institutions (*institutos terciarios)* enrol 30% of the all post-secondary students, but produce almost the same number of graduates as the universities. University degree courses in Argentina are between four and eight years long, significantly longer than in most OECD countries. Additionally they have rigid curricula, which prevent students from changing programme or university. Beyond the need to better prepare students for post-secondary study at secondary level, tertiary institutes and especially universities must offer more flexibility, a wider range of programme options, shorter programmes and work on the complementarity among entities, helping less prepared students to make a smooth transition from secondary to tertiary education.

Matching qualifications to labour market needs

In Argentina the gap between the available pool of skills and those skills that the economy requires is wide: 59% of formal firms report having difficulties hiring workers with the skills they need (Manpower Group, 2016; OECD/CAF/ECLAC, 2014) (Figure 2.25). A scarcity of technicians, engineers and skilled trades is a recurrent complaint of employers, while the sectors most affected are the metal and machinery; the software, telecommunications and multimedia; and energy and mining industries. In fact, half of the formal companies that looked for employers with technical skills encountered difficulties filling the opening mainly due to lack of cognitive skills and work experience (INET, 2016). Both the secondary and the tertiary education systems are heavily biased towards social science and humanities,

Figure 2.25. **Firms cannot find the skills they need**



Notes: OEDC average includes Australia, Austria, Belgium, Canada, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States; LAC average includes Argentina, Brazil, Colombia, Costa Rica, Guatemala, Mexico, Panama and Peru.
Source: Manpower Group (2016).

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producing few STEM graduates. Two out of three secondary graduates attain a humanities degree (DiNIECE, 2015) and only one out of ten tertiary education graduates hold a degree in science, technology, engineering or mathematics (UNESCO, 2016). This is not likely to change in the near future since 13% of the 15-year-old students who participated in PISA 2015 in CABA expect to work as science and engineering professionals and in technical occupations when they are 30 (OECD, 2016d). Current skills mismatches could be aggravated in a context where technological change, globalisation and trade are responsible for job destruction and new types of job creation (INET, 2016). The capacity of countries to improve the skills of their population and adjust to these changes will partially determine labour markets' outcomes, economic growth, productivity and competitiveness (OECD/CAF/ECLAC, 2015).

Reducing skill mismatches entails comprehensive policy action. Effective and well-informed career guidance at the end of lower secondary education plays an important role in achieving a good match between students' preferences and labour market needs (OECD, 2014c). This bias towards the humanities might lead into career paths with low demand. The lack of a career guidance system and information about labour market prospects might be one reason behind these decisions, which could be addressed by better career guidance. Providing reliable and free information on-line about employment options in the country, wage levels in different industries and labour market status by degree and university could help young students make better decisions regarding their professional future. Making this information available would help students better understand the relative value that qualifications have in the labour market and encourage students to enrol in those careers and institutions that offer the best employment and earnings prospects. This would also create greater competition between higher education institutions raising overall quality standards.

There is a need to improve the governance of the universities to make them more accountable, performance-based and responsive to Argentina's skills needs. Usually humanity degrees are shorter and more accessible than STEM degrees owing to costs and low quality of secondary education. The current governance, evaluation and financing scheme does not favour a rapid response to labour market needs, to make technical and engineering degrees more attractive to students and to avoid an excess of supply of graduates in certain fields and shortages in others.

Systematically collecting data on skills demand could help better match the supply. Lack of data on both individual skills and those demanded by enterprises hinders governments' capacity to solve the current skills mismatch. There is little knowledge on the population's literacy, numeracy, problem solving and technical skills capacity in Argentina. Information is also lacking on what types of higher level technical and professional skills businesses require now and in future. This information is the building block for countries to identify skills shortages and gaps, and plan for future skills needs to become more productive and competitive (OECD/CAF/ECLAC, 2016) (see Chapter 1).

Strengthening technical vocational education and training (TVET)

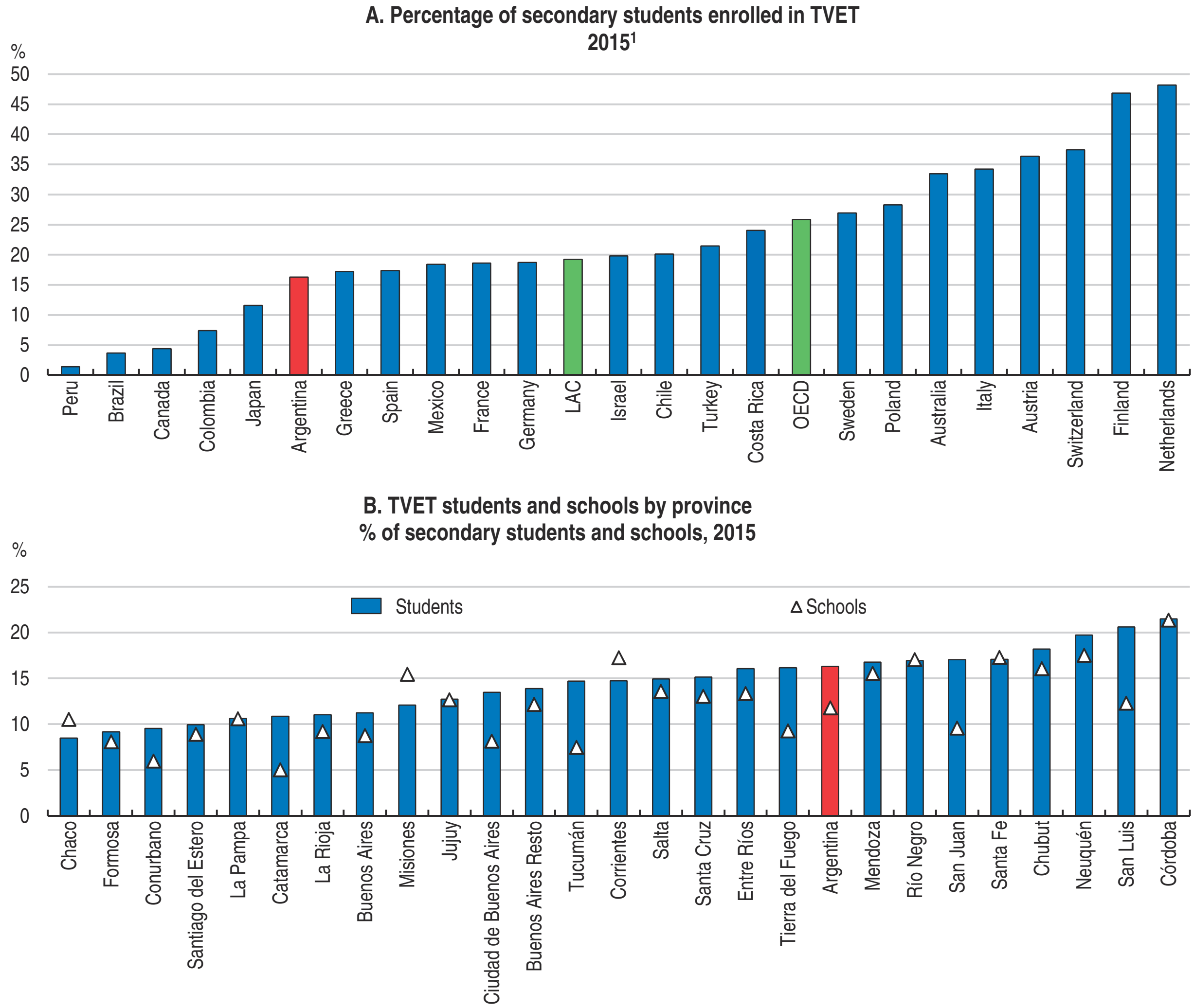
In Argentina, as in LAC, technical and vocational education and training (TVET) serves an important equity function. It caters to the needs of different segments of the population: school-leavers, students looking for more practical education and older individuals seeking to deepen their professional skills, make a sideways career move or return to work after an absence (Quintini and Manfredi, 2009). Alternative training courses can provide high school and tertiary education dropouts with job skills to increase their employability. High-quality vocational education pathways, particularly in upper secondary education, can help those who have become disaffected with academic education to re-engage with the education system and improve graduation rates. And tertiary education vocational and technical programmes can provide those with no appetite for academic education with practical skills that respond to the needs of the job market.

TVET is crucial to develop a highly skilled labour force, with a range of mid-level trade, technical, professional and management skills alongside those high-level skills associated with university education (OECD, 2014c). In emerging and less developed countries, TVET is increasingly perceived as a tool to respond to changing labour market needs, while at the same time supporting social cohesion. As such, it is – and should be perceived – as a complement to those more academic programmes typically found in universities. Given that poor skills, and hence low productivity, are sometimes seen as one reason for low levels of development, investment in TVET has been argued as a means of promoting a bottom-up labour market transformation (Eichhorst et al., 2012).

Few students are enrolled in vocational and technical education programmes at secondary and tertiary level. Only 16% of secondary students in Argentina are enrolled in TVET programmes (DiNIECE, 2015), compared with 26% in OECD countries, with the Netherlands reaching 48% (UNESCO, 2016). Likewise, the share of schools offering TVET education is low and half of the technical schools are located in Buenos Aires, Córdoba and Santa Fe, which might constrain the country's capacity to expand TVET education (Figure 2.26).

As TVET enhances job-related knowledge and prepares young individuals for the workplace, its importance continues beyond secondary education (OECD/CAF/ECLAC, 2014). In recent years Argentina has developed a relatively dynamic post-secondary TVET sector, which engages about 30% of all students enrolled in some form of education and training beyond secondary school (Rabossi, 2013). The nature, duration and quality of the post-secondary and tertiary TVET programmes in Argentina vary from institution to institution:

Figure 2.26. **Few students are enrolled in TVET and schools fall short**



1. LAC average includes: Argentina, Bolivia (Plurinational State of), Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, , Mexico, Nicaragua, Panama, Paraguay, Peru, and Uruguay. Data for Argentina, Bolivia, Chile, Colombia, Costa Rica, Domincan Republic are from 2015; for Australia, Austria, Canada, Finland, France, Germany, Greece, Israel, Italy, Japan, Netherlands, Peru, Poland, Spain, Sweden, Switzerland and Turkey are from 2014; for Brazil, Ecuador and Uruguay are from 2013; for Mexico, Panama and Paraguay from 2012; and for Nicaragua (2010).

Source: UNESCO (2016) and DiNIECE, Ministry of Education of Argentina (2015).

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high quality schools that are highly respected and generate positive returns for students and employers coexist with low quality ones, making it too difficult for employers to rely on them.

Vocational and technical programmes to provide youth with workplace skills and bolster lifelong learning have emerged as both an alternative and a complement to formal education in Argentina. Vocational training programmes in the form of dual training or apprenticeships play a prominent role in training vulnerable youth (i.e. high school dropouts from low-income households). However, programmes suffer from design and implementation problems, especially at local level, that could be improved. Programmes suffer from high rates of attrition and sometimes it is difficult for participants to secure a job when the programme is over given the low propensity of firms to hire apprentices because of costs (ILO/CINTERFOR, 2016).

Targeting adult education and lifelong learning towards the low-skilled has a long tradition in Argentina. Owing to the legacy of Argentina's low educational attainments and given that most of the population has already left the formal education system, improving the skills of today's adults is the most effective way of raising skills without waiting for a generation. Adult education has been a policy priority in the past with more than 1 million youth and adults enrolled each year in the formal education system, with two out of five of them engaged in TVET education (DiNIECE, 2015). Still, the offer falls short when it is noted that 40% of the adult population aged 24 to 64 – more than 8.5 million people – has not completed secondary education. Moreover, many of the training programmes offered by the Ministry of Labour, Employment and Social Security are targeted at the most vulnerable groups and should be expanded to other low-skilled categories of the population to help upgrade the country's human capital given the low labour productivity.

There is little co-ordination between TVET programmes and the general education system. TVET is offered by the Ministry of Education, the Instituto Nacional de Educación Tecnológica (INET), the Ministry of Labour, Employment and Social Security and by private schools, companies and organisations. Institutions operate in silos, limiting students' ability to advance academically and sometimes attain a higher degree. Additionally, skills acquired from TVET often go unrecognised by the traditional education system; many students are unable to proceed to higher levels of general education studies based on TVET certificates. Recently, the INET together with the Federal Council of Education worked on mechanisms to facilitate skills certification and offer short tertiary degrees with intermediate certifications. Strengthening co-ordination among all actors as well as implementing a National Qualifications Frameworks could align TVET education with general secondary and tertiary education. National Qualifications Frameworks, which classify qualifications by level based on learning outcomes, standardise qualifications in order to facilitate the evaluation and comparison of skills across systems. ChileValora and the Ministry of Education in Chile, and INFOTEP and the Ministry of Education in the Dominican Republic, for example, have implemented these frameworks (OECD/CAF/ECLAC, 2016).

TVET struggles with quality, prestige and status. Often, TVET is looked upon less favourably by employers and students than general tertiary education systems. Moreover, current TVET programmes may enhance inequality. Students enrolled in TVET are more likely to be from poor households or at risk of falling into poverty than those in general education (OECD/CAF/ECLAC, 2014). As a result, TVET can perpetuate inequality by amplifying the discrepancies in opportunity between those with higher and lower socio-economic status. Additionally, TVET can amplify gender disparities: many of the higher-paying, technical tracks in TVET are male dominated, while women tended to focus their studies on low-paying trades (UNESCO, 2010). All of this calls for improving TVET programmes in Argentina to help ease the associated stigma and to contribute towards a more equal education.

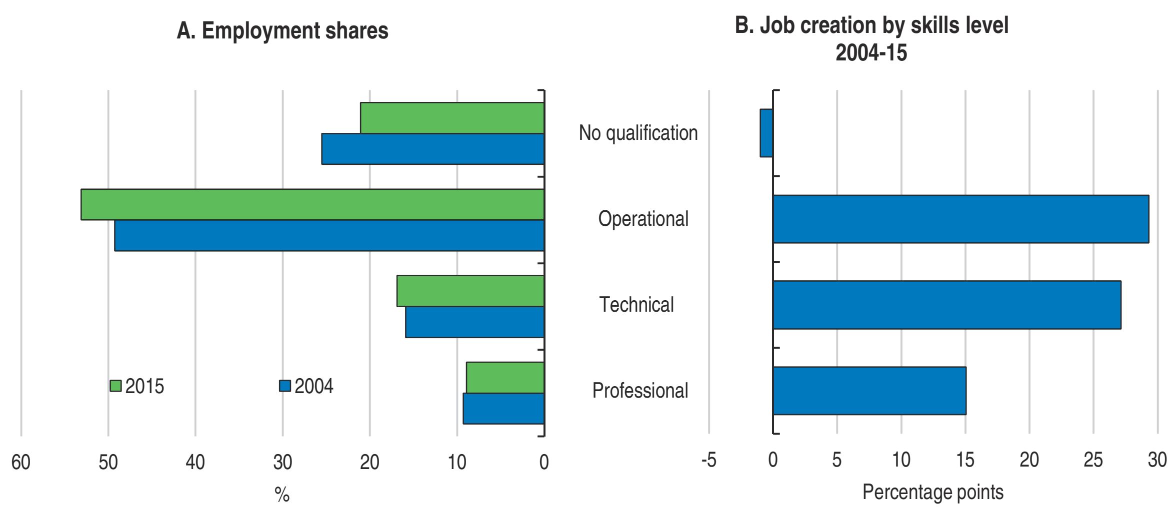
Finally, TVET is misaligned with the demands of the labour market. Linkages between the TVET system and employers are relatively weak, illustrated by the low level of involvement of employers in TVET policy development. Recently, the national government has made advances in better linking TVET with the skills demanded. In 2016, the national government of Argentina launched two nation-wide programmes to improve the skills in two critical areas, health and computer programing: the *Programa Nacional de Formación de Enfermería* (PRONAFE) that will train 50 000 new nurses by 2020 and the *Programa 111 "Analistas de Conocimiento"* that will train 80 000 people in computer coding by 2020.

Additionally, the INET has signed more than 60 apprenticeship agreements with private businesses to train TVET secondary students with labour market relevant skills in banking, automobile and the food industry (INET, 2017).

Labour market incentives for upskilling should be stronger

Education and skills policy changes should be designed taking into account the employment structure of the country as well as the returns to education and other incentives individuals have for acquiring skills. Current changes in the occupation structure of the labour force in Argentina signal an increasing demand for workers with a technical degree and operational skills. The demand share of technicians and operational workers has increased over the past decade, with a reduction in the share of non-skilled and professional workers (Figure 2.27). Likewise, the median salary of workers with technical, operational and no skills has increased at a faster pace than that for those with jobs that require professional skills, narrowing the gap which is still wide (Ministry of Labour, Employment and Social Security, 2016).

Figure 2.27. **Occupation structure is changing**



Note: Refers to population aged between 15 and older. Data for Argentina are representative of urban centres of more than 100.000 inhabitants.
Source: Ministry of Labour, Employment and Social Security based on Encuesta Permanente de Hogares (EPH).

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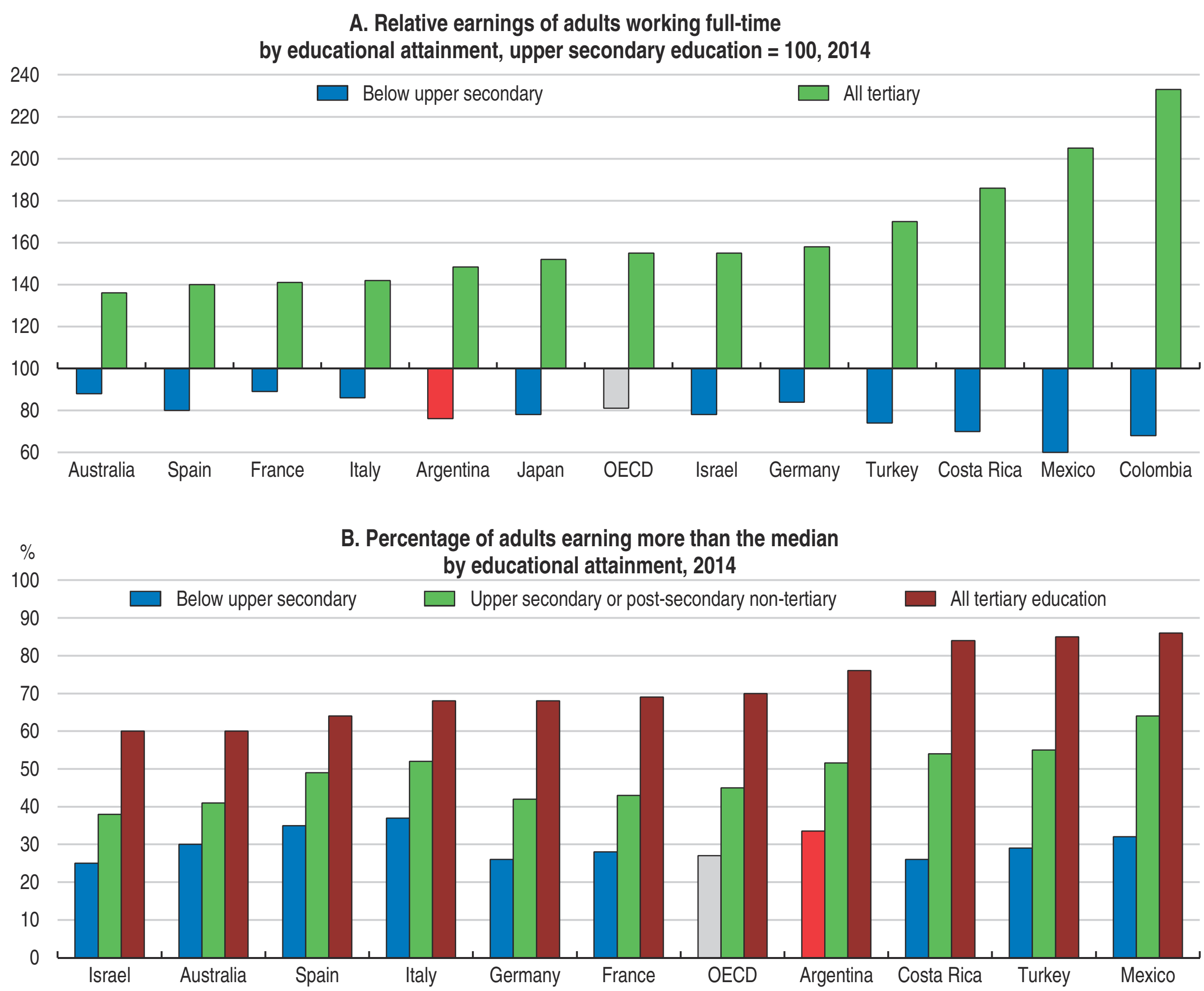
Returns to education for male workers have declined in the past decade, especially for those with tertiary education; while the returns to education of women have stayed constant (SEDLAC, 2016). This trend can be partially attributed to the expansion of education, the recent boom in commodity prices that could favour unskilled workforce and other within-sector forces, such as technological diffusion or skill mismatches that may reduce the labour productivity of highly educated workers (Gasparini et al., 2011). Likewise, the wage gap between high-skilled workers, those with more than 13 years of education, and low-skilled workers, those with 8 years of education, has almost halved since 2003 (SEDLAC, 2016).

The incentives for acquiring skills should be actively reinforced given the relatively low levels of skills in the Argentinian workforce. Enabling more students to gain further skills can have high pay-offs for the country and individuals. In fact, increasing the available talent pool of the future generation is central to developing a knowledge-based economy and enhancing productivity (see Chapter 1). However, the observed differences in wages, which have fallen recently, do not seem to provide incentives for investing in skills as strong as in countries with similar education level. Education in Argentina plays a similar role in determining earnings among workers to that in OECD countries (Figure 2.28). Workers with tertiary education in Argentina make 48% more earnings than their counterparts with upper secondary education. This places Argentina on a par with OECD countries and well below Brazil, Chile, Colombia and Mexico where workers with higher education earn more than twice their counterparts with upper secondary education. Additionally, workers with less than upper secondary education make 14% less than workers with secondary education. Differences in earnings are both a reflection and a source of unequal distribution of income in Argentina; yet, attending tertiary education or even completing upper secondary degree has similar impacts on labour market outcomes and well-being to those in OECD countries, rather than to other countries with similar levels of education.

Figure 2.28. **Incentives for upskilling are weaker than in other Latin American countries**



Note: Calculations based on earning of 25-64 year-olds workers with income from full time employment. Data for Argentina are from 2016 and are representative of urban centres of more than 100 000 inhabitants.
Source: Encuesta Permanente de Hogares (EPH) for the third quarter of 2016 (INDEC) and OECD, 2016b.

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Recommendations to foster inclusive growth in Argentina

Key recommendations

- Undertake a revenue-neutral tax reform, including
  - Lowering the income threshold where taxpayers start paying personal income taxes.
  - Introducing progressivity into social security contributions.
  - Lowering social security contributions temporarily for low-paid workers whose jobs are brought into the formal sector.
- Enforce formalisation and compliance with more labour inspections.
- Simplify administrative procedures and licensing requirements to start an activity.
- Scale up training, employment services, and incentives for small business development.
- Integrate existing social protection programmes and allow them to share registries and targeting tools.
- Index pension benefits to consumer prices.
- Align retirement ages for women to those for men.
- Protect workers with unemployment insurance and training rather than strict labour regulations.
- Expand early childhood education, promote flexible working time arrangements and extend paternity leave.
- Strengthen mechanisms to identify and support students at risk of dropping out through tutoring and individualised support.
- Merge teacher training institutions and strengthen their quality standards, governance, accounting requirements and transparency.

Other recommendations

- Phase out energy subsidies while ensuring a string social safety net.
- Further develop the technical and vocational education and training system by involving employers more.
- Implement a National Qualifications Framework to align technical education with general secondary and tertiary education.
- Strengthen the integration of planning between secondary and tertiary education systems and improve the coherence in their curricula.
- Align tertiary curricula with labour market needs, offering better quality technical programmes and shorter university degrees.
- Provide reliable and free information about employment options, wage levels in different industries, and labour market status by degree and university.

Notes

1. In 2015 PISA tests, performance in education was only available for the City of Buenos Aires and not in Argentina as in previous rounds of PISA tests.
2. Students at proficiency levels 5 or 6 are able to draw on and use information from multiple and indirect sources to solve complex problems in mathematics; critically evaluate texts and understand details the content or form of which is unfamiliar when reading; and identify thescientific components of many complex life situations and compare, select and evaluate appropriate scientific evidence for responding to these situations. They will be at the forefront of a competitive knowledge-based global economy (OECD, 2012b).

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ANNEX 2.1

Table A2.1.1. **Income, taxes and expenditure distribution by decile, in percent (pensions are treated as government transfers)**

Deciles	Market income	Personal income tax	Monotributo	Social security contributions	Total direct taxes	Net market income	Family allowances	Assig nacion universal por hijo	Pension mora torim	Unemployment insurance	Seguro de capacitacion y empleo	Scholarships	Youth employment and training programs	Other direct transfers (Targeted or not)	Contributory pensions	All direct transfers	Disposable income
1	0.0	0.0	0.0	0.0	0.0	0.0	1.1	5.7	33.5	4.0	13.1	2.9	8.3	5.3	35.1	30.3	7.4
2	0.5	0.0	5.6	0.0	0.1	0.7	4.5	22.8	23.2	7.3	17.4	7.2	13.5	18.4	20.8	20.3	5.5
3	2.4	0.0	11.3	0.4	0.4	3.2	7.0	33.7	9.1	8.4	11.3	17.5	20.2	25.7	6.9	9.2	4.7
4	4.1	0.0	11.9	1.7	1.5	5.0	15.1	17.9	8.1	56.4	13.0	16.3	25.2	19.9	5.9	8.0	5.8
5	5.8	0.0	11.0	4.1	3.3	6.7	14.4	10.0	7.7	4.9	14.4	18.4	7.3	12.4	6.5	7.6	6.9
6	7.6	0.0	9.5	6.8	5.4	8.4	17.9	5.2	5.1	3.6	7.4	16.8	15.6	8.6	4.5	5.6	7.7
7	9.7	0.0	9.5	9.7	7.6	10.5	15.3	2.0	4.9	1.0	4.0	9.9	5.2	4.6	6.3	6.3	9.5
8	12.8	0.0	13.3	13.1	10.2	13.8	13.3	1.8	3.1	14.5	3.3	7.2	2.1	2.3	3.8	4.1	11.4
9	18.0	0.2	13.6	19.4	15.0	19.1	9.1	0.7	3.0	0.0	7.9	0.9	0.2	1.9	4.7	4.3	15.5
10	39.1	99.7	14.3	44.8	56.6	32.7	2.4	0.1	2.5	0.0	8.2	3.0	2.4	0.9	5.6	4.3	25.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: OECD calculations based on EPH for the third quarter of 2016 (INDEC).

Table A2.1.2. **Income, taxes and expenditure distribution by decile, in percent (pensions are treated as differed income)**

Deciles	Market income	Personal income tax	Monotributo	Social security contributions	Total direct taxes	Net market income	Family allowances	Assig nacion universal por hijo	Pension mora torim	Unemployment insurance	Seguro de capacitacion y empleo	Scholarships	Youth employment and training programs	Othe direct tranfers (Targeted or not)	All direct transfers	Disposable income
1	0.4	0.0	4.2	0.0	0.1	0.5	0.8	27.4	46.3	8.9	29.6	7.7	23.7	20.9	33.1	3.2
2	2.3	0.0	10.6	0.4	0.4	2.8	8.3	33.6	9.9	61.3	13.8	15.3	16.9	27.1	14.9	3.9
3	3.7	0.0	10.9	1.4	1.2	4.5	12.9	19.1	11.4	7.9	11.3	17.9	21.2	18.3	13.4	5.2
4	5.1	0.0	8.4	3.3	2.6	5.8	16.1	8.8	8.1	2.8	12.2	16.6	9.6	11.7	9.9	6.1
5	6.4	0.0	7.2	5.2	4.0	7.0	17.2	5.3	5.3	3.6	4.1	15.1	17.1	9.0	7.7	7.1
6	7.8	0.0	10.5	6.4	5.0	8.7	12.2	2.0	5.7	0.2	5.6	9.5	6.2	5.4	6.2	8.5
7	9.7	0.0	11.1	9.1	7.1	10.5	10.8	1.2	3.9	8.3	4.9	10.1	1.3	3.1	4.7	10.1
8	12.3	0.0	9.0	13.6	10.5	12.8	12.5	1.8	3.0	7.0	8.9	4.7	1.3	1.4	4.3	12.1
9	17.0	1.3	15.1	17.7	14.0	17.9	7.3	0.9	4.2	0.0	0.9	0.6	0.2	2.3	4.0	16.7
10	35.3	98.7	13.1	43.0	55.0	29.4	1.9	0.1	2.2	0.0	8.4	2.5	2.4	0.7	1.7	27.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: OECD calculations based on EPH for the third quarter of 2016 (INDEC).

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OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(10 2017 16 1 P) ISBN 978-92-64-27804-2 – 2017

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Volume 2017/16
July 2017

OECD*publishing*
www.oecd.org/publishing

ISSN 0376-6438
2017 SUBSCRIPTION
(18 ISSUES)

ISBN 978-92-64-27804-2
10 2017 16 1 P