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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/17

10:00 a.m., January 24, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
J. Anson	C. Taylor
J. de Groote	H. G. Schneider
B. de Maulde	A. Le Lorier
A. Donoso	M. Teijeiro
	C. Dallara
	T. Alhaimus
	Jaafar A.
	T. Yamashita
	M. Casey
A. Kafka	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
M. A. Senior	
J. Tvedt	L. Vidvei
	Wang E.

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

Asian Department: L. H. De Wulf, W. G. Evers, M. R. P. Salgado. European Department: P. L. Hedfors. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; K. B. Dillon, M. Guitian, C. M. Loser, J. R. Marquez-Ruarte. External Relations Department: H. P. Puentes. IMF Institute: E. H. Rosconi, Participant. Legal Department: S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; N. M. Kaibni, E. A. Milne. Treasurer's Department: A. M. Al-Samarrie. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; C. E. Sansón, Deputy Director; H. Arbulu-Neira, M. E. Bonangelino, C. Brachet, J. M. F. Braz, M. Caiola, C. Cha, J. Fajgenbaum, M. T. Hernandez, E. S. Kreis, J. S. Lizondo, C. L. Ramirez-Rojas, B. C. Stuart, I. C. Tandeciarz, E. V. Zayas. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, J. R. N. Almeida, C. J. Batliwalla, S. E. Conrado, J. Delgadillo, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: H. Arias, R. Bernardo, L. E. J. Coene, T. A. Connors, R. J. J. Costa, I. Fridriksson, G. Gomel, M. Hull, W. Moerke, V. K. S. Nair, Y. Okubo, J. Reddy, C. A. Salinas, J. Schuijer, D. I. S. Shaw, H. Suzuki, P. Verly, A. A. Yousef, Zhang X.

1. ARGENTINA - 1982 ARTICLE IV CONSULTATION; REQUEST FOR STAND-BY ARRANGEMENT; AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1982 Article IV consultation with Argentina, together with a request by Argentina for a stand-by arrangement equivalent to SDR 1.5 billion (EBS/83/8, 1/10/83; and Cor. 1, 1/21/83). In addition, they took up a request by Argentina for a purchase equivalent to SDR 520.1 million under the compensatory financing facility (EBS/83/11, 1/11/83; and Sup. 1, 1/21/83). They also had before them a report on recent economic developments in Argentina (SM/83/12, 1/17/83; Cor. 1, 1/20/83; and Cor. 2, 1/21/83).

The staff representative from the Western Hemisphere Department made the following statement:

> The staff has very recently learned that Argentina maintains a restriction on payments and transfers for current international transactions in addition to those described in Appendix IV of EBS/83/8.
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> As noted in item 2(b) of that appendix, sales of exchange to effect the transfer of profits, dividends, royalties, and payments for technical assistance have been suspended since April 20, 1982. At that time, the Argentine authorities also introduced provisions whereby such transfers could be made by purchasing U.S. dollar-denominated bonds issued by the Government of Argentina and by selling those bonds in the secondary market.
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> It has now been brought to the attention of the staff that enterprises owned or controlled directly or indirectly by British subjects who are not residents of Argentina, or by residents of the United Kingdom who are nationals of other countries, are being denied the opportunity to sell such bonds and use the proceeds as a means of transferring profits, dividends, royalties, and payments for technical assistance. This practice constitutes a restriction that discriminates against a member of the Fund, and accordingly the Fund's approval has not been requested and is not being recommended. It should be noted, however, that the Argentine authorities have committed themselves to reach understandings with the Fund on a precise schedule for the elimination by December 31, 1983 of all restrictions on current payments and transfers. That schedule is to be established at the time of the May review and, according to paragraph 4(f) of the stand-by arrangement, which is a performance clause, Argentina will request no purchase under the stand-by arrangement after July 31, 1983 if such understandings have not been reached. In conducting the review foreseen by that provision, first priority will be placed on the elimination of this discriminatory practice if it were still to be in effect at that time.

Mr. Teijeiro made the following statement:

Argentina is requesting the use of Fund resources under the compensatory financing facility and a stand-by arrangement in special circumstances, mainly due to the world economic situation.

Wide fluctuations in terms of trade and in the availability of foreign loans have constituted major external shocks; in addition they have reinforced each other. During 1979-80, while benefiting from a boom in its terms of trade, Argentina saw the availability of foreign credit increase dramatically, mainly due to the improved prospects of exports and the trade balance.

From the second half of 1981 on, the opposite behavior was the rule; at the same time that the terms of trade fell significantly, the flow of foreign capital ceased. The figures are quite impressive:

Table 1

(In billions of U.S. dollars)

	1979	1980	1981	1982	1983
New loans	6,538	8,128	8,509	329	1,000
Interest payments	-1,174	-2,175	-3,850	-5,031	-4,440
New flow	5,364	5,953	4,659	-4,702	-3,440
As a per cent of exports	68	74	51	58	36

These figures were not counterbalanced by equivalent trade deficits, as an important part of the loans was first sterilized in foreign reserves and later financed a significant private capital outflow between 1980 and 1982.

The adjustment of the economy

The mirror image of this unstable external framework has been the wide fluctuations in domestic output and relative prices, particularly the real wage and the real exchange rate.

During 1981 and 1982, the Argentine economy had already adjusted to external developments; the magnitude of the adjustment, as Table 2 indicates, is remarkable, particularly considering the short time span involved:

Table 2

	1978	1979	1980	1981	1982	1983
Index of private wages in terms of U.S. dollars 1/	1.65	3.47	5.56	1.99	1.24	--
Public sector wage bill (In billions of U.S. dollars) 2/	7.5	12.2	20.4	11.4	5.6	5.4
Public expenditure (In billions of U.S. dollars) 3/	20.7	31.4	49.1	29.9	16.3	16.4
Real effective exchange rate 4/	91.6	75.3	65.5	79.7	111.5	111.5

Sources: Central Bank of Argentina; and Fund staff estimates.

1/ As of end of year; industrial sector.
2/ Includes wage outlays corresponding to the Central Government and state enterprises.
3/ Total expenditure of Central Government plus capital expenditure of state enterprises.
4/ Export-weighted effective rate (December 1969 = 100)

Short-term and medium-term prospects

Assistance from the Fund is very important for several reasons. It will allow the completion of the economic adjustment in certain fields in a more orderly manner, given that the adjustments are to be conducted within a framework of fiscal and monetary control that will restrain inflationary pressures and will promote the recovery of the balance of payments. In addition, it will help Argentina in the servicing of its foreign debt.

One step taken by the Government to supplement the help given by the Fund is the arrangement with several commercial banks, signed on December 31, 1982, which consists of a bridge loan equivalent to $1.1 billion, a medium-term loan equivalent to $1.5 billion, and an understanding to reschedule all principal service due in 1983. The net result would be a minimal increase in exposure on the side of the banks of less than 3 per cent; this increase will reflect the small deficit in current account forecast for 1983 and the projected use of Fund resources during that period. In addition, most of the disbursements will be tied to the possibility of drawing from the Fund as foreseen.

The Argentine Government has made and will continue to make every effort to return its foreign financial relations to normalcy.

The Government believes that the set of policy measures already planned is appropriate to deal with present circumstances. However, it stands ready to adjust these policies if circumstances prove it necessary.

Finally, the authorities are confident in the medium-term prospects for the Argentine balance of payments. Confidence is based on the capacity to adjust the trade balance and the elasticity of present figures with respect to changes in world economic conditions.

The reversal of the trade balance has been possible due to the continuous growth of exports and the low ratio of essential imports to exports.

In addition, the remaining deficit on current account will disappear and will eventually become a surplus when the terms of trade and international interest rates return to normal levels.

The developments in world markets are such that an index of prices for Argentine exports in 1982 was 30 per cent lower in real terms than the average for the period 1970-82. Therefore, a recovery of commodity prices to a level equivalent in real terms to the average for 1970-82 would imply an increase in export value equivalent to approximately $1.5 billion.

In the case of interest payments on foreign debts, the reduction of payments would be about $350 million a year per point of reduction. A reduction of 3 points in the interest rate would eliminate the current account deficit.

These features show good medium-term prospects for the current account. In addition, it should be noted that the increase in foreign debt has financed private capital outflows in an amount of no less than $10 billion. This fact creates the possibility of a new Government providing a medium-term horizon for economic decisions to set the proper incentives for repatriation of capital and repayment of foreign debt.

In essence, although prospects for the Argentine economy show a solvent economic situation in the medium term, temporary financial difficulties remain in the short term. The funds provided by the current arrangement will alleviate these difficulties, and the expected recovery of the world economy will contribute to redressing the present situation.

Extending his remarks, Mr. Teijeiro thanked the Managing Director for the important role he had played during negotiations between his authorities and the committee of private banks. His authorities were well aware of the extraordinary efforts by the Managing Director and the Deputy Managing Director in bringing about the successful completion of the negotiations. His authorities wished also to express their gratitude to the authorities of the United States for their support during negotiations with private and official financial institutions. They were particularly grateful to Mr. Volcker and Mr. Cross of the Federal Reserve System and to Mr. McNamar and Mr. Leland in the U.S. Treasury. Finally, his authorities wished to express their thanks to the staff; their efforts had resulted in the successful completion of discussions between his authorities and the Fund.

On the question of Argentina's exchange restrictions, Mr. Teijeiro made the following additional statement:

I would like to comment on the issue of Argentina's exchange restrictions. The authorities' intentions in this regard are reflected in the planned review of exchange policies with the Fund during the second quarter of 1983, during which understandings are to be reached with the Fund on a schedule for eliminating these restrictions. This review has, as the Board is aware, been made a performance criterion.

I wish to stress that in accordance with this policy, the authorities have already begun to take steps in this direction. The authorities expect to terminate the system of special rebates for exports to new markets by February 28, 1983 and to eliminate all payments arrears by June 30, and they have agreed to eliminate all other restrictions on payments and transfers for current international transactions no later than December 31, 1983.

Accordingly, I would like to assure the Board that the Argentine Government is determined to spare no efforts to eliminate all restrictions as soon as possible during the program period. In this context, my authorities will make their best efforts to ensure that all exchange arrangements that are in effect beyond the May review, including any restrictions that may temporarily remain, will be completely nondiscriminatory in both character and operation. My financial authorities fully recognize the importance of the need to avoid such exchange arrangements, and therefore will, as I indicated, make their best efforts to ensure that by the time of the May review no discriminatory arrangements are in place.

I believe that the progress that Argentina has already made in reducing the exchange and trade restrictions that were put into place in 1982 shows the determination of the Government to implement fully its obligations under the program with regard to the elimination of restrictions on payments and transfers for current international transactions.

Mr. Kafka commented that it was clear that the difficulties faced by Argentina could not be attributed to a single set of factors. However, the behavior of the public sector and the exchange rate policies adopted by the authorities had played an important role. The authorities were well aware of the need to improve the finances of the public sector and they were acting with determination to do so. Public sector operations excluding interest had exhibited relative constancy in recent years except for 1981, as a share of GDP. Including interest, there had been a continuous decline in both the current account surplus of the general Government and the savings of state enterprises. Despite some reduction in capital expenditures, the financing needs of the public sector had consistently increased. The proposed program was therefore a step in the right direction; it envisaged more than doubling the current account surplus of the general Government and bringing about a large increase in the savings of state enterprises as a means of reducing dramatically the financing needs of the public sector. The task would not be easy in view of the contrary pressures that the Government would face, and the solution must be sought not so much in an increase in revenues as in a reduction of expenditures. The recent erosion of the tax base could not realistically be reversed in the short run, although more could perhaps be done to strengthen the indexation of tax liabilities even in the inflationary conditions prevailing in Argentina. He would be interested to hear from the staff or from Mr. Teijeiro on that point.

In the exchange rate field, Mr. Kafka went on, the unification of commercial and financial markets during December 1982 had been most welcome, as had the restoration of real effective exchange rates before export taxes to historically sustainable levels. He would be interested to receive data regarding the evolution of the real effective exchange rate after export taxes. The parallel market was of course worrying, but the present premium represented a significant advance over the situation that had prevailed as late as December 1982, and even more over the situation of June 1982.

As to the program itself, Mr. Kafka observed that he agreed with the staff that it was important to achieve real financial savings during the program period. He therefore welcomed the intention of the authorities to keep interest rates under continuous review. Despite its short-term problems, Argentina had no structural trade difficulties or balance of payments problems. The country had a solid base on which to resume sustainable growth, with a well-educated labor force, many comparative advantages, and a diversified line of primary products. There was still considerable scope for expanding industrial exports. The proposed program was well balanced, and it should be helped by the probably more favorable trend of prices for primary products in 1983.

Mr. de Groote considered that the request by Argentina deserved special attention because of its potential consequences for the international monetary system as a whole. As in similar cases recently discussed by the Executive Board, close cooperation between the Fund and the commercial banks would continue to be required if a durable solution to Argentina's crisis was to be found. The success of the program would be very important not only to Argentina but also to the Fund's continued ability to mobilize private bank support for future Fund programs. He did, however, have some doubts about the likelihood of the program being implemented as planned.

First, Mr. de Groote went on, the program, which was to run for 15 months until the first quarter of 1984, seemed extremely optimistic. In such a short time it seemed very ambitious to try to achieve not only a reduction of the current account deficit from 4.5 per cent of GDP in 1982 to about 0.7 per cent by the first quarter of 1984, but also a reduction in the wholesale price index rate of increase from 310 per cent in 1982 to 85 per cent in the first quarter of 1984--in passing, the targeted wholesale price increase rate of 85 per cent in 1984 given in the Government's memorandum was shown as 131 per cent in Table 2 of the staff report. In addition, the aim was to reduce the public sector financing needs from 14 per cent of GDP in 1982 to 5 per cent by the first quarter of 1984. Those requirements, which were not all the objectives listed in the stand-by arrangement, could impose such a heavy burden on the Government as to exclude the possibility of complete observance. To allay doubts concerning such a considerable effort, he would welcome staff comments on a number of points.

First, he understood that the present Government needed to take strong measures rapidly to pave the way for an elected government during the first half of 1984, Mr. de Groote stated. Nevertheless, he wondered whether it would not have been more realistic to try to carry out an adjustment lasting two or three years. He did understand that political considerations might prevent the adoption of a smoother adjustment course. Second, he wondered whether Argentina and the Fund might not find themselves engaged in a series of renegotiations of the program, arising from a possible lack of consensus within the country on enduring the evident sacrifices. Third, the Fund would have to maintain good relations with the commercial banks. If in fact there were to be several negotiations of the program during the 15-month period, good relations might suffer. It would surely have been more prudent to establish the performance criteria for a very short time, for instance, up to May 1983. Such an arrangement would allow the Fund to redesign the criteria in the event of difficulties as a way of meeting the new problems, rather than canceling the program.

That sort of flexibility would have given greater reassurance to the commercial banks, which had become particularly sensitive to the smooth functioning of economic adjustment programs in the countries to which they were lending. By acting in that way it would be possible to avoid giving the impression that Argentina was unable to perform, when in fact it was only adapting the program to changing circumstances.

Commenting on Argentina's restrictive system, Mr. de Groote said that, while he welcomed Mr. Teijeiro's announcement about the progressive elimination of multiple currency practices and discriminatory restrictions on transfers, both policies were contrary to the basic rules because they resulted in discrimination against a Fund member. He wondered whether those practices should not be eliminated before the review of the stand-by arrangement scheduled for May 1983, instead of having them discussed at that time with a timetable for their elimination by the end of the year. Mr. Teijeiro had referred to the possibility of gradual elimination during the program period. That was too long. He would have preferred it if the decision on exchange measures had included a timetable for the elimination of those restrictions and if the decision on the stand-by arrangement had brought out more clearly the fact that the restrictions should be eliminated by the time of the 1983 review. If that was really the intention of the authorities, it would be as well to express it in the decision before the Executive Board.

Regarding the request by the Argentine authorities for a drawing under the compensatory financing facility for an amount representing about 60 per cent of Argentina's quota, Mr. de Groote stated that he would welcome a clearer explanation by the staff of the causes of the shortfall in certain exports. Without such an explanation, it looked as though a major, although not the only, cause of the shortfalls was the events of 1982, as the staff seemed to have implied. The request by Argentina to draw an amount over 50 per cent of quota seemed to underscore the need for more precise guidelines to assess what kinds of causes were beyond the control of the authorities. The Fund's policy on that matter clearly needed re-examination. Although he would not oppose the proposed decision for that reason, it was open to doubt and reservation because it was not obvious from reading the staff assessment that the situation had been entirely beyond the control of the member. Moreover, he found it difficult to believe that the shortfall was of a temporary nature since the prospects of recovery were rather weak, as the staff itself had said in EBS/83/8, only to contradict itself in the data for projected exports in Table 3 of EBS/83/11. Naturally, all such matters involved a great deal of judgment, but the basic principles had to be applied.

Taking up a number of technical points regarding the presentation of the staff papers, Mr. de Groote noted that data concerning the current account deficit and the overall balance were presented in two different ways in Tables 3 and 5 of EBS/83/8. He wondered why the staff had chosen to show balance of payments data once in U.S. dollars converted to Argentine pesos at actual average exchange rates and then at an exchange rate for the Argentine peso that kept the peso/dollar exchange rate constant in real terms at its 1970 level. The second method was probably better for giving a picture of the long-term balance of payments. Nevertheless, providing the same data in two different ways seemed rather confusing. Second, in EBS/83/11, Table 3 on page 6 showed natural gas not in shortfall but in surplus to the extent of SDR 71.5 million. However, on page 15 of the same paper, the staff had written that the largest shortfall was estimated for natural gas--SDR 72 million. Moreover, on the same page the staff had written that "gas is calculated to have an export excess of SDR 71.5 million."

As Executive Directors would recall, Mr. de Groote continued, the World Bank was currently financing the development and production of hydrocarbons (fuel oil and gas oil) in Argentina. It was clear that hydrocarbon production would have to be encouraged and that higher prices for the products would have to be obtained if the investments were to be successfully financed. He wondered whether the increase in the domestic price of fuel oil to 110 per cent above the wholesale price increase would bring the retail price up to the international level. Naturally, it would also be useful to encourage domestic substitution of gas for oil as a means of increasing exports of oil. He would be interested to have more information about the future role of those investments in promoting economic recovery and bringing about an increase in output, expected to amount to 5 per cent during 1983. The expectation seemed very optimistic, since later on in the paper the staff had stated that private investment was expected to show no increase in 1983 and that public investment was expected to improve only slightly. In addition, the weak external demand and the resulting low prices of petroleum products cast doubt on the prospects for quick fiscal returns or very substantial export opportunities. Hydrocarbons had only accounted for 6 per cent of total exports during 1981, and they were estimated by the staff to reach only 5 per cent during 1984.

The motor of Argentina's recovery was therefore more likely to be traditional exports such as cereals, oils, and meat than hydrocarbons, Mr. de Groote considered. It would have been useful to have had a special annex dealing with the relationship between Argentina and the World Bank, as had been found in a number of earlier staff reports. A major effort had certainly been demanded of the people of Argentina in a very short time.

Mr. Dallara stated that he was in broad agreement with the staff appraisal, and that he supported the proposed decisions. Argentina had clearly faced a formidable adjustment task. The current account deficit of the balance of payments would have to be reduced further in 1983, following a sharp reduction in 1982. Fortunately, the program could allow for an increase in imports during 1983, as exports were forecast to rebound and the deficit on services account, together with the reserve loss, was expected to decline. The relatively small decrease in net international reserves projected for 1983 would depend not only on further current account adjustments but on a substantial improvement in the capital account. Achieving the projected improvements might in fact prove more difficult in the current account than in the capital account.

The center of the adjustment effort would have to lie in the implementation of sound fiscal policy, Mr. Dallara commented. In addition, monetary policy would have to be less inflationary, and some means would have to be found to restore confidence in the peso as a financial asset. Changes in monetary and fiscal policy, coupled with a realistic exchange rate, supported by price and incomes policies and sufficient world demand should facilitate external adjustment and make a substantial contribution to restoring growth and reducing the high rate of inflation. The sharp reduction in the fiscal deficit planned for 1983--roughly 6 per cent of GDP--would clearly require a great effort by the authorities. It was at least partly reassuring that the fiscal adjustment was to be brought about through a number of different actions intended to raise revenues and reduce the growth of expenditure. The most important were perhaps public sector price adjustments, better tax administration, and the control of government expenditures, particularly with regard to wages and salaries.

For the medium term, Mr. Dallara went on, he had some concern about the implications of the BONEX scheme, which had been used in 1981 and 1982 to help clear up the external arrears of the private sector. The staff had said that the BONEX arrangements could give rise to a potentially massive domestic credit expansion and reserve loss when they were unwound. It would be interesting if the staff would say whether it felt that anything could be done to mitigate the potentially large adverse effect.

He strongly endorsed the staff view that it would be very important to pursue a monetary policy with the objectives of reducing the rate of inflation, encouraging a willingness to hold real money balances, and discouraging capital outflows, Mr. Dallara remarked. It might be necessary to raise interest rates over and above what was provided in the formula, since it was not clear that the formula would yield positive real rates. Mr. Teijeiro had indicated that the authorities were prepared to adjust policies if necessary. He hoped that they would be particularly diligent in monitoring interest rate policy. The authorities would have to be extremely cautious if they were to attain their credit targets. A large part of financing for the private sector during the program would be on account of a variety of autonomous expansionary elements, including the automatic consolidation of interest due on a series of loans, the cost of indexing large amounts of deposits with the Central Bank, and the cost of subsidizing investment loans to small and medium-sized enterprises.

The authorities should be commended, Mr. Dallara considered, for gearing wage policy to the achievement of a significant deceleration of inflation. The abandonment of wage indexing in the public sector and the Government's policy of nonintervention in private sector wage negotiations should be helpful. Nevertheless, he was still concerned about wage policy, since excessive nominal wage increases could jeopardize the program. A lasting improvement in real wages could only come about through increased productivity and output in an environment of decelerating inflation.

It was clear that an inappropriate exchange rate policy had played a major role in creating Argentina's balance of payments problems in the past, Mr. Dallara considered. It was also clear that the exchange rate had played a significant positive role in the adjustment process in late 1981 and early 1982. Accordingly, the authorities should be commended for their commitment to manage the rate flexibly and to coordinate interest rate and exchange rate policy as a way of attaining their balance of payments objectives. Timely adjustments would clearly be needed in both areas. Another aspect of external policy that called for early attention by the authorities was the elimination of the array of exchange and trade restrictions that had been put into place in the course of 1982. The restrictions were inconsistent with the broad thrust of the policies embodied in the program, and with the need to restore economic activity together with a sustainable payments position. He urged the authorities promptly to eliminate multiple currency practices and the restrictions on payments and transfers for current international payments. He placed special emphasis on the review to be completed by May, during which understandings were to be reached, inter alia, on a schedule for the elimination of all restrictions. Like other Directors he had noted with concern the discriminatory practices to which the staff had referred. He welcomed the assurances given by Mr. Teijeiro; in the light of the clearest assurance that his authorities would make every effort to ensure that restrictions that remained in effect beyond May 1983 would be non-discriminatory, he would not ask for a change in the stand-by arrangement.

Nevertheless, Mr. Dallara stated, he had one question concerning performance criteria. He interpreted the performance criterion on external debt to cover all public sector debt including short-term debt. He would be interested in hearing from the staff why short-term debt had been included under the ceiling in the present case, since it had generally been excluded. Did the staff consider that it might be either suitable or desirable to include short-term debt under debt ceilings in other cases in the future?

Although he could support the request under the compensatory financing facility, he was rather troubled by two aspects, Mr. Dallara said. First, in a number of places the staff had alluded to the fact that the multiple exchange rate regime that had been in effect for part of the shortfall year had led to a shift toward unrecorded trade. In other words, the actual export shortfall was likely to be somewhat less than the calculated shortfall, so that there might be some degree of overcompensation. It would be very difficult to estimate the extent to which unrecorded trade had increased, but he would appreciate it if the staff could give some estimate of what the increase might be, perhaps as a percentage of calculated exports. Second, like Mr. de Groote, he was bothered by the extent to which the exchange rate policies implemented during 1982, coupled with the general uncertainties surrounding economic policies, might have contributed to the export shortfall. He did understand that there would be difficulties in trying to calculate the extent to which the exchange rate policies had affected the shortfall, but he would like some answer from the staff or Mr. Teijeiro.

In brief, Mr. Dallara concluded, he commended the authorities for devising, with the support of the staff, an adjustment program that was aimed at addressing the difficult economic problems facing Argentina. However, there was a margin for error in the program. It was one in which the exchange rate, fiscal, and monetary policies were all extremely important, and in which all policies would have to be fully implemented if the program was to succeed. Even with full implementation of the policies, the favorable international economic and financial environment would have to improve if the external objectives--particularly the capital account objectives--were to be met. There had been frequent sharp policy changes in Argentina, and it was difficult to know which policy would work best in the present environment. Nevertheless, the mix selected did look appropriate, although he would have felt more comfortable with an interest rate policy that would produce clearly positive real rates. Fully to implement the program would take a determined effort by the authorities. Anything less was unlikely to succeed.

Mr. Anson commented that the staff had provided a helpful account of the difficult economic situation in Argentina and the factors lying behind it. He was in broad agreement with the thrust of the analysis and policy recommendations set out in EBS/83/8, and he was glad to note that some of the recommendations had already been implemented by the authorities.

Continuing his remarks, Mr. Anson then made the following statement:

> Although Argentina, like many other countries, has suffered from the world recession and high interest rates, its problems have also, to a substantial extent, derived from inappropriate and inconsistent economic policies, not least in the period since the last Article IV consultation. The need now is for a period of stabilization with emphasis on fiscal and monetary restraint.
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> The authorities have generally shown themselves to be flexible on the exchange rate, but this flexibility has been undermined by failure to sustain prudent domestic policies. An exception was perhaps the period early last year when domestic problems were more squarely addressed and confidence began to be restored, but this was not followed through.
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> The basic objective should be to improve domestic saving, particularly in the public sector, and reduce recourse to external borrowing, which has obviously saddled the economy with a heavy burden of debt. Progress toward kindred objectives--the reduction of inflation, and improvement of the balance of payments--should follow.
>
> There are also important structural adjustments in the economy that need to be tackled as soon as circumstances allow, and a more prudent fiscal policy should help. The size of the public sector has in the past been considered one of the main stumbling blocks to the restoration of the economy. The losses in the public sector agencies were a serious part of the problem in 1982.

A further key improvement would be the liberalization of the system of protection surrounding domestic industry. I hope that the authorities will turn their attention to that question once they have dealt with the network of emergency trade and payments restrictions, removal of which should be their first priority in the external field.

As the staff documents had made clear, the buildup of external debt has been extremely worrying, not just in the past 12 months but for a number of years, and it is likely to remain so for some time. External debt has risen by an average of nearly $8 billion in each of the last four years. Even if the authorities obtain an important measure of debt relief when, as is to be hoped, they reach agreement with the international banks over the rescheduling of the $5.5 billion of public sector maturities falling due this year, the debt interest burden will still remain heavy.

International interest rates have, of course, fallen and may perhaps fall further, but such benefits will tend to be offset by the higher spreads over the London interbank offered rate (LIBOR) that Argentina may now have to pay. In these circumstances, the efforts being made to raise net exports and restore investors' confidence will be crucial.

The authorities should still be prepared to observe prudent limits on their future external borrowing and I welcome the ceilings that have been set. I particularly welcome the introduction of a subceiling on debt maturing before the first quarter of 1987. It seems desirable that the authorities should be given every encouragement to continue the successful efforts they have been making to reduce their reliance on short-term foreign borrowing. (In passing, I hope that consideration can be given to the application of short-term borrowing ceilings in other Fund programs where the circumstances recommend it.)

The prospects for recovery in Argentina's trade are very difficult to assess. The staff projects a small improvement in the trade balance this year (page 22, EBS/83/8) but such projections must be particularly hazardous. The outcome will depend on many uncertain factors, including the pace of recovery in the main export markets and the degree to which the exchange rate becomes more genuinely competitive.

At present the exchange rate in the unified market can be sustained only through a very extensive system of restrictions, the impact of which is reflected, as the staff points out, in a very active parallel market where there was last month a 50 per cent premium over the official rate for the U.S. dollar.

I will return later to the specific question of those restrictions that fall within the Fund's approval jurisdiction. But, apart from those, there is a remarkable web of restrictions of all kinds--moreover rapidly changing--which must be a considerable handicap to enterprise. These include restrictions on imports and exports, on air services, and on eligibility for public sector contracts, and the placing of overseers (veedores) in individual commercial enterprises. In all these cases, there are also significant discriminatory elements that are contrary to the general principles that the Fund seeks to promote.

The cumulative effect of all these restrictions on Argentina's recovery can only be harmful. In addition, I note that Argentina has not renewed its agreement with the European Community on multifiber products. Until it does so, it will be denying itself the benefits of duty-free entry into the Community for some of its textile products.

At a time when Argentina is having to make such strong adjustment efforts, it is not unreasonable to expect that all possible action be taken to remove existing impediments to adjustment; and that external trade should be conducted according to the same conventions and in the same spirit of goodwill as has been shown by the international financial community in recent weeks.

I am glad to see, therefore, that trade restrictions will be included as an important aspect of the May review. I hope that the staff and the authorities will examine them carefully on that occasion, as an issue of considerable importance to Argentina's economy and balance of payments, as well as to its response to its debt problem.

Before I leave that topic, it may be convenient to mention the questions that I have on the proposed drawing under the compensatory financing facility. I have no objection, on balance, to this proposal, but I shall be glad to hear the answers to the questions by Mr. Dallara and Mr. de Groote. I note, in particular, that the export shortfall has been boosted by unrecorded trade in 1982. This raises a question, which the staff may want to consider as a general issue, whether it should seek to adjust official export figures where they are substantially affected by unrecorded trade.

The recovery of some exports does of course hinge importantly on sustaining the real peso devaluation so far achieved. It also depends on world economic conditions, and a 15 per cent annual growth in the category of "other" exports may be difficult to sustain in practice. I should like to ask the staff what assumptions it has made about the continuation or otherwise of trade restrictions, in making its projections of Argentine exports.

Turning now to fiscal and monetary policy, I note that a good deal of effort is to be put into improving the yield of the tax system and increasing other sources of public sector receipts. Given the extent of tax evasion, an improvement in the tax administration would certainly seem to be necessary.

I welcome too the steps being taken to raise public sector tariffs to economic levels. Much ground was lost last year, as indicated on page 15 of EBS/83/8. It is to be hoped that higher costs will be passed through to prices more rapidly in future, to the extent that they cannot be counteracted by greater efficiency.

Despite these measures, domestic revenue sources are unlikely to be buoyant for some time, given the weakness of economic activity and the rather narrow tax base. Receipts from export taxes should, however, remain buoyant bearing in mind the expected record harvest, although it does seem worrying that reliance on "emergency" export taxes may rise as high as 2 per cent of GDP this year, notwithstanding continued low world prices.

With only a fairly moderate recovery expected on the revenue side, much will depend on prudent expenditure policies and an improvement in expenditure controls. I note the plans to cut manpower in the general government sector, but more might have been said about the precise way in which the authorities intend to secure the significant projected decline in real current expenditure of the general Government.

Effective wage moderation in the government sector will clearly be an essential element, and I therefore welcome the abandonment of the policy of effectively indexing to past inflation for government employees, and also the shift to less frequent adjustment. It is probably right that wages in the private sector should be allowed to find their own levels, since the weakness in the labor market should help to deter unreasonable increases. It will, however, be important to ensure that wages in the private sector do not run ahead of those for government employees, if undue increases in public sector prices are to be avoided.

It seems right that ceilings under the program should apply to borrowing by the entire nonfinancial public sector in view of its importance. I wonder, however, whether the staff is satisfied that the criteria are comprehensive enough to embrace domestic arrears and whether such arrears can be monitored effectively enough to ensure that the ceilings have the desired effect.

I welcome the moves made recently towards a more market-oriented level of interest rates. The seriously negative real rates during some periods in 1982 have clearly had a damaging effect. However, the recent changes have so far been concentrated on relatively short-term loans and deposits, and I trust the authorities will stand by their intention to broaden the changes so as to increase the attractiveness of longer-term financial instruments. Financial intermediation has been characterized in recent years by the greater development of short-term instruments, no doubt because returns on these more readily respond to inflation, but this has had the undesirable effect of increasing the volatility of funds in the banking system.

While the formulas to be used as a basis for interest rate determination seem reasonable in the circumstances, it will be necessary for the authorities to maintain a flexible approach toward interest rate policy. Because of the timing of public sector tariff increases, consumer price inflation is likely to rise sharply at times this year. It will be important to manage this as smoothly as possible so that interest rates provide an adequate attraction for savings without being unduly volatile.

I turn now to the proposals for a stand-by arrangement and a compensatory financing drawing.

The proposals before us today have to be seen within the context of our concern for the stability of the international system, and our recent discussions of how we can best avoid, or if necessary cure, major strains in that system. As in some other recent cases, the Fund has an important role to play here in linking financial assistance with a degree of adjustment which, in this particular instance, needs to be especially profound.

My authorities stated some time ago that they would like to see stability restored to the Argentine economic and financial system, and that they welcomed Argentina's approach to the Fund. For the reasons indicated in my remarks on the Article IV consultations, we judge this program to be well designed and its implementation to be helpful in improving the stability of the international system. I am glad therefore that agreement has been reached on it.

I must, however, express serious concern about the continued existence of discriminatory exchange restrictions within a program supported by the Fund. These include not only those mentioned by the staff this morning, but also the foreign financing terms, for which--rightly in my view--Fund approval has not been requested.

It had been our hope that by now all such restrictions would have been eliminated, which would have been the normal practice before the Board considered a proposal for a stand-by arrangement.

I am very glad to note, therefore, the statement that Mr. Teijeiro has been authorized to make, to the effect that his authorities will do their best to ensure that any exchange restrictions that remain after the May review will be nondiscriminatory in both character and operation.

I am also glad to note the statement of the staff that in conducting the review, first priority will be given to removal of the discriminatory restrictions to which they referred.

The agreement of a schedule during the May review for the removal of any remaining multiple currency practices and restrictions on payments and transfers for current transactions is, as they stated, a performance criterion under paragraph (f) on page 44 (EBS/83/8). My authorities consider that the removal of any remaining discriminatory restrictions should be a prior condition for the agreement by the Fund to such a schedule. But of course I also hope that any discriminatory elements will have been removed much sooner than that. I agree with Mr. de Groote that on such a matter of observance of general Fund principles, the view of the Board should be very clearly expressed. Subject to that qualification, I can support the proposed stand-by arrangement and the compensatory financing drawing.

Mr. Lovato commented that the figures provided by the staff, together with its candid and disquieting appraisal, and the collection of policy measures deemed necessary to restore some degree of external and internal balance provided a picture of the severity of the crisis affecting Argentina. As a general observation, it seemed to him that it would be better in such cases to negotiate a three-year extended arrangement, which would allow a more gradual approach in pursuing the desired corrective policies, for which a broad consensus was seen by the authorities as a necessary condition for bringing about some adjustment in the country's economy. When, as in the present instance, the program was limited to a little over one year, and emergency therapy was required quickly to redress some of the most severe maladjustments, a higher degree of stringency was required in selecting corrective policy measures. Even though as a matter of principle he favored some gradualism, the shorter the time span within which the program was allowed to operate, the stronger the case for a more restrictive policy stance.

Nevertheless, in the present instance, Mr. Lovato continued, he wondered, like Mr. de Groote, whether the program could reasonably be expected to be successful when the authorities felt that it needed general consensus and it was likely in the staff's view that it would instead meet broad resistance. In any event, the authorities should bear in mind the need for maintaining some degree of continuity in formulating economic policies. It was imperative to avoid the destabilizing effects caused by abrupt reversals in public policy if confidence was to be restored.

Dealing with individual aspects of the proposed program, Mr. Lovato stated that he was inclined to agree with the staff that, in view of the uncertainties prevailing in the domestic field, the external sector would become a crucial factor in promoting adjustment. For several years, the authorities had followed a misguided exchange rate policy. The current real effective rate for the peso was judged by the staff as being somewhat more competitive than the rate prevailing in 1977-78, a period during which Argentina had recorded sizable trade surpluses. He would encourage the authorities to adhere to the chosen exchange rate with firmness. Besides having beneficial effects on the country's trade performance, such a policy might be conducive to a recovery in Argentina's credit standing, with positive repercussions on the capital account. He supported the staff's handling of the existing restrictions in the exchange and trade system, and he commended it for reaching specific understandings with the authorities about their phased elimination. Both the provisions stipulated under the performance criteria and the special review clause incorporated in the stand-by arrangement were critical ingredients of the program. He also welcomed the statement made at the beginning of the meeting by Mr. Teijeiro; nevertheless, he shared the view expressed by others that it would be advisable to eliminate the restrictions sooner than envisaged, and in any case to eliminate the discriminatory restrictions as soon as possible.

As to the revival of the real economy, it seemed clear that domestic demand could not be relied upon to provide the motor, Mr. Lovato stated. Not only was investment spending discouraged by low business confidence, widespread financial instability, and high rates of unused capacity; consumer expenditure was held back by declining incomes and soaring unemployment. The main stimulus to output and employment would therefore have to come from foreign demand. He would be grateful if the staff could provide some estimate of the implied rate of increase in exports consistent with the assumed rise in real GDP by 5 per cent in 1983.

As to fiscal policy, Mr. Lovato noted that the expected turnaround in the public sector accounts from a deficit amounting to 5 per cent of GDP to a surplus of about 1.5 per cent of GDP would require an impressive performance by an economy in which domestic activity was very depressed and incomes had been declining at a substantial rate. The extent of the planned budget measures was commendable; but in view of the cost in terms of additional output forgone, he doubted whether such an outturn in the public sector budget was feasible. The same could be said for the policies on wages and salaries. He understood that the Government intended to change the indexation system for public sector employees, and to allow wage rates to be fixed by bargaining in the private sector. It might well be true that the labor market situation was such as to prevent excessive wage increases. On the other hand, the revival of political parties and trade unions was not a particularly favorable atmosphere for self-restraint, especially as purchasing power had already fallen during 1982 and inflation was still running very high.

The inflationary process was particularly serious in Argentina, Mr. Lovato considered, because it had become rooted in the mentality of the economic agents. Even so, the staff had not paid much attention to it. In view of the array of adjustment methods envisaged by the program, new and more powerful inflationary spurts might occur. The changes in the wage-setting process and some of the budget measures might well have a dampening effect; but the ongoing depreciation of the peso and further increases in administered prices and tariffs would be reflected in higher recorded inflation, at least in the short run. The combined effect of the planned policies on expected inflation was difficult to assess. He wondered whether the staff would be prepared to offer a judgment.

Because inflation was still very rife in the country, Mr. Lovato observed, credit expansion to the private sector should not be allowed to accommodate the projected growth in nominal GDP; on the other hand, interest rates should be set sufficiently high to induce domestic financial savings.

As to Argentina's external debt, amounting according to the staff to some $32 billion in 1983, Mr. Lovato observed that debt servicing on such a scale was bound to be difficult for a country that had net international reserve liabilities. In the negotiations between Argentina and its creditors, the Fund would again have to appear as a main performer. The completion of the stand-by arrangement would be the first step in upgrading Argentina's credit standing in international financial markets, but the viability of the adjustment process would depend on the country itself.

He would support the proposed stand-by arrangement, Mr. Lovato stated, although he understood that even if successful it would do no more than improve the country's present economic circumstances; it would have to be complemented by measures aimed at overhauling the structure and raising the productivity of the economic system. He could also support the request under the compensatory financing facility, although with some doubts regarding the staff conclusion that the shortfall was largely attributable to factors beyond the member's control. On page 18 of EBS/83/11, the staff had listed a number of factors that had been taken into account in determining the calculated shortfall, without however putting them in any particular order. In principle, some quantitative estimates of the relative weight of each factor would be desirable.

Mr. de Vries stated that he was prepared to support both the proposed stand-by arrangement and the proposed drawing under the compensatory financing facility, although each of them raised certain doubts. While some of the aspects of present policy were not fully satisfactory, it was hard to indicate better ways of dealing with Argentina's very difficult situation.

As mentioned by Mr. de Groote and Mr. Dallara, there were a number of features in the proposed drawing under the compensatory financing facility that might make it necessary to reconsider what was meant by the term "largely beyond the control of the authorities," Mr. de Vries stated. In the present instance, the staff implicitly argued that wars were beyond the control of governments. His own view was that wars were made by governments. The Fund might well be faced by a situation in which two primary producing countries made war on each other, and each of them came to the Fund for a drawing under the compensatory financing facility, maintaining that they were suffering from a shortfall in exports. Such a situation could involve the Fund in judgments of the sort that it did not wish to make; the Executive Board might have to try to determine whether its present procedures were as satisfactory as they could be made.

A second feature that the staff apparently considered to be beyond the control of the authorities, Mr. de Vries went on, was the subsequent reintroduction of multiple exchange rates, which had clearly inhibited the recovery of exports. He had difficulty in following the staff argument, especially as it had not indicated the relative significance of the various factors on which it had relied in calculating the shortfall. Nevertheless, while he believed that further work would be required on each of the two points he had mentioned, he did not wish to translate his doubts into opposition to the proposed decisions. He had also been interested in Mr. Dallara's point that the introduction of unrealistic exchange rates was likely to lead to the existence of unrecorded exports. That too was a point that ought to be tackled by the Fund in general terms.

While it was certainly true that Argentina had been subjected to severe external shocks, internal developments had clearly had a bearing on the present situation, Mr. de Vries remarked. The instability of economic policy in Argentina had done the country no good. During the period 1980-83 there have been three separate stabilization programs, and the Fund was currently tackling a very difficult situation by proposing a fourth. In the circumstances, the results could hardly be satisfactory. The Argentine authorities seemed to have a tendency to adopt very strong programs, which naturally created a great deal of opposition, whereupon the programs were abandoned and replaced by different measures. In the long run, greater benefits might well be achieved by adopting a more moderate sustainable policy supported by a general consensus that could be maintained over a number of years. But perhaps political circumstances prevented the present program from fitting that description. With elections due in 15 or 18 months, regrettably the economic horizon must again be a short one. He was glad that Mr. Teijeiro had suggested that it might be possible for a new government to provide a medium-term horizon for economic decisions.

Commenting on some of the individual features of the rather short-term program to be implemented by the Argentine authorities, Mr. de Vries noted that there was to be a major increase in government savings and in the savings of the state economic enterprises. The change was indeed essential, especially as the reduction in those savings had made a considerable contribution to the difficulties of the present situation. Like Mr. Kafka, he would have welcomed additional information on the possibilities of further indexing tax liabilities in Argentina. Given the rate of inflation, such an arrangement might have important consequences.

As for monetary policy, Mr. de Vries observed that interest rates were again to be set according to some formula. He had previously remarked that such formulas did not always work well in practice in Argentina. He attached importance to keeping interest rates positive in real terms because there was a pressing need for additional savings for the private sector. One major improvement was the fact that wages were to be indexed not to past inflation, but to targeted future inflation. He hoped that the new technique would fare better than some of the other techniques tried in Argentina in the past. In any event, to reduce inflation, the links with past inflation had to be broken, and he hoped that the proposed measures would have the desired effect.

The exchange rate regime and the exchange rate system were both complicated, Mr. de Vries considered. The exchange rate was to be managed with considerable flexibility. What was important was the real exchange rate after export taxes, and he wondered why such heavy reliance on export taxes was needed. There were still restrictions on international payments, and he hoped that they could be lifted more quickly than was intended at present. There were also discriminatory restrictions, which were contrary to the spirit of the Fund. He had, however, noted Mr. Teijeiro's statement assuring Executive Directors that they would have been removed by the time of the May 1983 review. In view of Mr. Teijeiro's statement, no changes in the proposed decision were needed.

The proposed program would rely heavily on demand restriction and on efforts to reduce inflation through indexing wages to future inflation rather than to past inflation, Mr. de Vries said. Unfortunately, no other course seemed realistic in the circumstances. The weakness of the program was that the authorities seemed to hope that the private sector could be relied upon to produce growth. There had been so many shifts in both internal and external policies that the medium-term outlook was necessarily uncertain. Consequently, the private sector was likely to act in a disappointing manner for the next 15 or 18 months. It was to be hoped that, with time, a consistent medium-term perspective could be developed that would gain the consensus of a large part of Argentine public opinion, and that in due course a climate would be created in which it would be possible for the private sector to fulfill the role assigned to it in the present program.

Mr. Senior commented that the preparation of the staff papers had taken place in circumstances in which events had sometimes overtaken decisions, and in which financial programming in a medium-term context became a rather academic exercise. He warmly supported the two requests by Argentina and the proposed decisions. In general, moreover, he could agree with the staff appraisal. Argentina was clearly facing a severe economic crisis, with imbalances so great that any rectification of the position was bound to be a prolonged process in which the authorities' determination and perseverance would be essential ingredients. The crisis was in part due to the world economic situation, with the recession affecting Argentina's exports and terms of trade, and with rising interest rates in the international capital markets making even more burdensome a growing external debt required to finance the emerging imbalance. More important, when most needed to help to stay the imbalances and underpin the adjustment policies required for gradual correction, Argentina's access to the international capital markets had virtually ceased, in part due to the conflict in the South Atlantic. Accommodating internal policies and sudden recurrent changes had also had a major effect on Argentina's economic situation.

The deterioration could be epitomized by the sharp falls in output, real wages, and employment during the past two years, with a marked acceleration in inflation and a shift in the overall balance of payments from a substantial surplus in 1979 to an even larger deficit in 1982, Mr. Senior considered. In the past two years, the Argentine economy had undergone substantial adjustment, largely forced upon it by a severe scarcity of foreign exchange. In such circumstances the formulation of economic policy was bound to be very difficult. Any program could only be considered a kind of holding operation, allowing the authorities time to find a basis for more substantial adjustment in the future, as economic and financial conditions became more stable, and the circumstances became easier to perceive. It was difficult to demand a more comprehensive program in present conditions, since policies could really only be formulated when conditions were relatively stable. He could therefore concur with the proposed program, which was quite realistic and appropriate in the circumstances.

Although some of the targets were ambitious, Mr. Senior went on, they could be attainable if confidence and an appropriate climate for investment were gradually restored. To achieve such a result the authorities would have to exhibit considerable perseverance. Argentina's potential was well known, and he hoped that the pursuit of more consistent economic policies would lead to the restoration of confidence. He had been struck by the substantial falls in real wages between 1980 and 1982, and by the accompanying fall in output and investment. While the fall in real wages was a negative factor so far as economic performance was concerned, it did highlight the potential for recovery once the situation was reversed.

The authorities would have a difficult task in the coming few months, and even then they would only be taking the first steps toward recovery, Mr. Senior stated. Clearly, more substantial efforts would be required in the near future, and a comprehensive medium-term program would have to follow. The request for a drawing under the compensatory financing facility clearly met all the requirements.

Mr. Casey observed that he welcomed Mr. Teijeiro's statement regarding the elimination of discriminatory trade and payments practices, and was in accord with Mr. Anson's comments on the subject. He could support the proposed stand-by arrangement for Argentina, even though it was only a first step in what might be called crisis management. It was hard to understand how a potentially rich economy had encountered so many difficulties, and especially how inflation, which could almost be classified as hyperinflation, could have become so firmly entrenched. The main causes seemed to have been not only external shocks, but inconsistent economic management and sudden switches in policy lacking any discernible sense of direction. In those circumstances it was perhaps not surprising that the people had lost confidence and that capital had flowed out of the country.

With such a background, it was disappointing that the program could not be designed more with structural adjustment in view, Mr. Casey observed. It was impossible to be sure of the impact of quantitative performance criteria specified in nominal domestic currency terms, especially as the inflation rate was running at over 300 per cent a year. In such an inflationary environment it was very difficult to formulate a financial program, if only because the margin of error was large.

The fiscal adjustment planned by the authorities looked not only impressive but optimistic, Mr. Casey noted. Nevertheless, the 1982 fiscal deficit had been abnormally swollen by nonrecurring outlays. Moreover, the reduction of international interest rates had provided a strong easing for the fiscal position in 1983. Even then, the fiscal adjustment would not be sufficient to avoid crowding out the private sector. More fundamental measures would have to be taken with respect to government spending, the state enterprises, management and pricing policies, and the tax base. In connection with the latter, he had found no reference to income tax measures. The authorities would have to obtain a firmer grip on tax evasion, which was estimated to be 50 per cent of total payments. He did not understand why tackling tax evasion had to be a gradual process; perhaps the authorities would benefit from technical assistance from the Fund.

The authorities had stated that they would completely avoid any external borrowing by the nonfinancial public sector, Mr. Casey commented; yet he saw from Table 7 of EBS/83/8 that under the performance criteria the public sector might bring in $2 billion of external debt during the program. While he could understand that the apparent contradiction was probably a matter of terminology, distinguishing the financial and the nonfinancial public sectors, he wondered to what use the $2 billion were to be put.

He noted that M-4 was expected to increase by 185 per cent during 1983, considerably faster than the nominal growth of GDP, Mr. Casey stated. The staff maintained that the purpose of such a rapid increase was to restore real money balances. He was not at all convinced by the argument, particularly in a situation where inflation was running at over 100 per cent; he therefore asked for some explanation. On the other hand, domestic credit creation was to be tight, apparently as a means of forcing the private sector to repatriate its own capital from abroad and thus help the overall balance of payments. Naturally, the private sector would only act in the desired way if confidence were restored, interest and exchange rates were appropriate, and government policy continued to remain credible. He agreed with the staff that in view of the credit needs of government and private enterprises, interest rates should be sufficiently high to encourage domestic saving. The problem was that if people expected inflation to accelerate, they might lose confidence in the currency and either export their savings or increase consumption. Consequently, a very flexible interest rate policy would be needed, and he agreed with Mr. Dallara and others that the interest rate formula might need to be changed from time to time. In those circumstances, the authorities might do well to watch closely any freely negotiated interest rates, as they might serve as possible indicators of equilibrium rates.

Commenting on the balance of payments, Mr. Casey noted that during 1982 the current external deficit had widened, the capital outflows had been very large, and there had been a sharp fall in net reserves and a buildup of arrears. The still comfortable position of gross reserves gave no cause for complacency, mainly because the debt service ratio was more than 100 per cent. In those circumstances, it was difficult to understand how major improvements could be expected in 1983, especially with regard to suppliers' credits, even if it were recognized that 1982 was an unusual year. He agreed with Mr. de Groote regarding the optimism of the balance of payments projections for 1983.

The more flexible exchange rate policy did seem to be well conceived, Mr. Casey conceded. The elimination of arrears by June 1983 was also to be welcomed. The reduction of exchange and trade restrictions would improve the country's credit rating, and hence reduce the cost of borrowing. He was glad to note that the performance test would ensure that any debt restructuring would not be offset by new short-term borrowing.

The intention seemed to be to allow the market mechanism to determine wage changes, especially in the private sector, Mr. Casey noted. The Government itself, as an employer, should set an example and try to convince the community at large that the inflation rate would come down in the future. Publication of inflation targets might be worth considering in an effort to unwind inflationary expectations, especially as trade union activity was apparently becoming stronger.

Taking up a number of technical points, Mr. Casey remarked, first, that between December 1978 and August 1982 Argentina's external debt had risen by $21.6 billion as shown in Table 6 of EBS/83/8. During that period the economy had been stagnant, so that the question arose as to how the inflow of funds had been used. It was also difficult to relate the large increase in external debt to the capital account figures in the balance of payments table on page 22 of the same paper. The figures shown in that table were far more modest, and he wondered what the explanation might be. Another point referring to Table 6 was that the total disbursed debt in August 1982 was in the neighborhood of $34 billion, including short-term debt. Yet the text on page 25 referred to that figure as being long-term and medium-term debt only, as if to suggest that it did not include short-term debt. Furthermore, the Argentine authorities themselves had apparently published a higher figure, $37 billion, as representing their debt at the end of June 1982. It would be interesting if the staff could indicate how reliable it considered the debt figures to be, both for stocks and flows.

Like others, Mr. Casey went on, he believed that the request for a drawing under the compensatory financing facility was dubious, for the reasons given by Mr. de Groote and others, including the existence of unrecorded trade and the introduction of multiple exchange rates, which had inhibited exports during the shortfall year. Both those elements were within the control of the authorities, and the combined effect probably accounted for a significant part of the shortfall. A second concern was the rather optimistic postshortfall projection, which could lead to overcompensation, for which of course there would be a repurchase obligation. Finally, it would be interesting to know the exchange rate that had been used to convert pesos into SDRs in Table 3 of EBS/83/11, and whether it was the same exchange rate that had been used to convert the balance of payments statistics into U.S. dollars in EBS/83/8.

Mr. Suraisry began by saying that he could support the proposed decisions. Yet, while supporting the request for a drawing under the compensatory financing facility, he wished for clarification regarding the choice of a shortfall year. While it was appropriate for the authorities to choose any 12-month period as the shortfall year, as long as the estimated data were not for a period of more than 6 months, it was rather peculiar to choose a shortfall year with 11 months of actual data and 1 month of estimated data. The staff could for instance have chosen the year ended August 1982 as the shortfall year, so that all calculations would be actual.

The Argentine economy had been suffering from difficulties caused both by external factors and by domestic policy maladjustments, Mr. Suraisry noted. The difficulties had intensified in 1982, when the economy had moved further into recession, the inflation rate had reached an estimated 310 per cent a year, and the balance of payments had shown another large deficit. The authorities had put together a package of corrective measures in the form of a stabilization program supported by the Fund. They were to be commended for so doing.

As to the program itself, Mr. Suraisry commended the steps that had been taken since October 1982 to reform the exchange and trade system. The unification of the exchange markets and the adoption of a policy of moving the exchange rate broadly in line with the inflation rate, together with the removal of the import restrictions imposed in May 1982, represented steps in the right direction. The authorities had committed themselves to further reforms of the exchange and trade system during the period of the stand-by arrangement; he hoped that they would remove the many restrictions as soon as possible and that any that remained by the time of the May 1983 review would be nondiscriminatory.

The borrowing requirements of the nonfinancial public sector had risen steadily in recent years to about 14 per cent of GDP in 1982, Mr. Suraisry observed. The authorities had aimed at reducing the borrowing requirements of the nonfinancial public sector to 8 per cent of GDP in 1983 and 5 per cent during the first quarter of 1984. While such a change represented a major fiscal adjustment effort, he believed that it was feasible. The revenue performance would be strengthened by the application of various tax and price increases. If expenditures were kept within limits, the envisaged strengthening of the public finances could be achieved.

Commenting on wage policy, Mr. Suraisry considered that the practice that had been followed in the last 6 months of 1982--indexing wage increases in the government sector to past inflation--was not helpful in reducing inflationary pressures. The authorities' intention to determine wage adjustments in the government sector on the basis of targeted future inflation was welcome. Such an arrangement would allow the ratio of the government wage bill to GDP to remain at 7.5 per cent in 1983, some 3 percentage points lower than in 1982, and set the right example for wage settlements in the private sector and state enterprises. He could accept all the performance criteria in the stand-by arrangement, with the quantitative limits shown in Table 7 of EBS/83/8, as well as the provisions regarding the exchange and trade system. The performance criteria were comprehensive and entirely appropriate.

Mr. de Maulde stated that he too could support the two requests submitted by Argentina, although with certain qualifications regarding the adjustment program.

Before discussing the substance of the staff papers, Mr. de Maulde went on, he wished to pay tribute to the role played by the Fund and more specifically by the Managing Director in making the financial arrangements, which were a prerequisite for any commitment by the Fund. The present economic circumstances in Argentina were the outcome not only of recent exceptional circumstances, but also of several years of abrupt policy changes that had failed to address structural weaknesses, and had eventually had perverse results. In passing, he regretted that he had not had more time in which to study the staff papers; he hoped that in future it would be possible for the Executive Board to adhere to the normal timetable for documents. He could sympathize with the staff when it found it difficult to determine which policy mix held out the greatest hopes of steering Argentina's economy onto a path of recovery and internal and external equilibrium. While defining the optimum policy mix would be important, it would be still more important to ensure that any selective policies were implemented consistently.

He understood why it had not been possible to resort to the so-called shock approach, Mr. de Maulde observed. However, as a consequence, the complex formulation of the proposed program raised a number of questions. First, the performance criterion embodied in the program for the public sector was very complicated. There was a set of quarterly limits on the global borrowing requirements, which however encompassed all conceivable forms of borrowing. A straightforward ceiling on the overall deficit of the public sector, which was the normal formulation, would have been more appropriate. In Argentina sizable payments of interest were treated as amortization payments, and were accounted for outside the overall deficit of the public sector. Together with extrabudgetary expenditures, those interest payments amounted in 1982 to 4.3 per cent of GDP. Argentina was the only member to treat its payments in such a fashion. It would not be of importance if it were only a matter of unusual accounting, but there was more than technical refinement at stake. When the financing needs of the public sector were twice as high as the public sector deficit, it might be asked how relevant were targets for a fiscal policy expressed in terms of a restricted notion of the deficit. Argentina was now in the same position as some other countries, namely, that in order to stabilize its public sector deficit as a ratio of GDP, it had to curtail substantially its current expenditure, if only to offset the rise in interest payments. Full recognition of the meaning of the public accounts might well be of importance if it were to reveal a change in the stance of fiscal policy consistent with the fight against inflation.

Another cause for concern, Mr. de Maulde went on, lay in the monetary area. The current situation seemed to indicate a desire to move away from money, as shown by the sharp decline in real money balances. In those circumstances, the target for the growth of monetary aggregates ought not merely to be consistent with the targeted rate of inflation; it should provide for some gain in confidence and therefore be high enough to allow for a substantial decline in income velocity. While he had no objection to the design of the performance criteria, which would assist in achieving both those aims, he was not certain that the Central Bank had the necessary instruments to enable it to perform its role. Strong emphasis had been rightly placed on the role of interest rates, and it had been mentioned that the interest rate formula only set a floor. However, in Appendix D (SM/83/12), and especially paragraphs 2 and 4, the impression was given that uncontrolled sources of credit expansion might well threaten the attainment of monetary targets. It would be interesting to know why it had not been considered appropriate to allow for a more comprehensive reform of the channels of financial intermediation. If the present mechanisms were to prove too rigid, the Argentine authorities would have no other choice but to engage in drastic institutional reform to recover the necessary flexibility. It was therefore important to weigh the costs and benefits of such a course of action, as opposed to the more gradual correction that was a part of the program. There seemed to be no discussion of the point in the staff papers.

He was not convinced that the present program addressed what appeared to be an important characteristic of the Argentine economy, namely, the way in which the various sectors of activity seemed to act independently from one another, Mr. de Maulde commented. One important cause of the present difficulties was the distortion of relative prices. The various sectors of the economy had benefited or suffered from different exchange rates and different interest rates. The program included a number of corrections in public prices and tariffs, but it fell short of a comprehensive overhaul of the system, and a number of different rates were maintained for export taxes and interest rates, the impact of which had not been discussed.

However, Mr. de Maulde stated, he could fully support a number of features in the program. First, the unification of the exchange markets and the adoption of flexible exchange rate management were both undoubtedly warranted. The authorities would be unwise to resort again to a preannounced depreciation schedule or to any exchange guarantee scheme. On the contrary, they should fully take into account the impact of export tax rates on the effective exchange rate. His authorities also attached great importance to the strict compliance with the performance criteria related to the reaching of an understanding by Argentina and the Fund on the occasion of the comprehensive review in June 1983; he fully endorsed the statements by Mr. de Groote and Mr. Dallara on the question of discriminatory practices. It was also most desirable actively to pursue rescheduling operations with various creditors.

A moderation in wage settlements would be essential, Mr. de Maulde considered; public wage movements would probably be decisive. Changing public sector tariffs and prices alone had proven to be self-defeating in the past. Any change in the relative levels of prices in the coming months should not affect the intention of the authorities to hold the government wage bill to its level of 1982 as a percentage of GDP. It was also essential to bring about the intended reduction in the public sector deficit, in view of the reduced amount of available foreign financing. Moreover, the ways in which the public sector deficit was reduced would be important. In view of the major role of the public sector in Argentina, the intention to provide for a small recovery in public investment was welcome. In addition, it would be necessary to build up a consensus in support of the program and to restore public confidence, if the authorities hoped to achieve success.

Mr. Grosche considered that the case of Argentina was even more worrying than others that the Executive Board had been discussing in the recent past. He agreed with the staff that, even in the current world economic situation, few countries were facing such serious imbalances. The difficulties were deeply entrenched, reflected in hyperinflation, an external debt ratio exceeding 100 per cent, and massive capital flight over a considerable period due to loss of confidence in the ability of the authorities. The circumstances were particularly regrettable because Argentina possessed many skilled people, and the country was endowed with natural resources that would suggest a different outcome. Restoring confidence and returning Argentina's economy to a state of internal and external equilibrium would be a major undertaking. The proposed stand-by arrangement would only be partially adequate to the task. He endorsed the staff view that, in view of the size of the imbalances, a medium-term program supported by a Fund arrangement of equal length would have been more appropriate.

Three underlying assumptions were of crucial importance if the program targets were to be met, Mr. Grosche went on. First, exports would have to expand faster than the increase in imports. Second, trade unions would have to cooperate at least to the extent of not undermining the proposed restrictive fiscal and monetary policies. Third, collaboration between the authorities and the international banks would be of the utmost importance. He appreciated the Managing Director's part in the efforts aimed at reaching an understanding with the banks to provide the external financing that would be needed in the near future. Without the Managing Director's work, Argentina would not have been able to submit a reasonable stabilization program. Even now, it would not be easy for the Argentine authorities to prove that they could conduct a consistent policy and persuade the people to accept the additional burdens imposed upon them. He shared the reservations expressed by Mr. de Groote, Mr. Lovato, and others about the implementation of all the items mentioned in the program, and he therefore attached special importance to the May 1983 review.

On the program itself, Mr. Grosche remarked that interest rates would have to be sufficiently high to induce capital flows to return as backing for domestic savings. The only way in which success was likely to be achieved in that field was by ensuring that domestic interest rates in real terms exceeded interest rates abroad by an adequate risk premium. At present, nominal interest rates were lagging substantially behind inflation. The situation could be reversed by applying a new indexing formula, as described by the staff. In a situation of hyperinflation, it seemed reasonable to link interest rates to inflation as a way of guaranteeing appropriate rates of return. However, in the medium term such an indexation scheme might send the wrong signals to economic agents, only appearing to validate their expectations of continuing inflation. Another reason for concern might be the possible spillover effect of such a scheme into other sources of income, hampering the necessary adjustment.

Argentina had had the wrong exchange rates for too long, like many other countries, Mr. Grosche noted. He was pleased that the exchange rates had been revised in November 1982. A crawling peg system seemed workable, as it would keep Argentina's prices competitive and realistic. However, the present composition of exports, consisting mainly of agricultural products and minerals, suggested that Argentina was likely to be largely a price taker in the world markets. To what extent were Argentina's exports price-elastic? Despite the unification of the exchange rate, multiple currency practices existed due to the imposition of export taxes, rebates, and certain restrictions. He was glad that the authorities apparently realized that the restrictions might result in the inefficient allocation of resources, and he strongly supported their intention to dismantle them. He was grateful to the staff for the additional information it had provided concerning certain restrictions of a discriminatory nature. He was also glad to have heard Mr. Teijeiro's statement concerning his authorities' efforts to eliminate those practices fairly soon; like others he would urge the authorities to complete the work at the latest by the time of the May 1983 review.

Commenting on the nonfinancial public sector, Mr. Grosche said that while the planned drastic curtailment of current expenditures and increases in revenue were quite ambitious, they were nevertheless feasible. He had no doubts about the feasibility of the adjustment if, for instance, the tax system were made more appropriate. It was quite inappropriate, for instance, that the current budget plans for 1983 should imply a real increase in the remuneration of public employees by 5 per cent. On the other hand, like Mr. de Vries he welcomed the determination of the authorities to abandon the prevailing system of wage indexation for government employees in the early months of the program and subsequently to fix wage adjustments on the basis of targeted future inflation. A move away from the prevailing scheme would have a positive impact on the remuneration policies of the private sector.

As to the request for a drawing under the compensatory financing facility, Mr. Grosche said that he considered the shortfall temporary and that a balance of payments need had clearly been demonstrated. Like others, however, he had doubts whether the criterion that the shortfall should be largely beyond the control of the authorities was being properly met. Exports had certainly been affected by the disruptions of trade due to hostilities in the South Atlantic, and by the overvaluation of the peso.

The extent of the imbalances in the Argentine economy called for immediate action, Mr. Grosche stated. It was for that reason that he would support the two proposed decisions, although he would have preferred a medium-term program supported by the Fund with a financial arrangement of similar length. Such a program would still be necessary, and he considered the proposed stand-by arrangement merely a bridging operation. He would have difficulties, nevertheless, in supporting possible Fund assistance for a medium-term program, if it turned out that all the criteria in the stand-by arrangement had not been met.

Mr. Tvedt said that he would join Mr. de Maulde in commenting on the speed with which the request by Argentina had been put before the Executive Board. The papers issued in connection with the present meeting had been dated January 10, 11, and 17, 1983. While he could appreciate the need for urgent action, the short time since the papers had been issued had almost prevented his authorities from studying them. A similar comment had been made by an Executive Director during the recent discussion for drawings by Mexico, and the hope had been expressed that only in very exceptional circumstances would the schedule for the distribution of documents not be adhered to. While he would not object to the present discussion, he still felt that Mr. de Maulde's observation had much to commend it.

The economic difficulties facing Argentina were clearly very severe, Mr. Tvedt stated. The staff seemed to have shown fairly conclusively that many of the country's difficulties were of its own making. Inadequate policies and poor policy implementation had clearly made major contributions. The inappropriate exchange rate policy had apparently had wide-ranging effects. Large financial imbalances had developed, and foreign credit had been increasingly relied upon. Argentina's case might indeed be an epitomy of the excess borrowing of recent years. Foreign credit appeared to have been available in more or less unlimited amounts, so that financial imbalances had hardly acted as a constraint on the authorities. Finally, however, the maturity structure of the debt, combined with relatively small exports, had led to a position in which scheduled debt service payments had exceeded 100 per cent of gross export revenue in 1982 and would equal some 90 per cent in 1983. In addition, repayments of principal amounting to roughly one half of the external debt of $36 billion would fall due during 1983. The situation was hardly a testimony to the prudence either of the international commercial banks or of the Argentine authorities; however, it did demonstrate the need for closer surveillance of external debt developments in individual countries, not only for the total amounts involved but also for the maturities.

The performance criteria and the program relating to external borrowing were not only welcome but essential, Mr. Tvedt considered. The fundamental result of the policies followed by the authorities in recent years had been a crisis of confidence both at home and abroad. The rehabilitation effort would take several years and require a great deal of stamina on the part of the policymakers. He agreed with the staff that the program would be difficult to implement; in view of the size of the imbalances in the economy, a medium-term program supported by the Fund would have been the appropriate framework for the requisite adjustment effort.

A heavy burden was being placed on the monetary sector, and the recent initiatives should be welcomed, Mr. Tvedt stated. He realized that maintaining realistic real rates of interest in an environment of very high inflation would be a delicate endeavor; nevertheless, the effort should be made. Some of the mechanisms described were complicated at first sight; he only hoped that they would be workable enough to help bring about the desired results. Nevertheless, he wondered what the rationale was for allowing borrowers of fully indexed loans to choose between seven different price indices, as mentioned in footnote 1 to page 9 of EBS/83/8. He had also been interested to hear a description of the purpose of the reserve requirements imposed on the commercial banks, and of the role envisaged for the banks in the future. Meanwhile, he wondered how important the role of the Central Bank might be in controlling the lending operations of the commercial banks. The maintenance of realistic exchange rates was just as important as the maintenance of appropriate interest rates if the export sector was to be viable. The high rate of inflation seemed to dictate a continuous downward adjustment of the effective exchange rate if real rate distortions were to be avoided.

He fully supported the efforts to improve the public finances, Mr. Tvedt said. However, the administrative apparatus seemed to be less than perfect, as tax evasion was still a serious problem. He wondered whether the situation could hamper the adjustment effort, and whether reduced tax evasion would play an important role in the anticipated improvement of the public finances.

He wished to emphasize the need to reduce the automatic aspects of inflation in Argentina, Mr. Tvedt remarked, particularly the linkage between wages and prices. The modification of the indexation system represented an important first step. Real wages had fluctuated to such an extent that he wondered whether it would not make more sense to contemplate a comprehensive incomes policy package. Such a package could make an important contribution to the continuation of the adjustment effort beyond the immediate program period.

A significant portion of the foreign debt contracted in the period 1980-82 had only served to finance a substantial outflow of private capital, Mr. Tvedt observed. In the circumstances, he wondered whether it would not have been possible to control private capital movements out of the country. The real exchange rate had been much too high and real interest rates too low; in circumstances of a loss of confidence, the two together had clearly stimulated capital flight and produced an insatiable demand for foreign currency. It was essential for the authorities once again to attract capital into the country and, despite any preference for market principles, he would urge the authorities to keep a close watch on capital movements, as the present situation left no room for flexibility. The apparent lack of effort to restrain capital outflows in the years 1980 to 1982 by either direct or indirect means showed a certain recklessness on the part of the authorities.

Commenting on the request for a drawing under the compensatory financing facility, Mr. Tvedt said that, like several speakers before him, he was tempted to doubt whether the shortfall was entirely beyond the control of the authorities. He did agree with Mr. de Vries in suggesting that Executive Directors ought to examine present Fund policies guiding decisions under the compensatory financing facility. Moreover, he would like to hear a further description of the invoicing irregularities referred to by the staff, and of the unrecorded border trade. He wondered whether it was at all possible to quantify those factors or their influence on the calculated shortfall. It was clear that Argentina's problems were serious and deeply entrenched, and that they required urgent action. In the circumstances he supported the proposed decisions, although with some doubts. In so doing, he commended the Managing Director and the staff for the role they had played in putting the program together, and in successfully obtaining the essential cooperation of the international banking community. At the same time, it should be strongly emphasized that the program only represented the first step in what would be a long and arduous process of economic adjustment.

Mr. Alhaimus remarked that the staff papers clearly indicated the extent of the problems confronting Argentina and the urgent need for a stabilization program supported by the Fund.

The most evident feature of economic development in Argentina in the past few decades had been recurring difficulties and continuing inflationary trends, Mr. Alhaimus noted. Several stabilization programs had been introduced to address the circumstances between 1953 and the present. The limited results so far achieved seemed to indicate that the problems were of a structural nature, and that they could not be traced to measures taken by any particular economic team. The staff seemed to be well aware that the deterioration in Argentina's economic and financial position could not be attributed to a single set of factors; and yet the staff had placed a notable emphasis on the policies introduced by the economic team in power during the period July-August 1982. It might therefore be useful if the staff would provide a clear assessment of the impact of the various factors and their relevance to the real problems facing Argentina.

The complexity of the situation was also demonstrated by the difficulties encountered in formulating a clear strategy, Mr. Alhaimus considered. In March 1982, when the Executive Board had discussed the Article IV consultation with Argentina (EBM/82/29 and EBM/82/30), some speakers had regarded the shock approach as probably the most realistic in Argentina's present circumstances and the one most likely to hold out hope for positive results. The staff had indicated that it had become critically important to change the direction of policies in a sharp and decisive fashion. Other Executive Directors, however, had noted that Argentina's economic experience illustrated the risk involved in a shock approach, and emphasized the importance of the development of a consensus to strengthen the chances of success in the implementation of a stabilization program. The underlying theme in the present program was a more restrained approach, and the staff assessment of prospects was rightly cautious. The external environment, on which improvement in the domestic economy depended to a considerable extent, was still far from certain. The length of the program--only 15 months--might not be sufficient to induce the much needed confidence in the durability of public policy, if any policy shift was anticipated in 1984. Demand management was expected to face the inherent difficulty of what a World Bank report called "a highly politicized environment," especially as real wages had already fallen sharply since mid-1980, thus leaving less room for maneuver. Nevertheless, the adjustment program would have to be carried through as the only means of tackling the present crisis, restraining inflation, and restoring confidence in the financial viability of Argentina.

Finally, Mr. Alhaimus raised a point regarding the prospects for the hydrocarbon sector in Argentina. One primary objective of the program was to revive production in specific sectors of the economy, principally the hydrocarbon and export sectors. The staff had also stated that only a modest rise in public investment was foreseen, except in the hydrocarbon sector where there were prospects for turning Argentina from a net importer into a net exporter. However, according to SM/83/12, although Argentina enjoyed ample natural gas reserves, its proven oil reserves were very limited. It might be worthwhile for the staff to indicate whether the prospective investments were to be confined to oil, or whether they were also to cover seasonal natural gas exports to neighboring countries. It had been indicated in EBM/82/30 that such exports were intended only to address the problem of seasonal fluctuations in Argentina's gas consumption.

Mr. Wang remarked that the adjustment program submitted by Argentina in support of the 15-month stand-by arrangement with the Fund had been drawn up at a time when the Argentine economy had been facing severe economic difficulties and suffering from acute imbalances. The authorities of Argentina were to be commended for their determination to undertake such an adjustment program. Although the targets and performance criteria set out in the program and stand-by arrangement were challenging, and the implementation of the program would not be easy, he had no difficulty in agreeing with the staff that the program was appropriate for Argentina in the present circumstances, and that it merited the full support of the Fund. He could also support the request for a purchase by Argentina under the decision on the compensatory financing of export fluctuations.

Mr. Yamashita stated that he agreed with the staff and certain Executive Directors that, in view of the size of the imbalances facing the Argentine economy, a medium-term program supported by the Fund with a financial arrangement of equal length would have been the appropriate framework. However, because of the limited political horizon of the present Administration it had not been possible to take that course. He could endorse the staff view that the proposed program was appropriate to Argentina in present circumstances. Nevertheless, the program would certainly be difficult to implement in both the domestic and the external sectors. He therefore welcomed the authorities' intention to consult with the Fund about the progress made in implementing the program and in making any policy changes that might be appropriate in attaining the objectives. Such close consultations between the authorities and the Fund would be an integral element of the program, which was designed to bring about a rapid change in the country's economic policy.

Commenting on certain specific points in the program, Mr. Yamashita noted that the aim to reduce the public sector deficit from over 14 per cent of GDP in 1981 and 1982 to no more than 8 per cent in 1983 and 5 per cent in the first quarter of 1984 would involve a major effort. He hoped that the authorities would show determination and perseverance in containing the growth of government outlays, so that the reduction in the public sector deficit would be brought about as planned. Regarding the remonetization of the economy, he agreed with the staff and with certain Executive Directors that it was essential that interest rates should be set sufficiently high to halt the acceleration in the income velocity of money, and to provide for growth in domestic financial savings. It seemed to him that if interest rates were based on a three-month moving average of past and projected inflation, they could remain negative in real terms and that the authorities might find it necessary to raise interest rates above the levels determined by the formula. If such circumstances arose, there should be consultations between the authorities and the Fund. Moreover, he would be interested to know whether there was any specific reason for using the rate of increase in wholesale prices rather than that in consumer prices as a way of measuring inflation. He would support both the decision on the stand-by arrangement and that on the request for a purchase under the compensatory financing facility, although he shared many of the doubts put forward by previous speakers.

Mr. Prowse commented that the Argentine request represented a very difficult case; he was glad that the authorities, staff, and management had reached common ground on what seemed to be an appropriate short-term package. He regretted that, like others, he had been unable to do full justice to the papers prepared by the staff. In any event, he supported both the proposed stand-by arrangement and the purchase under the compensatory financing facility. Confronted by pervasive and overwhelming deterioration in the performance of the economy, the Argentine authorities had shown great courage in initiating a program that the staff hoped would begin the process of recovery and readjustment. While the program was far from theoretically ideal, it seemed to reflect all that was feasible. Some speakers had said that a three-year program would have been reasonable, although acknowledging the reasons why it had not been sought. However, under the shorter program there might be the advantage that both sides would focus on the ongoing situation.

Recalling the 1981 Article IV consultation with Argentina (EBM/83/29 and EBM/82/30) Mr. Prowse noted that a number of Executive Directors had suggested that a shock approach would be the one most likely to hold out hope of positive results. It was true that others had noted that the economic experience of Argentina had implied risks and emphasized the need to develop a consensus. On a purely theoretical basis, it would be interesting to consider whether a shock approach would have had more success than the more gradual approach. In other words, what lessons would the Fund derive from the experience of Argentina during 1982? He would have liked to see a program that sought a higher rate of adjustment. It was not very useful for the Executive Board to say that the program that it was approving was likely to produce results only slowly and perhaps assist the Argentine authorities in beginning the process of reversal. Were it to do any less, it would be difficult to support the program.

Clearly, management, staff, and the authorities had had a difficult task in deciding what was feasible in the circumstances, Mr. Prowse continued. His own conclusion was that at present a lengthy period of steady policies was needed. He took that line in particular because a central theme that emerged from reading the staff proposals was the need to restore private sector confidence. On page 32 of EBS/83/8, the staff had said that "private entrepreneurs appear (with some reason) to be frustrated and disoriented by the frequent and abrupt changes in Argentina's economic strategies...." He therefore wondered whether there was sufficient substance in the program to convince private entrepreneurs to begin repatriating capital and resuming productive investment. Perhaps in the present circumstances few options were available to the authorities. Nevertheless, Executive Directors would be optimistic to regard the program as anything more than a stopgap. As such, he was satisfied that 15 months was a reasonable period; it would enable both the authorities and the Fund to agree on a longer-term program earlier than would have been the case if the authorities had undertaken a three-year program.

Commenting on specific points in the program, Mr. Prowse endorsed Mr. Casey's remarks regarding the tax structure, and expressed concern with the heavy reliance on export taxes. He wondered whether the staff had a view on how far those taxes would provide a drag on the recovery of export earnings.

He agreed with the staff that one of the main ways in which the authorities could reduce both deficits and inflation was to abandon wage indexation for government employees, Mr. Prowse observed. In those circumstances, he wondered why the authorities had planned a real increase in the remuneration of public sector employees amounting to 5 per cent in 1983, and how the increase could be implemented without at least implicit indexation. Within the compass of a comparatively short program, the authorities ought to be aiming at less indexation in the economy rather than more. He would not wish the Fund to be seen to be giving even implicit support to the idea of indexing taxation, and particularly income tax.

On the external side, Mr. Prowse welcomed Mr. Teijeiro's statement about the intention of the Argentine authorities to eliminate the present discriminatory restrictions on current and capital movements. On a slightly different point, he had noted that the program had laid down a $2 billion ceiling on net external borrowing for the public sector, but had not indicated a ceiling on private borrowing. He could understand that it was possible to take the view that the more private borrowing abroad, the better it would be even if it added to the external debt burden. It would be interesting to hear the staff view on that point.

As to the purchase under the compensatory financing facility, Mr. Prowse said that he would certainly support it and that he had only one question regarding the forecasting of sugar prices. He understood that it was extremely difficult to forecast such prices, but he would be interested to know what had led the staff to revise the estimates of unit values for sugar. When the Executive Board had discussed a request by Brazil for a purchase under the compensatory financing facility, the staff had said that it expected sugar prices to rise from an index of 104 in 1983 to 132 in 1984. Nevertheless, for Argentina the staff expected that the index would do no more than rise from 89 at the end of 1983 to 107 in 1984. If the figures were correct, it would be interesting to know what the effect on the calculated shortfall for Argentina would be if the projections adopted for Brazil had been maintained for Argentina.

Mr. Malhotra commented that the situation confronting Argentina was difficult and complex. He could therefore understand the staff observation that it was not easy to select the right mix of policies or to determine the time frame within which various targets could be achieved. However, considering that Argentina had for some years been facing declining output, an increasingly difficult debt service problem, and a decline in investment brought on partly by external events but also by domestic policies, a strong adjustment program could hardly be avoided. The mix of policies suggested in the program appeared to be broadly along right lines. The program was a comprehensive one involving reduction in the overall deficit in the nonfinancial public sector from about 14 per cent of GDP in 1981 to 8 per cent in 1983 and 5 per cent in the first quarter of 1984; and a reversal in the trend of public sector savings from minus 5 per cent in 1982 to plus 3.5 per cent in the first quarter of 1984. The authorities also expected to bring about substantial moderation in the rate of inflation and major improvement in the balance of payments.

While all those objectives were desirable, Mr. Malhotra observed, he shared with Mr. de Groote some skepticism as to whether they could be attained in the short period of the stand-by arrangement. He indeed had speculated whether a somewhat less ambitious program might not have been more advisable, if only because it was doubtful whether the broad consensus, without which the proposed adjustment program could not be fully implemented, had materialized. An extended arrangement covering three years would have been more appropriate than a 15-month program. Accepting that at present a longer program was not feasible, he hoped that the one submitted by the staff would broadly achieve its object, thereby enabling the Fund to enter an extended arrangement with the Argentina authorities. It seemed unlikely that the economy would recover unless the adopted policies were pursued over a long period of time.

The key to any solution lay in controlling inflation, Mr. Malhotra considered. Unless the public believed that the rate of inflation would be brought down, the authorities would have great difficulty in controlling interest rates, exchange rates, or wage increases. He hoped that the various targets with regard to monetary growth and reduction of the overall deficit had been so designed that the desired decline in the rate of inflation would be achieved. If not, it might be difficult to make the program effective.

He noted with satisfaction the statement by Mr. Teijeiro that the Argentine authorities were committed to a progressive reduction of export restrictions, and in particular to the elimination of discriminatory restrictions very shortly, Mr. Malhotra mentioned.

Apart from complimenting the Managing Director for having arranged the program, Mr. Malhotra said that he was glad to note the parallel action taken by the management to consult with the commercial banking community on the debt position of Argentina. Such consultations would have to continue for a considerable time until effective improvement materialized. Argentina was a country with great potential and high endowments; with the right mix of policies pursued over a period of time the economy was likely to respond, resulting in a higher rate of growth and a generally more satisfactory economic performance.

Mr. Salehkhou complimented the Managing Director for the positive role he had played in helping the Argentine authorities; he could support the requests for both a purchase under the compensatory financing facility and for a stand-by arrangement.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/16 (1/21/83) and EBM/83/17 (1/24/83).

2. MAURITANIA - 1982 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/83/22 (1/19/83). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1982 Article IV consultation with Mauritania until not later than March 16, 1983.

Decision No. 7310-(83/17), adopted
January 21, 1983

3. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/83/26 (1/19/83).

Adopted January 21, 1983

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/28 (1/20/83) and EBAP/83/30 (1/21/83) is approved.

APPROVED: June 30, 1983

LEO VAN HOUTVEN
Secretary