FOR AGENDA

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EBS/90/90

CONFIDENTIAL

May 14, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Review and Modification of Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the review and modification of the stand-by arrangement for Argentina. Draft decisions appear on pages 28-33.

It is understood that the Executive Director for Argentina will be requesting the Board for a waiver of the circulation period, to enable this subject to be brought to the agenda for discussion on Friday, May 25, 1990.

Mr. Linde (ext. 8500) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

ARGENTINA

Staff Report for the Review and Modification of Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, Research, and Treasurer's Departments)

Approved by S. T. Beza and Eduard Brau

May 14, 1990

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I. Introduction

On November 10, 1989 the Executive Board approved a stand-by arrangement for Argentina through March 31, 1991 (EBS/89/199) in the amount of SDR 1,104 million or 99.2 percent of quota (70 percent on an annual basis). The first purchase in the amount of SDR 184 million was made upon the arrangement's entry into effect.

During the fourth quarter of 1989 there were slippages in policy implementation, and most of the program's performance criteria for end-December 1989 were missed by wide margins (Table 1). During January-April 1990, discussions were held between the Argentine authorities and the staff in Buenos Aires and in Washington to review the program and to discuss the measures the authorities have taken to put the adjustment effort back on track. 1/ In a letter to the Managing Director dated May 10 (and in the accompanying policy memorandum), the authorities request a modification of the November 1989 stand-by arrangement under which the February 1990 purchase would not be available. This would imply a reduction in access to SDR 920 million or 82.7 percent of quota (58.4 percent on an annual basis). Subsequent purchases would be made in four equal quarterly installments as called for under the schedule approved in November, with the first to be available upon completion of this review.

In the Memorandum on Economic Policy accompanying their letter to the Managing Director, the Argentine authorities also describe their external financing strategy, which has as its aim the achievement of sustained economic growth over the medium-term with a satisfactory balance of payments. In support of this strategy, they have requested that an amount equivalent to 25 percent of each of the final three purchases available under the arrangement be set aside to support debt and debt service reduction operations. Given the urgency of rebuilding reserves and the preliminary stage of negotiations with commercial banks, the authorities do not request a set-aside from the purchase that would become available upon completion of the present review. The right to draw on the set-asides from later purchases would accrue subject to observance of the performance criteria under the arrangement, and the disbursements would be conditional upon the completion by the Fund of a review pertaining to such debt reduction operations as may be agreed between Argentina and its commercial bank creditors.

1/ The mission, which visited Buenos Aires from February 9 to March 23, comprised Messrs. A. Linde (WHD), L. Kenward (WHD), G. Mackenzie (FAD), Ms. C. Atkinson (ETR), and Mrs. E. Frolia (Assistant-WHD). Mr. M. Figuerola, the resident representative in Argentina, assisted the mission. Mr. E. Feldman, Executive Director for Argentina, participated in the policy discussions.

On March 31, 1990 total Fund credit outstanding to Argentina, including under the compensatory financing facility, stood at SDR 2,178.9 million or 195.7 percent of quota. Assuming that purchases and repurchases are made as scheduled, Fund credit outstanding to Argentina at end-March 1991 would be SDR 2,385.2 million or 214.3 percent of quota (Table 2).

II. Background

1. Developments since mid-1989 and performance under the stand-by arrangement

a. Developments in the second half of 1989

The administration that assumed office on July 9, 1989 immediately launched a broadly-based program aimed at dealing with hyperinflation and the external payments crisis. The authorities took strong measures to reset relative prices, including a major adjustment in public sector prices to strengthen the fiscal accounts. In addition, the Government reached an agreement with leading firms aimed at moderating increases in prices and wages. Concurrently, the Government framed a medium-term strategy that placed heavy emphasis upon structural reforms to ensure a durable solution to the nation's economic problems. Most notable among the structural reforms were: a major tax reform and overhaul of the tax collecting agencies; an opening of the economy to foreign competition; a plan for privatization of public enterprises; and reform of the financial system, including the role of the official banks.

Consistent with this policy strategy, the authorities designed an economic program for the period through the end of 1990 which was supported by a stand-by arrangement. The program aimed at reducing inflation to international levels by the end of 1990 based on a major improvement in the public finances. The primary balance of the public sector was to shift from a small deficit in 1989 to a surplus equivalent to 6 percent of GDP in 1990. Domestic financing of the nonfinancial public sector would be curtailed substantially in the last quarter of 1989, and would be completely eliminated in 1990. The monetary and credit program was based on a conservative estimate of the demand for money, including only moderate remonetization of the economy as inflation declined. On the external side, there would be a large reduction in the overall balance of payments deficit (from US$3.1 billion in 1989 to US$560 million in 1990), with provision for a buildup in official reserves. The program envisaged growth of real GDP of 4 1/2 percent in 1990 following a decline in 1989.

The authorities' program recorded several early successes. Consumer price inflation, which peaked at a monthly rate of almost 200 percent in July 1989, dropped to 6 percent a month in October-November, while economic activity staged a sharp recovery. There was a marked improvement in the treasury accounts through November, and there were large inflows of private capital that helped rebuild official foreign reserves by some US$1 3/4 billion by the end of September. In addition, progress was made in restoring relations with external creditors; arrears to multilateral institutions were eliminated and an agreement was reached in late December with Paris Club creditors. In the area of structural reform, important steps were taken to liberalize the external trade system; a start was made in the process of privatization; and a framework was adopted for deregulation of the petroleum sector.

However, there were important slippages in policy implementation that raised doubts about the durability of the program. There were delays in the drafting and passage of the tax reform legislation, and the program of privatization proceeded more slowly and less firmly than had been intended. Credit policy did not follow a sufficiently steady course and on balance interest rates were not high enough to avoid net redemptions of central bank paper, which resulted in a substantial injection of liquidity into the banking system, especially during November and December. In addition, the improved state of the economy contributed to large wage increases in the private sector and in the public enterprises.

These slippages were reflected in the re-emergence of a spread between the official and parallel exchange rates in late October. In the period October 30-November 7, the authorities attempted to deal with the problem through exchange market intervention, which resulted in the loss of roughly US$560 million in reserves. As the exchange rate spread continued to widen, the authorities opted for stronger fiscal action in the form of an emergency revenue package announced on November 15, but markets reacted with skepticism to the announcement indicating doubts about the adequacy of the efforts to deal with the fiscal problem. A crisis of confidence developed with a run on the currency. The exchange rate spread widened from under 30 percent just prior to the announcement of the mid-November package to well over 50 percent within several days, and the Central Bank was forced to sell substantial amounts of foreign exchange (approximately US$300 million between November 16 and December 7) to maintain the official fixed exchange rate.

On December 11, a new set of measures was announced in an attempt to bring the situation under control. These included a 35 percent devaluation of the austral (to ₳ 1,010 per U.S. dollar from ₳ 655 per U.S. dollar) and the establishment of a free exchange market for capital and certain current service transactions; an average increase of 65 percent in public sector prices; and a lump-sum wage award to civil servants equivalent to a 20 percent salary increase, with smaller increases for employees of the public enterprises and the private sector. The package also included an increase in export taxes, a reduction in import duties, and a rescheduling for a two-year period of principal payments on domestic debt.

The announcement of the measures did not restore calm to financial markets. The measures were interpreted by markets as a compromise solution that did not offer sufficient assurance that the fiscal situation would be resolved promptly. A spread of close to 50 percent between the official and parallel exchange rates developed again, and consumer prices jumped by more than 25 percent in the second week of December. Further measures were taken on December 18, including unification of the foreign exchange market under a freely floating system to protect the remaining official reserves of the Central Bank. Another wage increase (roughly two thirds as large as the award of the previous week) was granted to all employees, and the earlier decision to increase export taxes was rescinded, while an accelerated schedule to reduce existing taxes was announced. However, no additional revenue measures were included in the package and it was announced that public sector tariffs would be held at existing levels. Around the same time the value-added tax legislation--which was to be the centerpiece of the tax reform--was approved by Congress, but the planned extension of the base of the tax to cover most private sector services was postponed until separate legislation covering services could be submitted to Congress.

The announcement of December 18 stabilized the exchange market for only a few days, but interest rates rose sharply. During the final days of 1989 the financial situation deteriorated rapidly: flight from the currency caused the austral to depreciate from approximately ₳ 1,300 per U.S. dollar on December 22 to ₳ 2,400 per U.S. dollar on December 28; there were runs on commercial banks; consumer prices rose by a total of 90 percent during the last three weeks of December; and soaring interest rates were giving rise to large quasi-fiscal deficits of the Central Bank.

With the sharp acceleration of inflation in December, all targets in australes for the program were exceeded by a wide margin (see Table 1). Inflation in December eroded the value of tax revenues that are collected with a lag, and the run-up in interest rates at year-end added significantly to the cost of servicing domestic debt. In addition, delays in the implementation of tax reform held down revenues relative to amounts that had been programmed under the November arrangement.

During the fourth quarter of 1989, the net domestic assets of the Central Bank increased by substantially more than had been programmed in November. An important factor in this regard was a shift in November from net placements to net redemptions of Central Bank paper (CEDEPS), which resulted in large injections of liquidity into the financial system that continued through December, by which time the entire stock of CEDEPS had matured. Cash losses of the Central Bank, rediscounts to financial institutions and financing extended to the social security system also contributed importantly to the rise in net domestic assets late in the quarter.

On the external side, there was considerable underperformance as regards the change in net international reserves of the monetary authorities. During the fourth quarter of 1989 net international reserves declined by almost US$2 billion, exceeding the programmed decline by more than US$1 billion, mainly reflecting the effort, described above, to maintain the official exchange rate in the face of deteriorating confidence in the currency. External payments arrears (other than those on certain commercial bank debts) increased to US$498 million instead of declining to US$200 million as had been envisaged. The targets for both outstanding external debt and for net disbursements of short-term debt were met.

b. Developments to date in 1990

The sharp rise in interest rates in late 1989 led to large quasi-fiscal deficits of the Central Bank financed by money creation. To remove the domestic quasi-fiscal deficit as a source of uncontrolled monetary expansion, on January 1, 1990 the authorities decreed that all austral-denominated bonds and term deposits in the banking system would be unilaterally converted into ten-year U.S. dollar-denominated Government bonds at LIBOR (see Section III.3. below). To carry out this exchange, banks were to acquire the dollar-denominated bonds from the Central Bank by using their remunerated deposits at the Central Bank; in practice, the domestic quasi-fiscal deficit was wiped out by transferring the liabilities of the Central Bank to the Treasury. While this measure reduced interest payments on domestic debt and halted the creation of monetary liabilities to finance the quasi-fiscal deficit, the operation effectively limited future access by the Government to noninflationary domestic financing, at least until confidence in financial assets denominated in local currency could be restored.

Economic developments in January and February reflected the interplay of tighter financial policies and reaction to the January 1 debt conversion operation. Some improvement was achieved in the fiscal accounts early in 1990 as the public sector was able to run a modest primary surplus in January and February, owing in part to the emergency revenue measures of late 1989 and to the adjustment of public sector tariffs by some 92 percent in February. At the same time, the Central Bank maintained a tight control over rediscounts and enforced strictly the legal reserve requirements. The result was that interbank interest rates rose steeply through February, reaching a monthly rate in excess of 1,000 percent for seven-day terms in early March.

Notwithstanding this tightening of financial policies, the public sought to reduce its holdings of australes, underscoring the fragility of confidence in austral-denominated assets in the aftermath of the compulsory debt conversion at year-end. After an initial appreciation in early January, the austral fell in exchange markets during most of January and then dropped precipitously during February. By the end of February, the exchange rate had moved to almost ₳ 6,000 per U.S. dollar compared with ₳ 1,300 per U.S. dollar immediately following the debt conversion measure of January 1; prices were again rising very rapidly and economic activity was contracting.

The authorities acted to strengthen their fiscal effort in a major way with the introduction on March 6 of a comprehensive package of measures. The package emphasized expenditure restraint, but it also included a number of revenue measures and other important steps described in Section III.2. below. In subsequent weeks, this package was reinforced by further tariff increases in the public enterprises, by an additional tax on fuel, and by an average increase of around 5 percentage points on all import tariffs, excluding the maximum rate of 24 percent.

A result of this strengthened policy stance was a striking turnaround in confidence beginning in early March. The value of the austral rose by some 10 percent and interest rates dropped during the week following release of the March 6 measures and the austral's strength has been broadly sustained through early May. The Central Bank took advantage of this strength of the austral to rebuild official reserves; purchases of foreign exchange by the Central Bank in the private market during March and April exceeded US$1 billion compared with only US$5 million for the month of February. Also, inflation came down markedly from over 115 percent during February (62 percent on average for the month) to 55 percent during March (96 percent on average) and to some 13 percent during April (11 1/2 percent on average).

III. Revised Program

1. Overview of program

The difficult circumstances that prevailed at the end of 1989 and in the early months of 1990 have led to a revision of the economic targets for 1990, but the principal objectives for the remainder of 1990 remain unchanged from the original program--namely, a rapid improvement in the public sector's position aimed at reducing inflation rapidly, to 2 percent a month in the second half of 1990, and achieving a buildup in international reserves while facilitating progress toward the restoration of relations with external creditors. As inflation declines and the financial situation stabilizes, economic activity is expected to recover beginning around midyear; the projection is that real output would record a small decline in 1990 compared with a drop of 3 1/2 percent in 1989 (Table 3). Similarly, the medium-term policy goals remain unchanged from the original program--ensuring a durable improvement in the public finances by making the tax system more broadly based, by improving tax administration, and by reducing the size of the public sector; increasing the economy's overall efficiency by restricting the scope of the operations of the public sector; liberalizing external trade and payments; and reforming the financial system.

2. Fiscal policy

In setting targets for the public sector's financial balance for the last three quarters of 1990, the authorities have assumed that no domestic financing will be available in the aftermath of the debt conversion operation at year-end. The limited amount of external financing available, the targeted increase in international reserves, and the heavy interest obligations of the public sector point to the need for a substantial primary surplus. The program envisages a primary surplus of the nonfinancial sector of 7 percent for the last nine months of 1990. Even a surplus of this size, which is larger than the surplus of the original program for this period, would not permit the servicing of all external debt unless additional financing on suitable terms was forthcoming (Table 4). For the year as a whole, the target for the primary surplus is now 5.6 percent of GDP, compared with 6.1 percent under the original program. Many of the additional fiscal measures taken by the Government to achieve this target were included in Omnibus Decree 435, which was promulgated on March 6, 1990 and was accompanied by a substantial adjustment in public sector tariffs. Further measures were announced in the following two months, including an additional adjustment to public sector tariffs.

Fiscal policy currently emphasizes expenditure control to a greater extent than under the original program although growth in revenue still accounts for the bulk of the planned improvement in the primary balance. The projected increase in the primary balance from a small deficit in 1989 to a surplus of 5.6 percent of GDP for the whole of 1990 is to be achieved through an increase in revenues of 4.7 percentage points of GDP and a reduction in expenditure of 1.2 percentage points (Table 5). Despite a number of new revenue measures adopted in March-May 1990, tax revenues are now projected to average 20.4 percent of GDP in the last three quarters of 1990 compared with 22.5 percent under the original program. The reduction in the revenue target results mainly from the impact of higher than programmed inflation in the second quarter of 1990, and a downward revision of the revenue yield of the tax reform.

With regard to structural reforms, in addition to the progress made in tax reform and privatization, measures have been taken that address the problems of overstaffing in the public sector and weaknesses in the financial performance of the public enterprises.

a. <u>Measures that address the budgetary imbalances</u>

The targeted increase in public sector revenues is to result mainly from an increase in taxes, although efforts to improve the financial position of the public enterprises and the cash receipts from the program of privatization and divestiture also will contribute. The tax effort is increased substantially (4 percentage points of GDP) as a result of the tax reform legislation of December 1989, which is to be supported by measures to improve tax administration and increase taxpayer compliance, as well as by a series of revenue-raising measures taken in the March-May period. The programmed abatement of inflation also will contribute to the increase in the tax effort by reducing the erosive effect of inflation on the real value of taxes collected with a lag.

The major achievement of the tax reform legislation of December 1989, described more fully below, was the broadening of the base of the value-added tax to include virtually all goods. Additional legislation was submitted to Congress in May that will extend the value-added tax to most private sector services. This expansion of the base will offset the impact of a decline in the general rate from 15 percent to 13 percent, and with the support of concrete administrative measures it should result in a substantial increase in the yield of the tax. The authorities plan to concentrate their administrative efforts on the value-added tax, and they will seek to increase the effectiveness of sanctions for tax evasion and fraud.

The VAT legislation and efforts to improve tax administration have been complemented by a series of additional revenue-raising measures. On March 6, the tax on company net worth was increased from 1.5 percent to 3 percent for the most recent tax year ending before December 31, 1990, and the ad valorem taxes on most agricultural and agro-industrial exports were increased by an average of 5 percentage points. In addition, the exemption from the VAT of suppliers of firms benefiting from the industrial promotion scheme, which was subject to substantial abuse, was eliminated, and temporary measures were announced to reduce the collection lag for excises and to index the value-added tax during the interval between its due date and the payment date. This last measure can be withdrawn once inflation has declined to close to international levels. Taxation of petroleum products was increased significantly by two adjustments on April 10 and May 8, as a result of which the price of a liter of high-octane gasoline rose from less than 25 U.S. cents in February to about 52 cents in May. Finally, at the beginning of May the minimum rate of duty on imports was raised from 0 to 5 percent, and other rates below the maximum rate were increased by 2 to 5 percentage points.

The targeted reduction in expenditure is to be achieved by highly restrictive limits on all expenditure categories. In respect of wages and salaries, which account for about 60 percent of expenditures on goods and services by the National Administration, the Omnibus Decree of March 6 implemented a freeze on the filling of vacancies and on promotions, and disallowed overtime and the holding of more than one position in the public sector. Through these measures and a conservative policy of general salary adjustments, the real value of the Government's salary bill is to be held close to its March 1990 level, which is at a recent historical low (see upper panel of Chart). A restrictive limit also has been established for expenditure on other current goods and services, and for capital expenditures. To help assure needed restraint over spending, Decree 435 included a temporary suspension of the contracting process, which is to be maintained until new procurement procedures are established.

Efforts are also being made to control expenditures of the provinces, whose importance is reflected in the large share of transfers to them in the expenditure of the National Administration. Most of these transfers are determined by the revenue sharing arrangement adopted in 1988, under which a fixed proportion (57.6 percent) of the revenue from most domestic taxes collected by the National Government is automatically transferred to the provinces. Consequently, transfers to the provinces will tend to rise in line with the projected increase in tax revenues noted above. To limit the degree to which these higher revenues to the provinces are used as a basis for new spending initiatives, the Government intends to reduce transfers to the provinces by the amounts they owe to the National Administration. In addition, the Government has used its discretionary power to reduce transfers to the provinces through the special accounts used to finance road and housing construction, which receive revenue from earmarked taxes in the energy sector, and is transferring responsibility for expenditure programs in secondary education to the provinces with effect from July 1, 1990.

b. Structural aspects of fiscal policy

The major achievement of the tax reform legislation of December 1989 was the broadening of the base of the value-added tax to include virtually all goods. Although the rate to be charged on the broader base was somewhat lower than had been originally envisaged (13 percent versus 15 percent), the legislation eliminated the preferential rate applying to construction and added a clause that allowed the Executive Branch to change the tax rate by up to 20 percent (that is, up to a maximum of 15.6 percent) without Congressional approval. The generalization of the base of the value-added tax is expected to be completed soon with the passage of additional legislation which will extend the tax to include most private sector services. The broadening of the base of the VAT is expected to increase the buoyancy of the tax in future years, provided that it is reinforced by improvements in the administration of the VAT.

The tax reform legislation also created a new tax on business assets, and eliminated the taxes on company net worth, personal wealth, and capital gains, all of which were administratively costly and low-yielding. In addition, the tax reform legislation made a number of changes to the personal and corporate tax laws, among other modifications to the tax code. 1/

The Government's efforts to improve tax administration are now centered on the value-added tax, which is expected to become a more important source of revenue than has been the case in recent years. All registered value-added taxpayers are now required to file monthly returns, and the administration of the tax is to become fully automated to handle the extra volume of returns. Payment can now be made through the banks, and it is planned to have the banks process the returns as well. Work continues on the establishment of an automated file that can

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1/ Appendix V presents a brief summary of the main changes to the tax code as a result of the legislation of December 1989.

be used to identify promptly nonfiling taxpayers. Also, the General Tax Directorate has started to impose the penalty of closure of the business premises of taxpayers who fail to file a return or to issue invoices to their customers when required to do so. Because the application of this penalty can be delayed by taxpayers who avail themselves of their right of appeal, legislation is being prepared to reduce the period between the time a taxpayer receives notification of delinquency and the closure of the premises. In addition, the new penal code for tax offenses passed in February 1990 imposes stiff penalties for tax evasion and should strengthen the hand of the Government in dealing with tax crime by reducing the burden of proof to be established before proceeding with criminal prosecution. It should be noted, however, that this legislation has yet to be tested in the courts.

The issue of overstaffing, which is generally recognized as a fundamental problem in the Argentine public sector, is addressed by Decree 435 through a number of measures designed to reduce the size of the civil service and the number of employees in the public enterprises. First, all staff within two years or already beyond the statutory retirement age are required to retire in the current year, and some 70,000 employees of the National Administration were retired as of May 1. Secondly, the organizational structure of the civil service has been revamped by the elimination of most of the positions of secretary and a reduction in the number of subsecretariats. By the end of 1990, total staffing reductions are expected to amount to 10 percent of employment in the National Administration and public sector enterprises. Further reductions are to take place in 1991. 1/ Although the impact of these measures on the public finances in the current year will be mostly offset by the increases in retirement and severance pay, substantial savings are expected in the years ahead.

In the past few months, the Government's program of privatization has regained momentum. Tenders for the exploration and operating rights to some 40 secondary areas (currently under the control of the national oil company) were solicited in February, with the bids to be opened in June and sales to be concluded by September 1990. Tenders for the sale of the national airline and the telephone company were solicited in March, but deadlines for submission of bids have been extended to give the authorities time to obtain certain waivers from their commercial

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1/ These measures do not affect employment at the provinces, which is estimated at over 900,000, compared with some 700,000 in the National Administration and 300,000 in the public sector enterprises. The provinces' efforts to reduce employment are being supported by technical assistance from the World Bank.

bank creditors. 1/ The sales are expected to proceed once waivers are obtained. The national shipping company is shortly to sell most of its fleet and lease newer and more efficient vessels, while the railway is to sell some of its lines or transfer them to local governments.

In other areas, the Government has recently established an agency to be responsible for the liquidation of physical assets of the public sector, including buildings acquired by the Central Bank as a result of the liquidation of certain financial institutions in recent years. Furthermore, the Government has started taking bids from the private sector for maintenance programs on sections of the nation's highway system and the public utilities have solicited bids from the private sector for their billing and metering functions. In total, the Government's privatization program and asset sales are expected to realize cash proceeds equal to about 1.2 percent of annual GDP, with most of this amount being realized in the second half of 1990.

In both 1988 and 1989, the nonfinancial public enterprise sector ran a primary deficit of over 1 percent of GDP (Table 6). The Government's current policy is to improve that sector's performance through measures that yield cost reductions and by setting enterprises' tariffs at levels well above their average for 1988-1989 in real terms. Accordingly, average tariffs were increased by 166 percent in nominal terms in two steps in March and April, bringing their level in real terms to roughly 9 percent above their average for 1988-89. Current policy is to maintain this level by means of timely adjustments.

To foster cost reductions, the Government has started to modify the framework for the control and supervision of the public enterprises by transferring the responsibility for this function to the Ministry of Economy. Comptrollers responsible to the Ministry have been appointed in each of the enterprises to supervise their treasury, personnel, and purchasing departments. To increase the incentives for cost reductions, all enterprises (except the Post Office) are now required to pay a tax of 5 percent on their gross sales. An additional 3 percent of the sales of the utility companies, which is to be credited to the accounts of the Treasury at the time consumers pay their utility bills through the banking system, will be applied against the enterprises' outstanding tax liabilities. Finally, a limit has been set on the Treasury's transfers to the enterprises, and capital expenditure is to be severely restrained.

The increase that had been projected in the November program for real benefits paid by the Social Security system did not materialize in the first quarter of 1990 owing to the acceleration in inflation, which lowered the real value of both revenues and the ratio of pensions to

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1/ Such waivers are necessary to allow the sales of these two enterprises to proceed without constituting an Event of Default under the umbrella agreement that governs all the separate agreements between the commercial banks and the public enterprises.

average wages. However, in view of the drop in inflation experienced in April 1990 and the further decline programmed for subsequent months, the real value of the system's revenues are expected to recover, at which time it should be possible to increase the real value of the average pension while strengthening the finances of the system.

In addition to the difficulties caused by high and variable inflation, the Social Security system faces a number of administrative and structural problems, most notably the high cost of the regime for the self-employed--which results mainly from a low contribution rate--and a high rate of evasion. The recently established National Institute for Social Services (INPS), which is a tripartite organization with directors representing the public sector, employees, and pensioners, is expected to take steps to improve the administration of the system. In particular, the new organization will have the power to institute legal proceedings against public sector entities in arrears in their remittances of contributions. To improve the long-run financial position of the regime for the self-employed, the Government is considering a proposal that would entail partial--if not full--privatization of that regime; the proposal also would increase the ratio of contributions to benefits.

3. <u>Monetary and credit policies</u>

As was noted above, on January 1, 1990 the authorities announced the forced conversion of the domestic debt of the Government and austral-denominated time deposits (which were generally of one-week maturity) into ten-year government securities denominated in U.S. dollars (BONEX) at LIBOR. 1/ As indicated in the policy memorandum of May 10, this action was taken to eliminate the quasi-fiscal deficit of the Central Bank as a source of monetary expansion. The authorities believe that the debt conversion operation also will lead to a major

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1/ As a result of their short maturity structure, time deposits had paid rates of interest that reflected current rates of inflation. Remunerated deposits of the commercial banks at the Central Bank, which were a major source of financing for the Government, paid interest rates that were tightly linked to rates paid on these time deposits. Viewed from the perspective of a financial balance sheet, the commercial banks wrote down reserves assets with the Central Bank and time deposits were eliminated on the side of liabilities. On the Central Bank's balance sheet, there was a decline in reserve liabilities to commercial banks (which paid market-related interest rates) accompanied by a drop in holdings of government debt (on which the Central Bank earned little interest) on the assets side. These measures were effective retroactively to December 28, 1989 at an accounting exchange rate of ₳ 1,800 per U.S. dollar. As part of the exchange, certain austral-denominated bonds (BICs and BOCEs) were offered in exchange for domestic debt of the Government and for any excess of banks' remunerated deposits at the Central Bank in relation to their time deposit liabilities.

restructuring of the financial system under which commercial banks will be forced to become more cost effective and to reduce their reliance upon credit from the Central Bank. To ensure that the restructuring occurs in an orderly fashion, the Government has indicated it will strengthen the supervisory powers of the Central Bank.

In support of the objective of reducing commercial banks' reliance upon central bank credit, in January 1990 the Central Bank undertook a policy of aggressively collecting outstanding rediscounts while enforcing legal reserve requirements in a strict fashion. As a result, there was a net decline in outstanding rediscounts during the first two months of 1990 that amounted to almost one-tenth of base money in December 1989. Moreover, on March 6 the Minister of Economy took steps to ensure that financial entities would repay remaining debts to the Central Bank by September 30, 1990. This policy is being enforced and payments are being received.

Monetary developments during the first quarter of 1990 reflected the interaction of the restrictive stance of monetary policy and the flight from the austral in the wake of the debt conversion operation. During this period the growth rates of the monetary aggregates measured in real terms were negative--average monthly declines of 22 percent and 34 percent were recorded for M-1 and M-2, respectively. At the same time, interest rates rose dramatically, reaching a peak in excess of 1,000 percent a month for one-week money in the interbank market in early March. During most of the first quarter interest rates were at very high levels in real terms (Table 7).

Early in 1990, measures were also taken to initiate structural reforms in the official banks. As a first step, on February 15 measures were announced to restructure the National Mortgage Bank through the closure and sale of 14 branches of that institution. As a follow-up action, on March 6 the retail operations of the National Mortgage Bank were discontinued with management of its portfolio assumed by the Banco de la Nación Argentina, the major state-owned commercial bank. Also on March 6, the Ministry of Economy moved to intervene in the operations of the National Development Bank so as to streamline that institution's operations and improve its loan recoveries.

The authorities have taken steps that would permit the reintroduction of time deposits into the banking system following the January 1 debt conversion described above. In March, banks were again allowed to accept deposits with a minimum term of 30 days and in early April the minimum term to maturity was reduced to 7 days. To encourage banks to offer time deposits with longer maturities, reserve requirements have been set at progressively lower levels along the maturity spectrum: 7-day deposits carry a reserve requirement of 22 percent; 14-day deposits carry a reserve requirement of 20 percent; and maturities beyond 30 days carry a requirement of only 1 1/2 percent. By way of comparison, the reserve requirement against savings deposits is 25 percent. This initiative has met with only limited success in the early stages of its operation; as of end-April, the outstanding stock of time deposits (measured in real terms) was only around 7 percent of the stock as of end-December 1989.

As indicated in their memorandum of May 10, the authorities believe that the monetary program should be based upon conservative estimates of the demand for money in the wake of the debt conversion at the end of 1989. In particular, despite the large decline in inflation expected in the course of 1990, the program contemplates only a modest remonetization of the economy. Following a sharp fall in the demand for real money balances during the first quarter of 1990, real M-1 has been projected to recover during April and the remainder of 1990 owing to improved confidence that would induce reflows of capital to rebuild the money balances of investors. However, by December 1990, the ratio of M-1 to GDP would still be somewhat below the level recorded before the forced conversion of time deposits at the end of 1989. The projected path for M-2 is similar to that for M-1. On the basis of this projection, and consistent with the program's inflation and balance of payments objectives, limits have been set on changes in the net domestic assets of the Central Bank (Table 8).

To achieve the objectives of the program, the Central Bank will continue its policy of acting vigorouly to recover outstanding rediscounts while enforcing legal reserve requirements. New rediscounts are to be restricted through the application of a provision in the omnibus decree of March 6 which requires the prior approval of the Ministry of Economy for all discounts extended by the Central Bank. In addition, as was noted earlier, financial entities are expected to repay their remaining debts to the Central Bank by September 30, 1990. The expansion of liabilities of the Central Bank during the projection period also will be held down by the programmed net reduction in central bank credit to the Government through 1990 (Table 9). Finally, the authorities intend to continue their policy whereby interest rates are freely determined by market forces and the Central Bank does not extend credit at subsidized interest rates.

4. External policies

a. The exchange rate and the balance of payments

The floating exchange rate system introduced in December 1989, with free access to the market for most operations, marked an important change from the fixed exchange regime that prevailed during much of the second half of 1989. The authorities have noted that the experience of late 1989 gave evidence of the danger of attempting to maintain a fixed official exchange rate in a climate of uncertainty, and they believe that the present system is consistent with the achievement of exchange rate stability as the fiscal adjustment takes hold and financial policies promote stability. Exchange market intervention will be guided by balance of payments objectives, with the Central Bank purchasing foreign exchange in the market as necessary to meet public external obligations and the programmed increase in official reserves.

The sharp swings in inflation and in the nominal exchange rate during the first quarter of 1990 led to wide fluctuations in the real effective exchange rate (see bottom panel of Chart). 1/ Following a substantial real appreciation in March as the nominal exchange rate appreciated from the low point reached in late February and early March, it is estimated that there was a further real appreciation in April when the exchange rate held steady in nominal terms despite sizeable purchases of foreign exchange by the Central Bank. In real effective terms the exchange rate is thus now estimated to be 15-20 percent above the benchmark level of June 1988, before the real appreciation that occurred under the August 1988 economic plan. It is expected that there will be an improvement in international competitiveness in the period ahead as inflation decelerates, export taxes are reduced, and the austral experiences a gradual depreciation.

After narrowing appreciably in 1989, the external current account deficit would widen slightly in 1990 to US$1.4 billion (2.1 percent of GDP), which would be considerably below the original program deficit of US$2 billion (Table 10). Exports are projected to increase to US$10.5 billion in 1990, in line with the original program, after a stronger than expected performance in 1989. The import projection has been revised downward to US$5 billion following the sharper than expected decline in imports in 1989 to US$4.1 billion. As in the original program, import volumes are expected to rebound sharply, rising by about 18 percent, as economic activity recovers and the effects of the Government's measures to open up the economy begin to be felt. Foreign currency interest obligations are now projected to reach US$6.2 billion in 1990, which is somewhat higher than had been originally projected; this increase is more than accounted for by the rise in the stock of dollar-denominated government bonds associated with the forced debt conversion at the end of 1989.

While capital inflows for the whole of 1990 are expected to be smaller than envisaged in the original program, the overall balance of payments deficit, at US$450 million, would be little changed from the original program's (the deficit in 1989 was US$4.4 billion). Moreover, the surplus on capital account of US$1 billion for 1990 would represent a much stronger situation than in earlier years, reflecting both increased official disbursements as described below and some revival of

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1/ The standard index developed in connection with the Information Notice System indicates that, from the time that the Executive Board was last informed of developments in Argentina's exchange system--in the Staff Report for the 1989 Article IV Consultation and Request for Stand-by Arrangement issued on October 17, 1989 (EBS/89/199)--through February 1990, the austral depreciated in real effective terms by 24 percent. Since developments in the exchange rate for the austral are discussed in the present paper, no separate information notice will be issued.

private capital flows, especially of foreign direct investment (excluding debt-equity swaps) which would respond positively to the stabilization of the economy and structural reform measures.

Argentina has already made considerable progress in re-establishing relations with official creditors, including moving ahead in discussions with the IBRD on a number of policy-based loans, described in more detail in Appendix II. A rise in disbursements from the multilateral development banks is thus foreseen in the coming months, provided that macroeconomic conditions remain appropriate for the disbursement of these loans, and that the remaining technical conditions for the Trade Policy loan are met and negotiations proceed swiftly on the Public Enterprise Reform Loan. Cofinancing from the IDB with the IBRD sector loans is also foreseen, alongside continued disbursements of project loans.

As regards bilateral creditors, in December 1989 the authorities reached agreement with official creditors under the aegis of the Paris Club on a rescheduling of arrears and current debt service due through March 31, 1991 on pre-cutoff date medium- and long-term debt, including previously rescheduled debt, subject to the effectiveness conditions as described in the report on the negotiations. 1/ Argentina has since remained current on its obligations under this agreement, while making progress in negotiating bilateral agreements.

The original program envisaged a reduction in external payments arrears, other than those on certain commercial bank debts, to below US$200 million by end-1989 and their elimination by March 1990. The deviations from the program at the end of 1989 and subsequent pressure on international reserves meant that these objectives were not met, and there was instead a further buildup in such arrears through end-March 1990, to an estimated US$630 million. Argentina has now eliminated arrears with the World Bank and the Inter-American Development Bank, and the revised program envisages further reductions in external payments arrears (which apart from the banks are now mainly to suppliers) by end-September and their elimination by December 1990.

Even with the considerable improvement expected in both the current and capital account, Argentina's balance of payments situation remains difficult. There is an urgent need to rebuild international reserves if new capital flows are to be attracted and some assurance provided of Argentina's ability to meet its external obligations in the future. The revised program thus provides for an increase in gross reserves from a very low level. As described in section c below, the fiscal constraint and resulting tight cash flow position means that without further external financing to the public sector beyond that already assumed, the 1990 program envisages that there will be room for only partial payments

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1/ Details of the agreement are provided in "Report on Argentina's External Debt Negotiations" (to be issued).

of the current interest of US$3.3 billion due on Argentina's medium- and long-term debt to commercial banks.

b. Current and medium-term balance of payments outlook

The Government's program of adjustment and structural reform, including the ambitious privatization program, is aimed at setting Argentina on a path to higher investment and growth over the medium term, in the context of a return to balance of payments viability. The opening of the economy and the maintenance of a free exchange market should help to attract foreign savings and investment. The sustained pursuit of fiscal adjustment, backed by appropriate credit policies, will be of critical importance in strengthening domestic savings and encouraging the repatriation of flight capital in pursuit of investment opportunities over the medium term.

The staff has developed preliminary illustrative projections of the medium-term balance of payments for the period 1990-95. A schematic baseline scenario, as presented at the top of Table 13, assumes that the financing needed to sustain a reasonable rate of growth and allow for the full servicing of external obligations is provided in effect through the refinancing of interest by commercial banks, while an alternative scenario illustrates how the medium-term outlook could be improved with debt and debt service reductions operations.

The projections are consistent with the latest commodity price projections from the World Economic Outlook, a six-month LIBOR in U.S. dollar terms of 8.3 percent a year from 1990-95, and U.S. inflation of 3-4 percent a year over the medium term. They also assume the pursuit of satisfactory fiscal, monetary and exchange rate policies that are consistent with real GDP growth of 4 1/2-5 percent a year, and a rising market share for nontraditional exports. In the early part of the projection period, import volumes would rise sharply as the economy recovers and inventories are rebuilt. They would continue to rise by well in excess of the growth in real GDP, perhaps by about 7-8 percent a year. A rise in foreign direct investment and sustained private capital inflows are envisaged, while high inflows of official capital (including rescheduling in the Paris Club) projected in the early part of the projection period are expected to decline thereafter. The scenario assumes that gross reserves will be maintained in relation to imports at the improved level now envisaged in the program for end-1990, although a stronger reserve buildup could be justified to enable Argentina's external position to be put on a firmer footing.

As noted in the presentation to the Board of the original program under the stand-by arrangement, in the absence of debt and debt service reduction a scenario of the kind described in the preceding paragraph, with all its simplifying assumptions, would call for additional financing throughout the projection period equivalent to perhaps as much as two-thirds of interest payments due to commercial banks on refinanceable debt. If it is assumed that these requirements are covered through interest refinancing, external debt ratios remain high; external debt would total about 75-80 percent of GDP, and the debt service ratio would be about 50 percent of projected exports of goods and nonfactor services.

The authorities believe that, over the medium term as in 1990, even with strong adjustment policies the present level of external debt cannot be fully serviced, with likely available financing, and that the debt burden will inhibit investment and growth. They have therefore started to develop financing proposals to discuss with commercial banks that would incorporate debt and debt service reduction, as described in the following section. At this stage, there remains considerable uncertainty about the possible contribution from Argentina's own resources and about the amount and timing of enhancement resources that may become available. The authorities' own work on the medium-term outlook and development of alternative scenarios has been delayed by the focus on immediate stabilization issues. The staff has nevertheless sketched out the first-round effects on the debt ratios of an alternative debt reduction scenario, presented in Table 13.

For the purposes of illustration, it was assumed that in 1990 such operations would consist mainly of debt-equity conversions that the authorities plan in association with the privatization of the telephone and airline companies. These could reduce the value of commercial bank debt by perhaps as much as US$5-7 billion depending on the market valuation of the companies and the implicit discount in the debt-equity conversion. Beyond that, it was assumed that total enhancement funds of US$4-4.5 billion would become available (from a combination of sources, including Argentina's own resources) over a three-year period.

In this case, the scenario suggests that phased debt and debt service reduction operations at market-related prices, alongside partial interest payments, could eliminate the need for exceptional balance of payments support by the end of the period. Thus, by 1994-95, on the same assumptions about domestic policies and the external environment as under Scenario A, Argentina would be in a position to meet fully its remaining external obligations at their reduced level. Argentina's external debt obligations would nevertheless remain substantial, although considerably lower than at present. External debt would be equivalent to just over 50 percent of GDP, while the total debt service ratio would decline to just under 40 percent of exports of goods and nonfactor services, compared with 50 percent under the hypothetical baseline scenario and 65-70 percent at present. The external interest burden would be reduced from 9 percent of GDP in 1990 to 4.7 percent by 1995.

This exercise does not take account of the positive effects on investor confidence and productivity that would be sought through debt reduction and that may be expected as Argentina's debt problem is resolved. However, it does assume the maintenance of a sustained adjustment effort, and favorable assumptions about continued inflows of capital from private sources and from officials, including the multilateral development banks.

Further improvement in debt ratios would require a greater degree of debt reduction or an even sharper improvement in underlying economic performance than already assumed. This indicates the importance of sustaining the adjustment effort, in particular with a view to encouraging direct investment and other nondebt-creating inflows, so that the full benefits of debt reduction may be felt. The maintenance of a satisfactory level of reserves in relation to external payments, as presented in the scenarios, will be an essential element in providing the necessary confidence to foreign and domestic investors.

c. External debt, debt service, and financing assurances

Argentina's debt ratios are high compared to those of many other debtor countries (external debt at the end of 1989 amounted to an estimated US$65 billion, almost equivalent to GDP) and, as noted above, the authorities intend to seek debt and debt service reduction from commercial banks. The authorities initiated contacts with commercial banks in late 1989. These were interrupted as the stabilization program went off track, but are now expected to restart in May. The authorities believe that a phased approach to resolving their debt problem is required, given that enhancement resources can be expected to become available only as a record of satisfactory economic performance is established and the urgency of rebuilding official reserves. However, they foresee considerable scope in the near term for debt-equity operations in the context of the privatization program and have now requested from banks the waivers needed for the privatization of the companies in question. Bidders for the telephone and airline companies have been invited to tender debt, together with a minimum proportion of cash for the companies. The authorities will also request from banks the broader waivers necessary to carry out further debt and debt service reduction operations when they present framework proposals for an agreement to address the financing needs foreseen during the program period and over the medium term.

In this connection, Argentina has, as noted above, requested inclusion of a set-aside from the Fund in the present stand-by arrangement, with which Argentina would begin to accumulate enhancement resources. Given the immediate liquidity needs and the still preliminary stage of negotiations with banks, the authorities are requesting that the set-asides be made from the last three purchases of the present arrangement.

The authorities also intend to begin shortly regular payments to banks. In view of the fiscal and balance of payments constraints, the authorities believe that these will not be sufficient to meet fully the current interest due to banks (in addition, interest arrears on bank debt at end-1989 amounted to US$5.2 billion). The authorities noted that partial interest payments should be started at a level that they were confident could be sustained.

Before payments to commercial banks, the program provides for a US$2 billion rise in international reserves; an increase of this size would still leave a level of liquid reserves that is not high in relation to the heavy external obligations falling due. As in the original program, however, this increase contains room for resources to be used in connection with the official medium- and long-term debt to commercial banks. These resources (which would now include the set-aside amounts under the arrangement with the Fund) would support the restoration of Argentina's relations with its bank creditors. With good progress in this area, and including the disbursement of the Fund set-asides, resources of up to US$1 billion could be used for these purposes, ensuring that a minimum underlying increase in liquid reserves of US$1 billion is preserved. In addition, payments of interest of US$400-500 million on short-term and private sector debt to banks are envisaged in 1990.

An important feature of the next program review, to be completed in August 1990, will concern the progress in negotiations with banks. Steps toward a satisfactory settlement would help assure that the Fund's financing assurances policy was being satisfied.

d. Policies as regards the trade and payments system

The authorities have made considerable progress in liberalizing the exchange and payments system since the change of government in July, 1989. However, exchange restrictions subject to approval under Article VIII remain, notably those evidenced by external payments arrears as described in the preceding section, and restrictions arising from a bilateral payments agreement with Bolivia under which a portion of payments for imports of natural gas are made into a special account, for use in paying Bolivian obligations to Argentina, rather than in cash (see Appendix IV).

Since unification of the exchange markets under the freely floating system in December 1989, there have been no other restrictions on access to foreign exchange and the minimum import financing requirements have been eliminated. Exporters are required to surrender exchange to commercial banks, but they may subsequently reconvert their domestic currency proceeds into foreign exchange if they wish.

The Government has recently taken steps to liberalize further the import regime in line with its goal of opening the economy to foreign competition, a key part of the program of structural reform aimed at eliminating distortions and revitalizing Argentina's economy. In three steps from July 1989 to March 1990, the Government reduced quantitative import restrictions by removing items from the list subject to prior consultation with domestic industry groups. The production coverage of goods on this list has dropped from the equivalent of a little over 18 percent of domestic production before July 1989 to an estimated 9 percent of domestic production. Goods removed from the list included a range of textiles in late 1989 and some intermediate pharmaceuticals in early 1990. Restrictions continue to apply, however, to some important sectors such as iron and steel, automobiles (below a certain size), finished pharmaceuticals and sugar. The program envisages that these will be removed, through legislation if necessary.

Certain other imports are effectively restricted through the application of high specific tariffs, while some electronic goods are subject to a 15 percent tariff surcharge, which is to be eliminated by September 30, 1990. The coverage of specific tariffs was expanded at the turn of the year to some of the goods recently removed from the prior consultation list, but the Government does not intend to increase the coverage or rates of these tariffs further and plans to reduce some specific tariffs during 1990.

Prior import declarations are required for all products, although in early 1990 the Government eliminated the requirement for clearing the declaration in advance of shipment and is committed to allowing full automaticity in the import of items not subject to quantitative restrictions.

Substantial reductions in import tariff rates and in their dispersion that were implemented in late 1989 and early 1990 have gone some way toward the Government's medium-term goal of a tariff structure with only three to four rates, ranging from 10-20 percent. The maximum basic tariff rate now stands at 24 percent--down from 40 percent in July 1989--and the number of tariff rates has been reduced to six. In addition, in April 1990, the Government reduced the number of customs items exempt from duty, increased intermediate tariff rates below the 24 percent maximum, raised to 10 percent the rate levied on goods previously subject to a 5 percent basic tariff, and raised the minimum tariff from 0 to 5 percent.

A number of incentive schemes for exports, primarily favoring industrial products, had been suspended temporarily as part of the economic emergency legislation of September 1989. In March 1990, the Government eliminated the export rebate system under which payments equivalent to 5-15 percent of the f.o.b. value of exports of certain manufactures and agro-industrial products were made to compensate for indirect taxes presumed to have been paid in the production process. It intends to replace this presumptive system with a more tightly defined scheme under which rebates would be more closely related to the taxes actually paid. As noted above, the Government temporarily raised general export taxes applicable to agricultural and agro-industrial goods by 5 percentage points as part of the package of fiscal measures of March 6. Nevertheless, the Government maintains its commitment to eliminate export taxes on industrial goods and has recognized the importance of lowering the average rate of tax on agricultural goods and reducing tax dispersion across products so as to encourage exports to develop in response to market signals.

e. Capacity to repay the Fund

As laid out in the staff report presenting Argentina's request for the November stand-by arrangement, scheduled repurchases from the Fund rise sharply in 1991, to SDR 724 million or about 7 percent of projected exports of goods and nonfactor services, as obligations under previous arrangements fall due. Thereafter, on the standard assumption that there is no further use of Fund credit after the present arrangement, scheduled repurchases decline to SDR 283 million by 1993, and to SDR 267 million in 1995 (with a rise in 1994 as obligations under the present arrangement fall due). By 1995, all debt service due to the Fund would amount to about 2 1/2 percent of projected exports, while total use of Fund credit would have declined from about 4 1/2 percent of GDP in 1990, to 0.2 percent of GDP. Gross Fund purchases in 1990 under the present arrangement, with the proposed reduction in access, would amount to about 8 percent of estimated total gross financing needs.

The previous staff report was based on a positive assessment of Argentina's capacity to meet its debt service obligations to the Fund. The program of structural reform and stabilization, together with the opening of the economy and encouragement of nondebt-creating flows, were judged to provide reasonable assurance that the balance of payments position would be strengthened over the medium term, laying the basis for a return to viability. A strengthening of Argentina's external reserves, as envisioned in the assessment of Argentina's financing requirements, is also seen as giving the Fund greater confidence.

The deviations from the program in late 1989 and early 1990 indicate clearly the risks and difficulties involved in dealing with hyperinflation and setting the economy on a durable path of growth. Nevertheless, the authorities' determination in renewing the adjustment effort, and the record in maintaining payments to the Fund during the recent period of extreme pressure on international reserves, are noteworthy. The staff thus believes that the proposed use of Fund resources continues to be consistent with the need to safeguard the revolving character of these resources.

As noted above, it will be of key importance for Argentina's medium-term prospects that the negotiations now underway with commercial bank creditors lead to a satisfactory resolution over time of its debt problem. The authorities' progress in regularizing relations with official creditors and the start now being made on developing financing proposals to address Argentina's medium-term financing needs and restoring relations with commercial banks provides some further assurance of progress at this stage towards external viability.

IV. Performance Criteria and Review Clauses 1/

The modified program contains the following performance criteria, all of which were referred to in paragraph 4 of the November 1989 stand-by arrangement:

1. Quarterly austral limits for the combined overall deficit of the nonfinancial public sector and the Central Bank; a limit on the overall cash deficit of the nonfinancial public sector; and a limit on treasury outlays (paragraph 6 and Table 1 of the Memorandum on Economic Policy). 2/

2. Quarterly austral limits on the net domestic assets of the Central Bank (paragraph 17 and Table 2 of the Memorandum).

3. Quarterly targets in U.S. dollars for the net international reserves of the monetary authorities (paragraph 22 and Table 3 of the Memorandum).

4. The reduction of external payments arrears on public sector debt, with the exception of debt service arrears on medium- and long-term public debt to commercial banks and other debts subject to commercial bank debt refinancing, to no more than US$350 million by the end of September 1990, the elimination of all such arrears by end-1990, and the avoidance of new arrears (paragraph 26 and Table 4 of the Memorandum).

5. Limits on the total external debt of the public sector and a limit on the cumulative net disbursements of short-term external debt to public sector entities (paragraph 27 and Table 5 of the Memorandum).

As indicated in paragraph 28 of the Memorandum, before the end of August 1990 Argentina will review with the Fund the progress made in the implementation of the program in order to reach understandings on additional measures that may be needed to attain the program objectives. In the review, special attention will be given to the status of negotiations with commercial banks (paragraph 27 of the Memorandum) and to the progress made in implementing policies to reduce overstaffing in the public sector (paragraph 10 of the Memorandum), in transferring expenditure programs to the provinces (paragraph 11 of the Memorandum), in strengthening tax administration and control over the public enterprises (paragraphs 13 and 14 of the Memorandum, respectively), and in the program of privatization (paragraph 15 of the Memorandum).

1/ Quantitative performance criteria are presented in Table 8.
2/ Referred to as the "Memorandum" in the remainder of this section.

V. Staff Appraisal

Against a background of many years of slow growth, high inflation, and external imbalances, the Administration that assumed office in July 1989 immediately launched a broadly-based adjustment program which was supported by the stand-by arrangement approved by the Fund's Executive Board on November 10, 1989. The program aimed at reducing inflation rapidly on the basis of a major improvement in the public finances following large adjustments in relative prices, including a major devaluation. Concurrently, the authorities framed a medium-term strategy that placed heavy emphasis on structural reforms aimed at producing a lasting solution to the country's economic ills. Initially, the authorities' program met with substantial success in several areas, but slippages in policy implementation, delays in legislative action, and excessive wage increases in the private sector and the public enterprises interrupted the adjustment effort, and most performance criteria for the fourth quarter of 1989 were missed by wide margins.

In the past several months the staff has worked closely with the authorities as they have been taking measures aimed at restoring their adjustment and reform efforts. The economic program that has been developed for the remainder of 1990 has the same basic aims as the program adopted in mid-1989. It seeks the achievement of a large primary surplus in the public sector, equivalent to 7 percent of GDP in the last three quarters of 1990, to bring inflation down swiftly while generating resources sufficient to improve the level of international reserves and facilitate the re-establishment of relations with external creditors. It also envisages the enactment of numerous structural reforms that would contribute to an improvement of saving and help to raise efficiency. The early results of the new measures have been positive, particularly with respect to inflation and the balance of payments, and have served to bring about a change in expectations.

Achievement of the major improvement of the fiscal position that is planned for 1990 will depend to a large extent upon the authorities' success in raising revenue, even though there has been some downward adjustment of the revenue projection in relation to the earlier program. The original timetable for the extension of the value-added tax to services was not met, and it is very important that the legislation to be sent to Congress be passed promptly without the creation of additional exemptions. Despite the authorities' efforts, tax administration remains weak and could pose a threat to the achievement of the fiscal program. Prompt implementation of the measures recommended by recent Fund technical assistance missions, including increasing the powers of the internal tax office to apply the sanction of closing the businesses of delinquent taxpayers, is essential. In the event of evidence that tax revenues are falling short of the objective sought, an increase in the rate of the value-added tax to the maximum permitted under existing law should be considered promptly.

Notwithstanding the dependence of the program on an improvement in fiscal revenue, the revised economic program for 1990 relies on expenditure restraint to a greater extent than the original program. A key element in this area will be the maintenance of a tight policy in respect of wages and salaries, which represent a high proportion of current expenditure by the National Administration. Even though the purchasing power of public sector wages and salaries has been reduced sharply, it is crucial not to attempt raising real wages by means of nominal wage awards that are inconsistent with the program's price objectives. It should be noted in this connection that the Government has started to address the problem of overstaffing, which is very important from the standpoint of achieving a strengthening of the public finances and making room for a recovery of real wages in the public sector.

Despite the progress made in implementing the program of privatization and divestiture, the delays experienced at various stages have been such that the current timetable allows no room for further revision if the fiscal program is to be kept on track. To proceed with the privatization of the telephone company and the state airline, various legal issues need to be resolved, including waivers from creditors and certain regulatory problems. It also will be important to extend the privatization effort to other enterprises, particularly the state oil company.

A central element in the effort to restore fiscal discipline will be the improvement of the financial performance of enterprises that remain in the public sector. At present the tariffs of the public enterprises are generally at levels that are adequate to generate economic rates of return, but in a situation in which costs and prices have yet to be stabilized developments must be kept under close review. The authorities also need to reinforce their efforts to exercise effective control over the operations of the enterprises, particularly in the light of deviations in recent months as regards wage awards and tax payments by a number of these enterprises.

Under current revenue sharing arrangements some 58 percent of all domestic tax revenues collected by the Central Administration are automatically transferred to the provinces. Given the efforts to boost revenue, the authorities are quite correctly seeking to expedite the transfer of expenditure programs to the provinces, and to subject certain transfers to conditions as a means of recovering overdue obligations of the provinces with the National Administration and the public enterprises.

Credit policy clearly will need to play a crucial role in the achievement of the macroeconomic goals of the program for 1990. The authorities will be aided in this effort by the net domestic financing surplus the public sector expects to generate in 1990 and by the absence of the domestic quasi-fiscal deficit that complicated the management of monetary policy in the past. At the same time, however, the conduct of monetary policy is hampered by the effects of the involuntary conversion of financial assets at the beginning of this year, which undoubtedly has affected the willingness of the private sector to hold claims in domestic currency and at the same time has reduced the range of financial assets on which the Central bank can operate. In these circumstances, the authorities intend to rely on a policy of collecting outstanding rediscounts while limiting new rediscounts and enforcing legal reserve requirements. The staff is of the view that these instruments are adequate for the task at hand, but the general limitation on the ability to conduct open market operations underscores the importance of achieving the program's fiscal objectives.

The Government made a start toward the structural reform of the financial sector through the measures of March 6, which focused in this regard mainly on the official banks. However, further action to streamline the operations of the National Development Bank and to improve its loan recovery performance is still pending. The debt conversion operation of January 1 reduced considerably the banking system's deposit base and its operating income; in these circumstances, it can be expected that the private banking system will undergo a restructuring to become more cost effective. For this process to proceed in an orderly fashion, it would be advisable to strengthen the Central Bank's supervisory powers.

The change to a unified flexible exchange rate system in late 1989 marked an important shift from the earlier economic strategy which had relied upon a fixed exchange rate. Experience during the final months of 1989 had clearly pointed to the difficulty of choosing the appropriate level for a fixed exchange rate in a climate of uncertainty as to how quickly the effort to reduce inflation would take hold. The financial policies that have been pursued in the last two to three months have provided the basis for a relatively stable exchange rate, and the authorities have been making purchases in the market not only to meet their needs for foreign exchange, including the planned increase in official reserves, but also to keep the austral from appreciating unduly.

The authorities have made commendable progress in liberalizing the exchange and payments system since mid-1989. Private sector access to foreign exchange has been unrestricted since the unification of foreign exchange markets in mid-December. At present exchange restrictions are confined to those on certain external payments on debt of the public sector and to those arising from a special payments agreement with Bolivia. Also, import restrictions have been reduced significantly, including substantial reductions in import tariff rates and in their dispersion. The staff would stress the importance of removing the remaining import restrictions and liberalizing the tariff structure, which continues to include very high specific tariffs, the coverage of which expanded in conjunction with the removal of some quantitative restrictions in 1989.

Argentina reached agreement with Paris Club creditors in December 1989 and the authorities report that payments have been made according to schedule in March and April 1990. As regards relations with commercial banks, the authorities believe that debt and debt service reduction will be needed to permit a satisfactory rate of economic growth over the medium to longer run in the context of a viable external situation. Discussions with banks along these lines are expected to be initiated very soon, although it may take considerable time before a final agreement can be reached. In this connection, the staff welcomes the authorities' request that a part of the final three drawings under the arrangement be set aside as a source of financing for debt reduction operations.

The authorities intend to make interest payments to banks while negotiations are under way. However, unless additional financing on suitable terms were forthcoming to ease the fiscal and external constraints described above, it is not envisaged that there will be sufficient resources to service fully the interest payments coming due and meet the reserves target; the question of the existing stock of interest arrears owed to banks also remains. Thus, interest arrears are likely to continue to rise pending agreement with banks. Progress in the discussions between the authorities and their bank creditors will be monitored in the context of program reviews.

To conclude, since early March there has been a major slowdown in inflation and an improvement in the country's external position. This turnaround reflects both the application of strengthened economic policies and the effects these policies have had on confidence. To extend these gains, it is important that the authorities implement their strategy fully and in a timely fashion. It is also important that they respond quickly to any signs of departures from the program. As was shown by the events of recent months, slippages in policy implementation can lead to a rapid erosion of confidence. On the basis of the improved economic performance in March through May and their economic program for the remainder of 1990, the authorities have requested that, a purchase be available on completion of this review. They also have requested a modification of the stand-by arrangement which would allow subsequent purchases as originally scheduled (subject to observance of performance criteria) and would involve a reduction in access because of the dropping of the February 1990 purchase.

The staff believes that the authorities' economic program for 1990 represents a reasonable effort to deal with Argentina's economic problems and deserves the support of the Fund. The authorities' intention to take any additional measures that may be required to deal with adverse developments is noted and the staff recommends Board approval of the purchase requested on completion of this review, notwithstanding the nonobservance of performance criteria for end-December and end-March, and of the modification requested by the authorities of the current stand-by arrangement.

VI. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

A. Review and Modification of Stand-by Arrangement

1. Argentina has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Argentina (EBS/89/199, Supplement 1) and paragraph 3 of the letter of October 12, 1989, from the Minister of Economy and the President of the Central Bank of Argentina, in order to reach understandings regarding further measures to achieve the objectives of its program and the circumstances in which purchases may be resumed under the stand-by arrangement.

2. The letter, with annexed Memorandum on Economic Policy and tables attached thereto, dated May 10, 1990, from the Minister of Economy shall be annexed to the stand-by arrangement, and the letter of October 12, 1989 with the annexed Memorandum on Economic Policy and tables attached thereto shall be read as modified and supplemented by the letter of May 10, 1990 with annexed Memorandum on Economic Policy and tables attached thereto.

3. Accordingly, paragraphs 1, 2, and 4(a), (b), and (c) of the stand-by arrangement shall be amended to read as follows:

"1. For the period from November 10, 1989 to March 31, 1991 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 920 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 184 million until May 15, 1990, the equivalent of SDR 368 million until August 15, 1990, the equivalent of SDR 552 million until November 15, 1990, and the equivalent of SDR 736 million until February 15, 1991.

(b) Each of the amounts that would be available in accordance with paragraphs 1 and 2(a) above, after August 14, 1990 during the remaining period of this arrangement, shall be reduced by an amount equivalent to 25 percent. The amount equivalent to corresponding reductions in the purchases made by Argentina under this stand-by arrangement shall be made available subject to the following conditions:

(i) Argentina represents that it has a need to make a purchase because of use of its reserves or impending payments for the discharge of liabilities under debt reduction transactions;

(ii) the Fund, after examination of the request, has determined that the requested purchase is needed for the replenishment of Argentina's reserves or for the making of payments in connection with debt reduction operation; and

(iii) the Fund, upon a review of the financing of Argentina's program supported under this stand-by arrangement, has determined that the debt reduction involved is consistent with the objectives of the program.

(c) Pursuant to a review under (b)(iii) above and if requested by Argentina, the Fund may decide to make available to Argentina, notwithstanding the phasing specified under (a) above and subject to the conditions specified in (b)(i) and (ii) above, an amount equivalent to 25 percent of the total of purchases that may be made by Argentina during the remaining period of this stand-by arrangement. In that event, the right of Argentina to make purchases under this arrangement shall be subject to such phasing of purchases and designation of amounts for debt reduction, as shall be determined.

(d) If requested by Argentina, the Fund may decide to discontinue the designation of amounts for debt reduction under (b) and (c) above, provided that the Fund determines that the objectives of Argentina's program supported under this stand-by arrangement can be achieved."

"4. Argentina will not make purchases under this arrangement that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota:

(a) during any period in which the data at the end of the preceding calendar quarter indicate that

(i) the limit on the combined deficit of the nonfinancial public sector and the Central Bank specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(ii) the limit on the cash deficit of the nonfinancial public sector specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(iii) the limit on treasury outlays specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(iv) the targets for change in the net domestic assets of the Central Bank specified in Table 2 of the Memorandum on Economic Policy annex to the attached letter of May 10, 1990, or

(v) the targets for change in net international reserves specified in Table 3 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(vi) the limit on external arrears of the public sector as specified in Table 4 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(vii) the limit on the external debt of the public sector and the limit on net disbursements of short-term debt of the public sector specified in Table 5 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990,

are not observed, or

(b) if Argentina fails to carry out the intention regarding the elimination by the end of 1990 of the remaining import prohibitions and restrictions referred to in paragraph 25 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990; or

(c) during any period after August 14, 1990, until the review contemplated in paragraph 28 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990 has been completed and understandings on additional measures that may be needed to attain the program's objectives had been reached, or after such understandings have been reached, while they are not being observed, or"

4. The Fund decides that the review contemplated in paragraph 4(c) of the stand by arrangement is completed and that, notwithstanding the nonobservance of performance criteria, Argentina may proceed to make purchases under the arrangement.

B. Exchange System

Argentina continues to retain exchange restrictions as described in Appendix IV to EBS/90/90. In the circumstances of Argentina, the Fund grants approval of the retention of the restrictions listed in Appendix IV, Section 1, b-c, until August 31, 1990, or the completion of the next review pursuant to paragraph 4(c) of the stand-by arrangement, whichever is earlier.

Table 1. Argentina: Indicators of Performance Under the November 1989 Stand-by Arrangement

(In millions of australes, except as indicated)

	October-December 1989		
	Programmed	Actual	Margin
Limit on the overall cash deficit of the nonfinancial public sector	-830,300	-944,506 1/	-114,206
Limit on the combined overall deficit of the nonfinancial public sector and the Central Bank	-770,500	-945,000 1/	-174,500
Limit on Treasury outlays	1,444,400	1,615,430 1/	-171,030
Limit on change in net domestic assets of the Central Bank	1,497,450	3,656,105	-2,158,655
Limit on change in net international reserves of the monetary authorities (in millions of U.S. dollars)	-950	-1,984	-1,034
Limit on total outstanding external debt of the public sector (in millions of U.S. dollars)	53,000	49,086	3,914
Limit on net disbursement of short-term debt of the public sector contracted after September 30, 1989 (in millions of U.S. dollars)	1,000	52	948
External payments arrears on public sector debt service (in millions of U.S. dollars)	200	498 1/	-298

Source: Ministry of Economy; Central Bank of Argentina; and Fund staff estimates.

1/ Subject to revision.

Table 2. Argentina: Projection of Fund Position

	Outstanding 9/30/89	1989 IV Qtr.	1990 I Quarter	1990 II Quarter	1990 III Quarter	1990 IV Quarter	1991 I Quarter	Cumulatives IV Qtr.'89 I Qtr.'90
(In millions of SDRs)								
Purchases		184.0	--	184.0	184.0	184.0	184.0	920.0
Under SBA		184.0	--	184.0	184.0	184.0	184.0	920.0
Under CCFF		--	--	--	--	--	--	--
Repurchases		143.5	179.9	94.3	118.3	121.1	196.1	853.1
Under SBA		109.1	145.5	94.3	118.3	56.2	131.1	654.7
Under CCFF		34.4	34.4	--	--	64.8	64.8	198.4
Total Fund credit outstanding (end of period)	2,318.3	2,358.8	2,178.9	2,268.6	2,334.4	2,397.3	2,385.2	
Under SBA	1,497.6	1,572.5	1,427.0	1,516.7	1,582.5	1,710.2	1,763.0	
Under CCFF	820.7	786.3	751.9	751.9	751.9	687.1	622.2	
(In percent of quota)								
Total Fund credit outstanding (end of period)	208.3	211.9	195.7	203.8	209.7	215.4	214.3	
Under SBA	134.6	141.3	128.2	136.3	142.2	153.7	158.4	
Under CCFF	73.7	70.6	67.6	67.6	67.6	61.7	55.9	

Table 3. Argentina: Summary of Output, Prices, Savings, and Investment

	1983	1984	1985	1986	1987	1988	1989	Proj. 1990
				(Annual changes in percent)				
GDP deflator	349.0	653.6	683.8	77.7	127.6	372.8	3,252.0	2,023.4
Consumer prices (end of period)	433.7	688.0	385.4	81.9	174.8	387.5	4,928.6	1,013.8
Real GDP	3.0	2.6	-4.3	5.6	2.2	-2.7	-3.5	-0.9
				(In percent of GDP)				
Gross Domestic investment	14.1	12.5	11.6	11.8	13.2	11.4	9.4	10.1
External savings	4.3	3.9	1.6	4.4	6.6	2.5	1.9	2.1
Domestic savings	9.8	8.6	10.0	7.4	6.6	8.9	7.5	8.0

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

Table 4. Argentina: Overall Financial Balance of Nonfinancial Public Sector

(In percent of GDP)

	1990					
	QI	QII	QIII	QIV	Year	QII-IV
Primary balance	1.2	5.3	8.7	7.1	5.6	7.0
Interest payments accrual basis	4.4	7.6	4.6	7.4	6.0	6.5
Nonfinancial public sector overall balance	-3.2	-2.3	4.1	-0.3	-0.4	0.5
Net external finance	1.0	3.9	-0.1	1.4	1.6	1.7
Interest not paid	4.1	3.9	0.8	3.2	3.0	2.6
Net amortization (-)	-3.1	—	-0.9	-1.8	-1.4	-0.9
Net domestic financing	2.2	-1.6	-4.0	-1.2	-1.1	-2.2

Sources: Ministry of Economy; and Fund staff estimates.

Table 5. Argentina: Summary of Operations of Nonfinancial Public Sector, Excluding Interest Payments 1/

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 Nov. Prog.	1990 Rev. Proj.	1990 II-IV Rev. Proj.
Revenues	21.2	22.7	21.3	19.8	18.6	27.7	23.3	25.9
National administration taxes	13.9	14.6	13.8	11.8	11.4	17.9	14.9	16.0
Social security taxes	3.6	4.0	4.0	4.4	3.5	4.8	4.0	4.4
Nontax and capital receipts	3.1	2.8	2.3	2.4	2.7	3.7	3.1	3.7
Operating surplus of the nonfinancial public enterprises	0.6	1.2	1.3	1.2	1.0	1.4	1.3	1.7
Revenue	10.5	10.8	10.1	10.0	9.5	10.6	9.2	10.1
Expenditure	9.9	9.6	8.8	8.8	8.5	9.2	7.9	8.3
Expenditure (excluding interest payments)	20.4	20.9	22.3	20.7	19.0	21.6	17.8	18.9
National administration wages	4.0	3.4	3.6	3.5	3.5	3.5	2.9	3.0
Other goods and services	1.2	1.6	1.7	1.4	1.2	1.4	1.0	1.0
Pensions	5.8	6.0	5.6	5.3	4.7	5.5	4.6	4.8
National administration	0.4	0.5	0.5	0.5	0.6	0.6	0.4	0.4
Social security	5.4	5.6	5.1	4.8	4.1	4.9	4.1	4.4
Transfers to provinces	5.1	5.7	6.5	6.2	6.0	6.9	5.9	6.4
Other transfers	1.0	1.0	1.1	0.8	0.9	1.2	1.1	1.2
Capital expenditure	3.3	3.1	3.8	3.4	2.8	3.2	2.2	2.4
Primary balance	0.8	1.8	-0.9	-1.0	-0.4	6.1	5.6	7.0

Sources: Ministry of Economy; and Fund staff estimates.

1/ Annual figures are quarterly averages.

Table 6. Argentina: Nonfinancial Public Sector 1/2/

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 Year Nov. Prog.	1990 Year Rev. Prog.
I. Central Government							
Total revenues	11.3	11.8	10.9	9.2	9.8	15.5	13.3
Tax revenues	10.3	10.9	10.3	8.2	8.4	14.2	11.8
Nontax revenues	0.9	0.9	0.6	0.9	1.4	1.3	1.5
Expenditures excluding interest payments and intra public sector transfers	8.1	8.6	8.7	8.4	8.3	9.4	7.8
Wages and salaries	2.4	2.2	2.3	2.2	2.2	2.2	1.8
Goods and services	0.5	0.7	0.6	0.6	0.5	0.6	0.4
Transfers	5.1	5.5	5.3	5.2	5.4	6.2	5.3
Provinces and MBA	4.2	4.6	4.4	4.3	4.6	5.3	4.5
Pensions	0.4	0.5	0.5	0.5	0.6	0.6	0.4
Other	0.5	0.4	0.4	0.4	0.3	0.3	0.4
Extrabudgetary	—	0.1	0.3	0.2	0.1	0.1	0.1
Capital expenditure	0.2	0.1	0.2	0.2	0.1	0.2	0.1
Primary balance	3.2	3.2	2.2	0.8	1.5	6.1	5.5
II. Special Accounts							
Tax revenue	2.6	2.8	2.4	2.6	2.0	2.4	2.6
Nontax and capital revenue	0.6	0.9	0.8	0.7	0.7	0.8	0.5
Wages and salaries	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other goods and services	0.2	0.4	0.4	0.3	0.3	0.3	0.2
Capital expenditure	0.1	0.2	0.2	0.2	0.2	0.2	0.1
Transfers 3/	1.3	1.5	1.8	1.5	1.5	1.9	1.9
Provinces	0.9	1.1	1.4	1.2	1.0	1.2	1.4
Primary balance	1.4	1.4	0.5	1.0	0.5	0.6	0.6
III. Decentralized Agencies							
Tax revenue	0.9	1.0	1.2	1.0	1.0	1.2	0.6
Nontax and capital revenue	1.2	0.6	0.5	0.6	0.6	0.7	0.5
Wages and salaries	1.4	1.0	1.1	1.1	1.0	1.0	0.8
Other goods and services	0.5	0.5	0.4	0.4	0.3	0.3	0.3
Capital expenditure	0.6	0.7	0.6	0.6	0.5	0.4	0.4
Transfers 3/	0.2	0.2	0.6	0.7	0.5	0.6	0.2
Provinces	—	—	0.4	0.5	0.3	0.3	—
Primary balance	-0.5	-0.7	-1.0	-1.1	-0.8	-0.4	-0.6

Table 6. Argentina: Nonfinancial Public Sector 1/2/ (Concluded)

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 Year Nov. Prog.	1990 Year Rev. Prog.
IV. Social Security							
Total revenues	3.8	4.3	4.2	4.5	3.6	5.0	4.1
Tax revenues	3.6	4.0	4.0	4.4	3.5	4.8	4.0
Nontax revenues	0.2	0.3	0.3	0.1	0.1	0.2	—
Total expenditure 3/	5.4	5.6	5.1	4.8	4.1	4.9	4.1
Transfers to provinces	—	—	—	0.1	0.1	—	—
Primary balance	-1.7	-1.3	-0.9	-0.3	-0.5	—	-0.1
V. Nonfinancial Public Sector Enterprises							
Current revenue	10.5	10.8	10.1	10.0	9.5	10.6	9.2
Wages and salaries	2.8	2.8	2.8	2.7	2.7	2.1	1.7
Other goods and services	7.1	6.8	5.9	6.2	5.8	7.0	6.2
Transfers to provinces	—	—	0.4	0.1	—	—	—
Operating surplus	0.6	1.2	1.0	1.2	1.0	1.4	1.3
Capital revenue	0.2	0.1	0.1	0.1	—	0.8	0.5
Capital expenditure	2.4	2.2	2.8	2.5	2.1	2.5	1.6
Primary balance	-1.6	-0.8	-1.8	-1.4	-1.1	-0.3	0.2
Primary balance of nonfinancial public sector	0.8	1.8	-0.9	-1.0	-0.4	6.1	5.6

Sources: Ministry of Economy; and Fund staff estimates.

1/ Annual figures are quarterly averages.
2/ The definition of the nonfinancial public sector used in the report does not consolidate the operations of the provinces.
3/ Excluding intra public sector transfers.

Table 7. Argentina: Selected Financial Indicators

(In percent)

	Growth of Aggregates 1/ M-1	Growth of Aggregates 1/ M-2	Monthly Interest Rate 2/	Exchange Rate Spread 3/	Monthly Inflation Rate 4/
1988					
I	5.2	11.9	14.8	35.2	12.6
II	11.1	14.6	17.6	24.4	19.2
III	18.6	22.6	13.7	22.2	21.4
IV	15.3	12.2	9.5	22.0	6.0
1989					
I	12.9	13.2	17.0	72.9	11.6
II	51.6	53.0	113.9	57.6	86.7
III	68.2	62.9	18.4	5.2	77.7
IV	31.6	13.3	28.3	...	17.3
1989					
January	11.4	16.3	10.6	23.8	7.9
February	14.6	9.8	19.7	57.1	9.0
March	12.6	13.6	20.8	137.7	18.0
April	12.2	21.8	51.2	79.1 5/	45.7
May	53.6	40.5	146.3	n.a. 5/	91.5
June	90.6	91.9	144.2	93.8	123.0
July	109.2	99.5	36.2	13.8	202.9
August	65.5	60.2	12.3	1.7	23.2
September	39.0	28.9	6.7	--	6.0
October	32.9	22.6	5.6	7.1	3.6
November	18.1	9.0	9.1	34.9	4.0
December	43.8	8.3	70.2	...	44.4
1990					
January	50.1	-8.2	56.3	...	70.4
February	16.5	26.3	186.0	...	74.3
March	43.9	33.6	152.6	...	83.4

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

1/ Average seasonally adjusted monthly increase.
2/ Seven-day operations, with security of Government of Argentina bonds denominated in U.S. dollars (BONEX).
3/ Percentage difference in terms of australes per U.S. dollar between the exchange rates in the parallel and official exchange markets.
4/ Average monthly increase of consumer and wholesale prices.
5/ From mid-April until the end of May the official rate was allowed to float freely.

Table 8. Quantitative Performance Criteria under Stand-by Arrangement

(In millions of australes, unless otherwise indicated)

	April 1990-June 1990	April 1990-September 1990	April 1990-December 1990
Limit on the overall cash deficit of the nonfinancial public sector	-3,120,000	3,620,000	3,130,000
Limit on the combined overall deficit of the nonfinancial public sector and the Central Bank	-4,050,000	-700,000	-3,210,000
Limit on Treasury outlays	12,600,000	29,900,000	50,500,000
Limit on change in net domestic assets of the Central Bank	9,420,000	10,040,000	13,460,000
Limit on change in net international reserves of the monetary authorities (in millions of U.S. dollars)	-350	-90	-250
Limit on external arrears of the public sector (in millions of U.S. dollars)	560	350	---
Limit on total outstanding external debt of the public sector (in millions of U.S. dollars)	63,000	63,000	63,000
Limit on net disbursements of short-term debt of the public sector contracted after September 30, 1989 (in millions of U.S. dollars)	1,000	1,000	1,000

Source: Memorandum on Economic Policy.

Table 9. Argentina: Summary of Operations of the Financial System 1/

	End-December								
	1982	1983	1984	1985	1986	1987	1988	Est. 1989	Proj. 1990
I. Consolidated Financial System									
(Percentage change during previous 12 months)									
Net external assets 2/	-68.2	-65.9	-30.8	2.9	-15.9	-60.3	-42.4	-95.0	-29.3
Net domestic assets 2/	178.4	420.6	562.2	317.1	116.6	209.2	397.5	540.7	361.2
Private sector	138.6	287.0	360.5	196.6	67.3	122.9	232.1	596.8	227.7
Nonfinancial public sector	70.4	297.6	298.0	126.3	48.7	106.4	298.1	680.9	-0.1
Other 3/	-30.6	-164.0	-96.3	-5.8	0.6	-20.1	-132.7	-737.0	133.6
Liabilities to private sector	110.2	354.7	531.4	320.0	100.6	149.0	355.2	445.6	331.8
Monetary liabilities	224.7	368.2	524.7	596.2	85.5	124.9	337.6	7,986.5	323.2
Other liabilities	80.5	349.4	533.8	248.8	108.1	158.8	360.1	9.1	369.1
II. Central Bank									
(Percentage change during previous 12 months)									
Net international reserves 4/	-280.4	-68.9	-64.7	-8.1	-18.5	-60.8	-35.3	-1,085.9	-28.5
Net domestic assets 4/	1,034.9	425.1	511.8	713.1	91.2	185.1	508.1	3,897.8	314.2
Credit to financial system and private sector 5/	861.0	211.3	410.3	333.0	98.2	168.3	564.5	4,743.4	-16.6
Nonfinancial public sector	221.1	364.3	385.0	378.9	47.8	105.7	455.8	3,085.7	-0.3
Other 3/	-47.2	-150.5	-283.4	1.2	-54.8	-88.8	-512.2	-3,931.3	331.1
Liabilities to financial system and nonfinancial private sector	754.5	356.2	447.2	705.0	72.7	124.3	472.8	2,811.9	285.7
Nonfinancial private sector	191.9	427.1	583.2	561.7	97.6	129.4	365.6	4,051.3	570.8
Rest of financial system	1,542.5	338.6	406.5	762.8	65.0	122.5	513.7	2,452.6	151.4

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

1/ Assets and liabilities denominated in foreign currency are valued at the average exchange rate for each year.
2/ Change as a percentage of liabilities to private sector at the beginning of the period.
3/ Includes counterpart to unrequited foreign exchange transactions (including SDR allocations and valuation adjustments).
4/ Change as a percentage of Central Bank liabilities at the beginning of the period.
5/ Includes capitalization of unpaid interest.

Table 10. Argentina: Summary Balance of Payments

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988	1989	1990 Orig. Prog.	1990 Revised Prog.
Current account	-2,391	-953	-2,859	-4,238	-1,615	-1,274	-2,000	-1,415
Merchandise trade	3,523	4,582	2,128	540	3,810	5,437	4,512	5,450
Exports, f.o.b.	8,107	8,396	6,852	6,360	9,134	9,587	10,512	10,450
Imports, c.i.f.	-4,584	-3,814	-4,724	-5,820	-5,324	-4,150	-6,000	-5,000
Nonfactor services (net)	-205	-231	-573	-285	-298	-299	-141	-265
Factor services	-5,712	-5,304	-4,416	-4,485	-5,127	-6,419	-6,371	-6,600
Profits and dividends	-439	-425	-482	-558	-660	-664	-700	-700
Interest payments	-5,537	-5,132	-4,291	-4,145	-4,678	-6,023	-6,052	-6,172
Interest receipts	264	253	357	218	211	268	381	272
Transfers	3	--	2	-8	--	--	--	--
Capital account 1/	647	397	784	138	234	-3,120	1,440	962
Direct investment 2/	269	919	574	-19 3/	1,147	1,026	790	943
Export financing	511	140	-57	111	879	-789	-285	808
Import financing	-11	-952	-483	-603	-1,564	-1,469	126	-130
Loans from multilateral organizations	123	182	394	733	386	398	611	696
Other 4/	-245	108	356	84	-614	-2,286	198	-1,355
Overall balance	-1,744	-556	-2,075	-4,100	-1,381	-4,394	-560	-453
Financing	1,744	556	2,075	4,100	-1,381	4,394	560	453
Change in assets (increase -)	-207	-1,871	563	1,111	-1,785	1,700	-2,500	-2,000
Arrears	940	-2,445	-1,174	39	2,128	2,736	-5,431	-5,663
IMF position	--	1,007	145	614	18	-485	286	49
Purchases	--	1,007	547	1,253	541	233	942	723
Repurchases	--	--	-402	-639	-523	-718	-656	-674
Official creditors	600	1,017	897	384	387	1,402	417	361
Paris Club	--	1,617	897	384	387	1,402	417	361
Other	600	-600	--	--	--	--	--	--
Commercial banks 6/	--	3,096	1,207	1,244	454	--	--	--
Other liabilities 7/	411	-248	437	708	199	-959 8/	7,788 8/	7,706 8/
Memorandum item								
Gross official reserves (months of imports)	6.9	14.6	10.9	1.7 5/	5.5 5/	2.3 5/	3.6 5/	4.3 5/

Source: Central Bank of Argentina and staff estimates.

1/ Excludes from gross capital outflows the amortizations rescheduled with commercial banks and with other nonofficial creditors; the financing counterpart is likewise excluded from capital inflows.
2/ Includes debt capitalization of US$467 million in 1985, US$382 million in 1988, and US$354 million in 1989.
3/ Includes US$610 million in negative direct investment related to the purchase by Argentina of the COGASCO pipeline, which is largely compensated by foreign borrowing included in other capital.
4/ Includes payments of government bonds, the transformation of private debt with exchange guarantee into public debt, and other private capital flows.
5/ Excludes illiquid reserves.
6/ New money raised through concerted lending.
7/ Includes valuation, changes in residents' foreign currency deposits, and other adjustments.
8/ Includes financing to be obtained.

Table 11. Argentina: External Debt and Debt Service

	1984 1/	1985 1/	1986 2/	1987 2/	1988 2/	Est. 1989 3/	Prog. 1990
(In millions of U.S. dollars; end-year)							
Total disbursed debt 4/	46,171	49,326	51,422	58,324	58,734	64,795	66,848
By borrowing sector							
Public sector	35,527	40,869	44,726	51,793	...	...	...
Private sector	10,644	8,458	6,696	6,531	...	...	...
By maturity							
Medium- and long-term	...	...	...	...	...	...	...
Short-term	...	...	...	...	...	...	...
Arrears	4,163	1,718	544	583	2,927	5,663	—
By type of creditor							
International organizations	2,818	4,569	5,605	8,320	8,391	8,094	8,838
Official creditors	2,018	2,961	5,132	6,007	6,461	6,731	7,008
Banks	32,740	33,777	33,695	36,848	37,300	39,628	41,710
Bondholders	4,208	4,307	3,922	3,638	2,922	6,583	5,858
Other	4,288	4,097	3,352	3,621	3,660	3,759	3,434
(In percent of total)							
Disbursed debt by type of creditor 5/	100.0	100.0	100.0	100.0	100.0	100.0	100.0
International organizations	6.1	9.3	10.9	14.3	14.3	12.5	13.2
Official creditors	4.4	6.0	10.0	10.3	11.0	10.4	10.5
Banks	70.9	68.5	65.5	63.2	63.5	61.2	62.4
Bondholders	9.3	8.0	7.1	6.0	5.0	10.2	8.8
Other	9.3	8.3	6.5	6.2	6.2	5.8	5.1
(In millions of U.S. dollars and in percent)							
Debt service 6/	9,858	9,301	9,645	6,412 7/	...	...	...
Amortization	4,321	4,169	5,354	2,267 7/	...	...	...
Interest	5,537	5,132	4,291	4,145	4,678	6,023	6,172
Exports of goods, nonfactor services and transfers	10,050	10,259	8,738	8,472	11,301	11,903	12,747
Interest ratio to exports	55.1	50.0	49.1	48.9	41.4	50.6	48.4
(In percent of GDP) 8/							
Debt outstanding	75.8	82.2	79.1	85.3	85.7	98.5	97.3
Debt service	16.2	15.5	14.8	9.4	...	...	...
Interest	9.1	8.6	6.6	6.1	6.8	9.2	9.0

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

1/ Based on data from debt reporting system for 1983 and data from balance of payments flows.
2/ Based on data from debt reporting system.
3/ Based on data from debt reporting system for 1988 and data from provisional 1989 balance of payments flows, adjusted for exchange rate movements.
4/ Includes arrears on interest.
5/ Before rescheduling.
6/ Includes amortization on loans with an original maturity of more than one year, and all interest payments. Includes both public and private debt.
7/ After 1987 rescheduling of commercial bank debt.
8/ GDP in U.S. dollars is derived by converting GDP in australes using the U.S. dollar/austral exchange rate that would maintain the rate at its projected real level in 1990.

Table 12. Argentina: Outstanding External Arrears

(In millions of U.S. dollars)

	1987		1988		1989		1990
	June	Dec.	June	Dec.	June	Dec.	March
Total	449	583	1,447	2,927	5,322	5,663	6,503
Suppliers and commercial creditors	152	40	111	236	322	222	305
Paris Club	118	188	314	532	1,011	--	--
International organizations	12	107	182	188	326	130	148
Commercial banks 1/	152	228	825	1,956	3,493	5,165	5,874
Other	15	20	15	15	170	146	176

Source: Central Bank of Argentina.

1/ Medium- and long-term refinanceable public debt; includes Argentine banks.

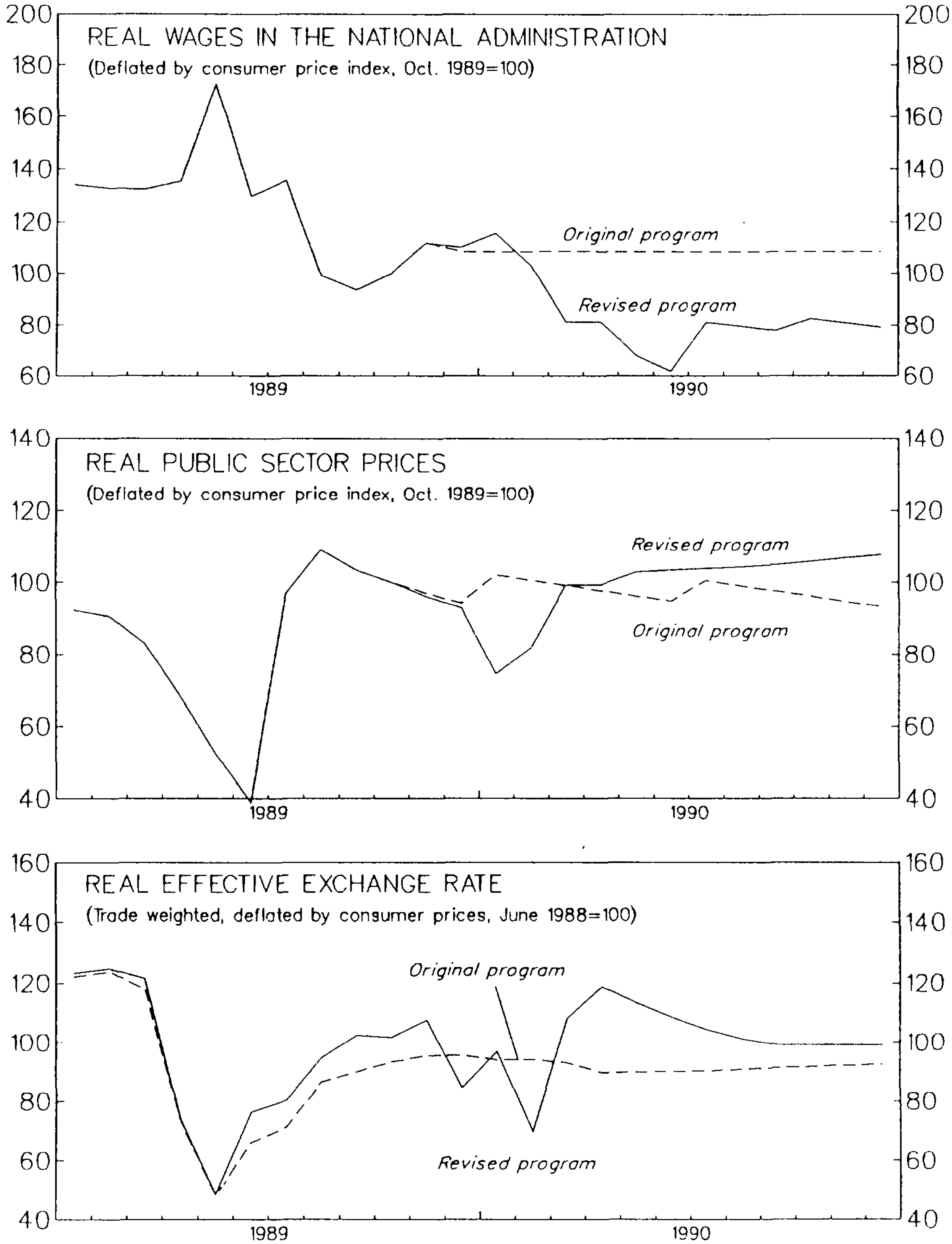
Table 13. Argentina: Medium-Term Balance of Payments Projections, 1990-95

	1990	1991	1992	1993	1994	1995
	(In billions of U.S. dollars)					
Summary balance of payments						
Current balance 1/	-1.4	-2.0	-2.1	-2.2	-2.2	-2.0
Trade balance	5.5	5.0	5.1	5.2	5.5	5.9
Exports	(10.5)	(11.0)	(11.9)	(12.9)	(14.1)	(15.5)
Imports	(-5.0)	(-6.0)	(-6.8)	(-7.7)	(-8.6)	(-9.6)
Nonfinancial services	-0.3	-0.2	-0.2	-0.3	-0.3	-0.3
Financial services 1/	-6.6	-6.8	-7.0	-7.1	-7.4	-7.6
Of which: interest payments 1/	(-6.2)	(-6.3)	(-6.4)	(-6.6)	(-6.7)	(-6.9)
Capital account flows 1/2/	9.1	3.2	3.4	3.1	3.2	2.9
Financing	-7.7	-1.2	-1.3	-0.9	-1.0	-0.9
Gross reserves (increase -)	-2.0	-0.5	-0.5	-0.5	-0.5	-0.5
Use of IMF credit	—	-0.7	-0.8	-0.4	-0.5	-0.4
Change in arrears	-5.7	—	—	—	—	—
	(In percent)					
Assumptions						
Interest rate (U.S. dollar, 6-month LIBOR)	8.3	8.3	8.3	8.3	8.3	8.3
Export volumes (annual change)	15.0	1.0	4.0	5.0	5.0	6.0
Import volumes (annual change)	17.8	15.0	10.0	9.0	7.5	7.5
Terms of trade (annual change)	-7.3	0.4	0.8	-0.2	-0.4	0.7
Real growth (annual change)	-0.9	5.5	5.0	4.8	4.5	4.5
Memorandum items						
Scenario A 1/						
Interest payments/GDP	9.0	8.8	8.3	7.9	7.5	7.0
External debt/GDP	97.3	96.1	90.9	86.2	82.0	76.9
Interest payments/exports 3/	48.4	46.6	43.9	41.5	39.2	36.5
Total debt service/exports 3/4/	67.9	66.7	59.8	53.8	53.6	49.5
Gross disposable reserves 5/	4.3	4.1	4.5	4.7	4.9	5.0
Scenario B 6/						
Interest payments/GDP	9.0	7.6	6.6	5.7	5.2	4.7
External debt/GDP	87.9	79.2	69.5	62.7	57.4	52.7
Interest payments/exports 3/	48.4	40.4	34.5	30.1	27.0	24.5
Total debt service/exports 3/4/	67.9	60.4	50.4	42.5	41.4	38.8
Gross disposable reserves 5/	4.3	4.6	4.9	5.1	4.9	4.8

Source: Staff estimates.

1/ Assuming no debt or debt service reduction.
2/ Includes financing to be obtained.
3/ Exports of goods and nonfactor services.
4/ After rescheduling of principal due to commercial banks.
5/ In months of merchandise imports.
6/ Assuming phased market-based debt and debt service reduction operations 1990-93, as described in text, financed by debt equity swaps in connection with privatization and enhancement resources of $4-4.5 billion obtained from a variety of sources.

CHART 1
ARGENTINA
COMPARISON OF PROGRAMS



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

Fund Relations with Argentina
(As of March 31, 1990)

I. Membership Status

(a) Date of Membership: September 1956
(b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 1,113.0 million

		Millions of SDRs	Percent of Quota
(b)	Total Fund holdings of australes	3,291.9	295.8
(c)	Fund credit	2,178.9	195.7
	Credit tranches (ordinary resources)	459.0	41.2
	Enlarged access resources	968.0	87.0
	CFF	751.9	67.6

III. Recent Stand-By Arrangements and Special Facilities

(a) Stand-by arrangements

Duration	Amount Drawn (SDR million)	Status
July 23, 1987- Sept. 30, 1988	616.5	Expired on Sept. 30, 1988 with two purchases for a total of SDR 331.0 million withdrawn
Dec. 28, 1984- June 30, 1986	1,182.5	Expired
Jan. 24, 1983- April 24, 1984	600.5	Canceled, Jan. 23, 1984

(b) Special Facilities: CFF

Year Approved	Amount (SDR million)
1988	233.1
1987	518.8
1984	275.0
1983	520.1

IV. SDR Department

(a) Net cumulative allocation: SDR 318.37 million
(b) Holdings: SDR 2.4 million or 0.8 percent of net cumulative allocation.
(c) Current Designation Plan: not applicable

V. Financial Obligations Due to the Fund

	Principal and Interest Due (SDR million)		
	Apr. 1-Dec. 31, 1990	1991	1992
Repurchases	333.7	723.8	637.7
Charges and Interest including SDR and TF (provisional)	151.0	182.4	114.9
Total	484.7	906.2	752.7

B. Nonfinancial Relations

VI. Exchange Rate

On February 6, 1989 Argentina established an exchange system comprising three exchange rates: a commercial exchange rate applicable to agricultural exports and to 50 percent of industrial exports; a special commercial exchange rate, to be fixed at 25 percent above the commercial exchange rate, applicable to 50 percent of industrial exports and to the major part of imports; and a free exchange rate applicable to all other services and to capital transactions. On February 21, 1989 twenty percent of both agricultural and industrial exports were transferred to the free market.

On April 4, 1989 the special commercial exchange rate was eliminated, and the percentage of trade transactions to be conducted at the free exchange rate was set at a uniform 50 percent, with the remainder to be conducted at the single official rate.

On April 13, 1989 the multiple exchange rate system was replaced by a unified floating exchange rate for all external current and capital transactions of the private and public sectors. However, in the case of exports, a 100 percent tax was levied on the difference between the free rate and a reference rate set at ₳ 36 per U.S. dollar. On May 2, 1989 this tax was replaced by a 20 percent tax on exports, and export receipts were entitled to the unified exchange rate.

On May 28, 1989, the floating exchange system was replaced by a unified fixed exchange system, exchange controls were reintroduced, and the free exchange market was banned. It was announced that the new official exchange rate would be adjusted periodically and that there would be a preferential exchange rate for pharmaceuticals. Also on that date, the tax on agricultural exports was raised from 20 to 30 percent. On August 8, 1989 the Central Bank suspended temporarily the access of loans for export prefinancing to the official exchange market.

On December 11, the official rate was devalued to ₳ 1,010 (selling) per U.S. dollar, and general export taxes were increased.

On December 18, the foreign exchange market was unified under a freely floating system; the export tax increase of December 11 was rescinded and an accelerated schedule was announced for the elimination of export taxes; and payments for imports were subject to the unified free market, with no minimum financing requirement period.

On March 5, 1990 export taxes applicable to agricultural and agro-industrial goods were increased by 5 percentage points.

From October 1, 1988 to April 13, 1989 the official exchange rate was subject to frequent adjustments, and by April 13 it stood at ₳ 20.15 per U.S. dollar (selling). Following the unification of the exchange markets, the exchange rate depreciated at a rapid pace and as of May 26, 1989, the floating exchange rate stood at ₳ 180 per U.S. dollar (selling). On May 28, 1989, the official exchange rate was fixed at ₳ 177 per U.S. dollar (selling) and after additional adjustments it stood at ₳ 305 per U.S. dollar (selling) on July 7, 1989. On July 9, 1989 the official exchange rate was fixed at ₳ 655 per U.S. dollar (selling). On December 11, it was devalued to ₳ 1,010 (selling) per U.S. dollar. The rate depreciated sharply after the unification of the markets on December 18, to stand at ₳ 1,800 per U.S. dollar on December 28, 1989. Following a further rapid depreciation through early March 1990, when the rate stood at almost ₳ 6,000 per U.S. dollar, the austral appreciated somewhat before fluctuating in a relatively narrow range around ₳ 5,000 per U.S. dollar through early May.

VII. Last Article IV Consultation

The 1987 Article IV consultation was concluded on November 10, 1989 (EBM/89/145).

VIII. Technical Assistance

The Fiscal Affairs Department has provided extensive technical assistance in the design of tax reform and tax administration, including missions to Buenos Aires in August and October 1989 and April 1990. A mission from the Central Banking Department visited Argentina in 1989 to advise on a new charter for the Central Bank.

Relations with the World Bank

Following five years of modest lending activity, World Bank lending operations in Argentina expanded substantially in the period 1986-88, with gross disbursements averaging some US$565 million per year (see panel III of the tabulation below). In 1989, the pace of lending dropped off somewhat, to disbursements totaling US$316 million. This decline mainly reflected the Government's inability to meet loan conditions under the Second Trade Policy Loan and the Banking Sector Loan; disbursements under these two loans were suspended in March 1989. The Banking Sector Loan later lapsed. Disbursements under the Housing Sector Loan and the Electric Power Sector Loan were not affected by these developments but further disbursements under the Trade Policy Loan are still pending. Release of funds will depend upon the authorities' compliance with certain conditions specified in the loan, especially as concerns ceilings on export taxes. As export taxes were increased as part of the fiscal measures of March 6 rather than reduced as had been specified in the Trade Policy Loan agreement, the authorities are expected to seek a waiver from World Bank management. The staff decision regarding such a waiver would depend upon two conditions: a tax reform must be in place to replace revenues accruing under the export taxes; and trends in the macroeconomic environment must be judged as suitable for reactivation of the loan.

Looking ahead, the Bank is currently pursuing policy based lending in the areas of Public Enterprise Reform, Public Sector Reform and Provincial Financial Development, which are all at the pre-appraisal stage of formulation. The Public Enterprise Reform Loan is expected to be presented to the Bank's Executive Board before the end of 1990, while the Public Sector Reform and Provincial Financial Development Loans could be presented for the Board's consideration in the first quarter of 1991. The Bank is also processing loans in the Health and Water Supply Sectors.

Financial Relations with the World Bank

(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursements	Undisbursed Amount
I. IBRD Operations (as of March 31, 1990)			
Fully disbursed loans	1,695.12	1,695.12	—
Loans in process of disbursement			
Agricultural and rural developments	106.5	70.5	36.0
Industry and industrial credit	125.0	33.8	91.2
Power and hydrocarbon	1,038.0	589.5	448.5
Public sector management	25.0	11.9	13.1
Transport and municipal development	270.0	101.5	168.5
Water supply	60.0	10.4	49.6
Trade policy	796.3	645.9	150.4
Social sector	328.0	18.7	309.3
Total loans	4,443.92	3,177.32	1,266.6
Repaid 1/	1,057.00	—	—
Outstanding	3,386.92	—	—

II. IFC Operations (as of March 31, 1990)

	Loans	Equity	Total
Commitments	664.8	32.4	697.2
Total held by IFC	384.0	29.4	413.4
Total undisbursed (including other participants)	79.6	12.1	91.6

III. IBRD Loan Transactions

	1986	1987	1998	1989
Disbursements	408.0	794.7	486.7	316.4
Repayments	134.4	133.1	187.8	220.7
Net lending	273.6	661.6	298.9	95.7

Source: World Bank.

1/ Includes repayment to third parties.

Summary of Economic Program

1. Principal objectives

a. On the basis of a major improvement in the public finances, the program aims at reducing inflation to around 2 percent a month by the second half of 1990. Following a marked decline in the first half of 1990, real GDP is expected to recover around midyear, expanding by about 6 percent during 1990 (declining by almost 1 percent on an average annual basis) compared with an estimated decline of 1/4 percent during 1989 (equivalent to an average decline of 3 1/2 percent).

b. The program envisages a slight widening in the current account deficit to US$1.4 billion in 1990 (US$1.3 billion in 1989) and a marked narrowing in the overall balance of payments deficit to US$450 million (US$4.4 billion in 1989), with a buildup of the Central Bank's disposable international reserves.

c. It is expected that Argentina will be re-establishing relations with its external creditors in the course of the program period.

2. Main assumptions

a. The external economic environment would evolve according to the most recent projections in the World Economic Outlook.

b. Money demand would strengthen only modestly as inflation recedes, with M-1 rising from a low 1.7 percent of GDP in March 1990 to 2.3 percent of GDP by December 1990.

3. Principal targets and instruments

a. Fiscal policy

The primary balance of the nonfinancial public sector is to shift from a small deficit in 1989 to a surplus equivalent to 5 1/2 percent of GDP in 1990; for the final three quarters of 1990, the target for the primary surplus for the nonfinancial public sector is equivalent to 7 percent of GDP. The overall balance of nonfinancial public sector would show a small deficit for 1990 as a whole (including a small surplus for the final three quarters of 1990), compared with a deficit equivalent to 15 1/2 percent of GDP in 1989.

The improvement in the fiscal accounts in 1990 would come from an increase in revenue equivalent to about 4 3/4 percent of GDP, and a reduction in spending of nearly 1 1/4 percent of GDP.

b. Monetary policy

The Central Bank would continue its policy of strictly enforcing legal reserve requirements while aggressively collecting outstanding rediscounts; rediscounts extended for individual banks to ease temporary liquidity problems will be provided with a very short recovery period, generally seven days. Interest rates are to continue to be freely determined by market forces and subsidies are to be eliminated in central bank credit. Net domestic financing to the nonfinancial public sector would be negative in 1990, while bank credit to the private sector would expand in real terms during the final three quarters of 1990 after substantial declines in 1989 and in the first quarter of 1990.

c. *Incomes policies*

The Government is following a policy of free collective bargaining in the private sector.

For the National Administration, real salaries are currently at compressed levels. The Government would continue a policy of wage restraint until overstaffing in the public sector is reduced, which would make room for improvement in the salary scale of the public sector.

d. External sector policies

The Government is following a floating exchange rate policy with the Central Bank purchasing foreign exchange as necessary to meet public external obligations and the programmed increase in official reserves.

The floating exchange rate regime, with virtually free access to the market for foreign exchange, will be maintained. Exchange market intervention will be guided by the program's balance of payments objective. This is expected to be consistent with a gradual improvement in international competitiveness in the early months of the program, after the real appreciation that has taken place during March-April 1990.

e. Structural policies

By mid-1990, the base of the value-added tax will be extended to include most private sector services, and tax administration will be strengthened to increase the yield and coverage of the VAT and other taxes. The new penal code for tax offenders will be strictly enforced. Measures to reduce overstaffing will lower employment in the public sector by about 10 percent by the end of 1990.

The program of privatization will be pursued vigorously, with sales during 1990 of assets totaling 1 1/4 percent of GDP.

A restructuring of the private financial sector is expected, with commercial banks again assuming the function of allocating credit among productive activities according to market-based criteria. Reform of the official banks will continue, and the supervisory powers of the Central Bank will be strengthened.

Import tariffs will be lowered and their dispersion reduced, while all quantitative restrictions would be eliminated. Export taxes on industrial goods are to be phased out and those on agricultural products are to be reduced.

Exchange and Trade System 1/

Argentina's exchange and trade system involves the following exchange restrictions on payments and transfers for current international transactions.

1. Exchange restrictions 2/

a. There exists an exchange restriction evidenced by arrears on payments of interest on medium- and long-term public debt to commercial banks and on other debt subject to the commercial bank debt rescheduling. According to official estimates, at the end of December 1989 these arrears amounted to US$5.2 billion.

b. There exists a further exchange restriction evidenced by arrears on other payments and transfers for current international transactions. According to official estimates, at the end of December 1989 these arrears amounted to US$0.5 billion. In accordance with paragraph 26 and the accompanying Table 4 of the Memorandum on Economic Policy attached to the authorities' letter of May 9, these arrears are to be reduced to US$350 million by the end of September and then eliminated no later than end-December 1990.

c. The sale of exchange is not permitted for the repayment of foreign loans for which the domestic borrower obtained an exchange rate guarantee during 1981 and 1982; in some cases these loans were related to trade finance. In order to obtain repayment, the foreign creditor must reschedule such loans, either by accepting a U.S. dollar-denominated debt instrument of the Government of Argentina, or by renegotiating the loan directly with the domestic borrower according to minimum terms established by the Central Bank.

1/ A more detailed description of the system as of December 31, 1989 will be provided in the 1989 Annual Report on Exchange Arrangements and Exchange Restrictions.

2/ Two multiple currency practices related to capital transactions arise from the existence of swaps and from an option for the early cancellation of loans covered by central bank exchange rate guarantees. In November 1986, the Government introduced the option for the early cancellation of the exchange rate guarantee covering US$180 million in swap arrangements undertaken, and US$600 million in debts taken over, by the Central Bank in 1981-82. Under the program the domestic debtor may accept a U.S. dollar-denominated bond for that part of the underlying obligation for which the Government is responsible as a consequence of the foreign exchange contract. The debtor would continue to owe to its creditor the difference between the debt assumed by the Government and the original amount of the obligation. Such amounts, however, would be deleted from the central bank register.

d. According to an agreement under which Bolivia exports natural gas to Argentina, a fixed proportion of payments by Argentina may be made into a noninterest-bearing account at the Central Bank of Argentina that can be used by Bolivia solely for purchases of Argentine goods to be used in Bolivia, and for Bolivia's debt service payments to Argentina.

2. Imports

All imports require a Sworn Declaration of Import Need (Declaración Jurada de Necesidades de Importación). Under the import licensing system introduced in 1984, imports are divided into three categories: prohibited goods; imports subject to prior Government approval, which customarily follows the recommendations of domestic producers' associations; and other imports for which clearance is more readily available. Quantitative restrictions arise from the prohibitions in the first category of imports, which now cover 900 tariff positions and account for about 3.5 percent of production coverage of industrial products, and from the prior consultation with domestic producers required for the second category of goods which now account for 6 percent of industrial production coverage.

The total production coverage of quantitative import restrictions, now 9 percent, has been reduced from over 60 percent at the beginning of 1987. When initially introduced, the prohibited list covered imports of most consumer goods and many industrial goods produced in Argentina. Imports requiring prior approval included most capital goods and certain industrial imports; in the case of iron and steel, control was exercised by the General Directorate of Military Industries, rather than by the Secretariat for Industry and External Trade (SICE). At present, prohibited goods are largely pharmaceuticals and food items controlled for health and quality reasons. The imports on the prior consultation list are mostly manufactured goods, in particular petrochemical products, and small automobiles and automobile products, as well as some mining and meat products and sugar. A further category of imports, including electronic goods, are effectively deterred through the application of very high specific tariffs. Electronic goods are also subject to additional ad valorem tariffs.

The structure of import tariffs remains complex, although the level and dispersion of rates have been reduced since 1987. Basic import tariffs are now in a range of 5-24 percent. In addition to tariffs, surcharges and the value-added tax, importers also must pay a 3 percent statistical tax, a consular fee of 6 percent, and some other charges.

3. Exports

Export taxes are applied to all exports at present; a general tax of 20 percent for industrial exports and 30 percent for agricultural exports was established in May 1989. The tax is being phased out gradually on industrial products and reduced on agricultural products.

A number of special export schemes (described in SM/89/30) were temporarily suspended under the Economic Emergency Law; among these, the system of export rebates was eliminated in early 1990. Another scheme, which permits exporters to have automatic duty-free access to a range of imported inputs provided these are re-exported within one year, has been expanded so that it now covers the bulk of raw materials and basic inputs.

Summary of the Tax Reform Legislation Enacted in December 1989

With the promulgation of Laws 23760 and 23765, significant changes were made to the structure of Argentina's tax system. In addition to the reform of the value-added tax, which was briefly described in the body of the report, the legislation introduced a new tax, the tax on business assets (impuesto sobre los activos), eliminated three other taxes, lowered the average rates of tax on personal and company income, lowered the rate of the tax on current account debits (checks), and made changes to certain minor excise taxes along with a number of other modifications to the tax system. This appendix summarizes the major changes made to the tax system.

1. Changes to existing taxes

a. Value-added tax (VAT)

(1) Changes to the base

Prior to the promulgation of Law 23765, the list of goods exempted from the VAT was lengthy, and included most foodstuffs, the major petroleum products, natural gas, many inedible raw materials, including leather, cotton, and various minerals, weaponry destined for the armed forces and police, paper and paper products, books and periodicals, and certain types of capital equipment. The new list of exemptions has been substantially shortened, so that the major exemptions are now books and periodicals, and final sales of milk, bread, and medicines.

Under the earlier legislation, services were mostly exempt, and in order to be taxed had to be listed. Legislation submitted to Congress in May has added an additional item to the list of taxable services that is meant to cover all those services that are not specifically exempted elsewhere. The legislation would also specifically exempt a fairly large number of services, including those provided by the media and public or publicly sponsored educational establishments, certain forms of public transportation, financial services, and most real estate rentals.

(2) Rates

Law 23765 lowered the general rate from 15 percent to 13 percent, and included a provision under which the Executive Branch can vary this rate by a margin of 20 percent either way: that is, from 10.4 percent to 15.6 percent. It also eliminated the preferential rate of 7 percent applying to the construction industry.

(3) Treatment of banks

The banking system is exempt from the VAT as such, but under Law 23760 was made subject to a special monthly tax on its value-added at the rate of 6 percent. The tax is assessed using the direct additive method on the sum of net profits and labor costs and no credit is given for any taxes paid on materials and supplies.

(4) Treatment of the small trader

The previous legislation included a simplified regime for traders whose annual sales exceeded ₳ 59.256 million but did not exceed ₳ 197.521 million (December 1989 prices), and exempted those traders whose sales were below this range. Law 23765 eliminates the simplified regime and introduces the distinction of registered versus nonregistered trader (responsable no inscripto). A trader may elect the status of nonregistered trader if annual sales are less than ₳ 30.000 million. Nonregistered traders are not required to pay tax on their sales, but registered traders who sell to nonregistered traders are required to pay an additional tax equal to 20 percent 1/ of the tax due on their sales on behalf of the nonregistered trader.

b. Income tax

(1) Change to the rate structure

The rate of tax for domestic corporations was lowered from 33 percent to 20 percent, and the rate of tax for local subsidiaries or local operations of nonresident corporations was lowered from 45 percent to 36 percent. The rate of tax on net income other than dividends of nonresidents from Argentinian sources was also lowered from 45 percent to 36 percent.

The maximum marginal rate for individual taxpayers was lowered from 35 percent to 30 percent, and the number of rates was reduced from 8 to 6, as shown below:

1/ If the nonregistered trader is a primary producer, the additional tax is 40 percent of the tax on the sales of the registered trader.

Previous bracket structure		New bracket structure	
Income range (In millions of australes December 1989)	Rate (In percent)	Income range (In millions of australes December 1989)	Rate (In percent)
0.000 - 1.850	6	0.000 - 1.000	6
1.850 - 4.623	10	1.000 - 10.000	10
4.623 - 9.248	14	10.000 - 21.000	15
9.248 - 15.722	18	21.000 - 42.000	20
15.722 - 24.044	22	42.000 - 84.000	25
24.044 - 34.218	26	84.000 -	30
34.218 - 46.240	30		
46.240 -	35		

No changes were made to the basic personal and dependents' exemptions.

Rates on withholding tax applied to dividends and other distributions were changed as follows:

	Previous rate	New rate
	(In percent)	
Payments to registered residents not subject to corporate income tax	0	10
Payments to nonregistered residents	22.5	20
Payments to nonresidents or subsidiaries or branches of nonresident corporations	22.5	20

The legislation also changed the coefficients used to convert payments to nonresidents to net income paid to nonresidents, as follows:

	Value of coefficient	
	Previous value	New value
(In percent)		
Interest payments	35	40
Rental payments	50	60
Payments for technical assistance, under licensing agreements and the like that do not satisfy certain conditions stipulated by the Law of Technological Transfers	100	90
Miscellaneous payments	80	90

(2) Other significant changes to the income tax

(a) The loss carryover provision was changed to allow 100 percent carryover of any loss incurred in the five preceding years. Previously, only 50 percent of any losses could be carried over.

(b) A limit of 15 percent of the allowable personal deduction and deductions for dependents was set for the deductability of contributions of individual taxpayers to medical insurance plans for themselves and their dependents.

(c) The limit on the allowable annual deduction for employer's contributions to retirement funds in determining the employer's taxable income was reduced from ₳ 1.749 million to ₳ 0.437 million per employee (December 1989 prices), and the limit on the allowable deduction by the employee himself in determining his taxable income was reduced from ₳ 3.499 million to ₳ 0.875 million; in addition, the scope of the deduction was broadened to include contributions to mutual organizations.

(d) The fixed limit on the allowable deduction for representational expenses was eliminated.

2. Tax on current account debits (tax on checks)

The rate of the tax on checks was lowered from 7 per mil to 3 per mil, and the provision allowing a credit of 70 percent of payments of this tax against other tax liabilities was eliminated.

3. Elimination of taxes

a. The tax on net worth of companies (impuesto sobre los capitales) was eliminated as of the tax year beginning January 1, 1990.

b. The tax on personal net wealth was eliminated as of December 31, 1990. The base of the tax was net wealth as of the last day of the year.

c. The tax on capital gains (impuesto sobre los beneficios eventuales) was eliminated as of January 1, 1990.

4. New taxes

Tax on business assets (impuesto sobre los activos)

Law 23760 created a new tax on the gross assets of companies, which is levied at the rate of 1 percent. The base of the tax includes both real and financial assets, including urban rental property, but excludes property not domiciled in Argentina. Financial institutions are required to include 40 percent of their financial assets in the base of the tax; rural property is allowed a deduction of 25 percent. Newly acquired capital equipment is excluded from the base in the year of and the year following its acquisition.

Payments of this tax are creditable against liability for income tax, although taxpayers whose liabilities for this tax exceeds that for income tax are not entitled to receive a refund or to carry over a credit to apply against future income tax liabilities. In the case of subsidiaries or branches of foreign corporations, the credit is restricted to 20 percent of taxable income, or 55.6 percent (20/36ths) of income tax liability.

Argentina--Basic Data

Area and demographic indicators	
Area	2,766.9 thous. sq. km.
Population (1988)	32.0 million
Annual rate of population growth (1983-88)	1.5 percent
Density (1987)	11.6 per sq. km.
Crude birth rate	23.6 per 1,000
Crude death rate	8.9 per 1,000
Infant mortality	34.4 per 1,000 live births
Social indicators	
Population per physician	500
Population per hospital bed	200
Percent of personal income, highest quintile (1970-76)	50.3
lowest quintile (1970-76)	4.4
Percent of population - urban (1980)	65.0
rural (1980)	17.0
Access to electricity (1980)	87.0 percent of population
Consumption per capita (1985)	14.60 kg. of oil equivalent
Calorie intake (1982-85)	119.2 percent of requirement
Per capita protein intake (1982-85)	99.7 grams per day
Adult literacy rate (1978)	93.0 percent
Primary school enrollment (1982-85)	107.0 percent
GDP (1989)	SDR 51,362 million 1/
	US$65,834 million 1/
	₳ 25,512,922 billion
GDP per capita (1989)	SDR 1,581 1/

	1985	1986	1987	1988	1989	Proj. 1990
Origin of GDP			(percent)			
Agriculture, livestock and fishing	15.8	14.5	14.6	14.9	13.8	14.8
Mining	2.7	2.4	2.4	2.7	2.9	2.8
Manufacturing	22.5	24.1	23.4	22.4	21.9	21.5
Construction	3.2	3.3	3.7	3.2	2.5	2.5
Electricity, gas, and water	4.6	4.7	4.9	5.3	5.4	5.5
Commerce	14.0	14.4	14.3	13.9	14.4	14.4
Transport and communications	11.7	11.6	11.7	11.6	11.6	11.5
Finance and banking	7.8	7.9	7.9	8.1	8.7	8.0
Other services	17.7	17.0	17.0	17.8	18.8	19.0
Ratios to GDP						
Exports of goods and nonfactor services 1/	17.1	13.4	12.4	16.5	18.1	18.6
Imports of goods and nonfactor services 1/	9.8	11.0	12.0	11.4	10.3	11.0
Factor services (net) 1/	-8.8	-6.8	-6.6	-7.5	9.8	9.6
Current account of the balance of payments 1/	-1.6	-4.4	-6.2	-2.4	-2.0	-2.0
Central government revenues 2/	11.3	11.8	10.9	9.2	9.8	13.3
Central government expenditures 2/3/	8.1	8.6	8.7	8.4	8.2	7.8
Primary balance of public enterprises	-1.6	-0.8	-1.8	-1.4	-1.1	0.2
Primary balance of nonfinancial public sector	0.7	1.8	-0.9	-1.0	0.1	5.6
External debt (end of year) 1/	82.2	79.1	85.3	85.7	98.5	97.3
Gross national savings	10.0	7.4	6.6	8.9	7.5	8.0
Gross aggregate investment	11.6	11.8	13.2	11.4	9.4	10.1
Financial system liabilities to private sector (average)	13.8	18.4	19.4	20.2	12.7	2.7
Annual changes in selected economic variables						
Real GDP per capita	-5.7	4.0	0.7	-4.1	-6.4	2.4
Real GDP at 1970 prices	-4.3	5.6	2.2	-2.7	-3.5	-0.9
GDP at current prices	649.7	87.7	133.0	353.4	3,151.0	2,021.3
GDP deflator	683.4	77.7	128.0	366.0	3,368.9	2,140.6
Wholesale prices (annual average)	662.5	63.9	122.9	412.5	3,431.4	2,111.6
Consumer prices (annual average)	672.2	90.1	131.3	343.0	3,080.5	2,143.1
Financial system liabilities to private sector	320.2	100.6	149.0	355.2	445.6	331.8
Monetary liabilities	596.2	85.5	124.9	337.6	7,986.5	323.2
Other liabilities	248.8	108.1	158.8	360.1	9.1	369.1
Net domestic assets 5/6/	317.7	116.6	209.2	397.5	540.7	361.2
Credit to private sector 5/	196.6	67.3	122.9	232.1	596.8	227.7
Credit to public sector 5/6/	126.3	48.7	106.4	298.1	680.9	-0.1
Other 5/	-5.8	0.6	-20.1	-132.7	-737.0	133.6
Merchandise exports (f.o.b. in U.S. dollars)	3.6	-18.4	-7.2	43.6	5.0	9.0
Merchandise imports (c.i.f. in U.S. dollars)	-16.8	23.9	23.2	-8.5	-22.1	20.5

	1985	1986	1987	1988	1989	Proj. 1990
Balance of payments		(billions of U.S. dollars)				
Merchandise exports, f.o.b	8.4	6.9	6.4	9.1	9.6	10.5
Merchandise imports, c.i.f.	3.8	4.7	5.8	5.3	4.2	5.0
Interest payments	5.1	4.3	4.2	4.7	6.0	6.2
Other factor income (net)	-0.2	-0.1	-0.3	-0.4	-0.4	-0.4
Other services and transfers (net)	-0.2	-0.6	-0.3	-0.3	-0.3	-0.3
Balance on current account	-1.0	-2.9	-4.2	-1.6	-1.3	-1.4
Direct investment	0.9	0.6	--	1.1	1.0	0.9
Loans from international organizations	0.2	0.4	0.7	0.4	0.4	0.7
Other capital (net)	-0.7	-0.2	-0.4	-1.3	-4.5	-1.4
Overall balance	-0.6	-2.1	-4.1	-1.4	-4.4	-0.5
Change in official assets	-1.9	0.6	1.1	-1.8	1.7	-1.0
Change in arrears	-2.4	-1.2	--	2.1	2.9	-5.7
Other	4.9	2.7	3.0	1.1	-0.2	7.1

	December 31				
	1985	1986	1987	1988	1989
International reserve position			(billions of SDRs)		
Central Bank (gross)	4.2	3.5	2.1	3.7	2.7
Central Bank (net)	-5.6	-6.5	-8.6	-10.3	-11.1
Central Bank and Treasury (net)	-7.7	-8.3	-10.1	-11.7	-16.0

1/ GDP in U.S. dollars is derived by converting GDP in australes using the U.S. dollar/austral exchange rate that would maintain the rate at its real level in the second half of 1985. GDP in SDRs is obtained by converting this estimate for GDP in U.S. dollars using the actual SDR/U.S. dollar exchange rate.
2/ Data are on a cash basis, except external interest payments which are on an accrual basis.
3/ Interest payments exclude inflationary component.
4/ Annual figures are calculated as simple averages of quarterly ratios.
5/ Change as a percentage of liabilities to the private sector at the beginning of the period.
6/ Includes credit to the nonfinancial public sector and the operating losses of the Central Bank.

Buenos Aires
May 10, 1990

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

The attached Memorandum on Economic Policy contains a description of the economic policies the Government of Argentina intends to follow in the period through the end of 1990. These policies are aimed at reinforcing the adjustment effort and the program of structural reform described in the policy memorandum attached to the letter of October 12, 1989, and supported by the stand-by arrangement approved by the Executive Board of the International Monetary Fund on November 10, 1989.

As is described in the memorandum, the adjustment effort was not consolidated as quickly as had been expected and there were policy slippages, leading to the non-observance of the performance criteria. In response to these developments, the Government of Argentina has strengthened its economic policies. Given the confirmation in recent weeks that developments are proceeding in line with the revised program, the Government requests a modification of the stand-by arrangement and a purchase to become available on completion of the first review of the program. Access under the modified stand-by arrangement for the period through March 1991 would amount to SDR 920 million.

As outlined in the attached memorandum, the Government intends to seek understandings with its commercial bank creditors to allow for phased market-based debt and debt service reduction. In support of the financing strategy outlined in the policy memorandum, which is considered essential for the restoration of the medium-term viability of the balance of payment, the Government requests that an amount equivalent to 25 percent of each of the final three purchases available under the present stand-by arrangement after mid-August 1990, be set aside for debt reduction operations.

The Government of Argentina believes that the modified policies described in the attached memorandum are adequate to achieve the objectives in the economic program, but it will take any further measures that may be appropriate for this purpose. In any event, the

Government will review with the Fund before the end of August 1990 the progress made in the implementation of the program. As progress is made in achieving the program's objectives, the Government would be interested in further support from the Fund in the form of an extended arrangement.

Yours sincerely,

/s/

Antonio Erman Gonzalez
Minister of Economy

Attachment

ATTACHMENT

CONFIDENTIAL

Argentina: Memorandum on Economic Policy

Introduction

1. As was indicated in the memorandum attached to the letter of intent dated October 12, 1989, the Argentine Government that assumed office on July 9, 1989 inherited an economy suffering from recession, hyperinflation, and severe balance of payments difficulties, including large payments arrears. To deal with that situation, the Government immediately launched a broad program of adjustment and structural change. In the short term, the strategy centered upon reducing inflation quickly to low levels by resetting the level of the exchange rate, supported by a tight credit policy, strong fiscal measures, and a prudent wage policy. For the medium term, the strategy placed heavy emphasis on structural reforms, most notably: a major tax reform and overhaul of the tax collecting agencies; privatization of public enterprises; liberalization of the country's exchange and trade system; and financial system reform, including changes in the role of official banks and a new charter of the Central Bank that would make it independent of the Executive Branch.

2. The stabilization strategy scored several immediate successes and initial steps were taken in the program of structural reform. Inflation declined sharply through November while economic activity recovered, and reflows of private capital helped rebuild official reserves. In addition, there was a marked improvement in the treasury accounts through November, and the Government began to repair its relations with external creditors, including the elimination of arrears to multilateral institutions and an agreement with its Paris Club creditors in late December. As regards structural reforms, the Government made a start in the process of privatization, adopted a framework for the liberalization and deregulation of the petroleum sector, and made substantial progress in liberalizing the external trade system.

3. Notwithstanding these successes, the stabilization effort could not be consolidated as quickly as had originally been anticipated. There were delays in the drafting and passage of the tax reform legislation and the program of privatization proceeded more slowly and less firmly than had been expected. Credit policy did not follow a sufficiently steady course and on balance interest rates were not high enough to avoid net redemptions of central bank paper, which resulted in an injection of liquidity into the banking system. In addition, the improved state of the economy led to excessive wage increases in the private sector, which spilled over into the public enterprises. These slippages in policy were reflected in exchange pressures starting in October, which led to a widening spread between the official and parallel exchange markets. In response, the Government intervened for a short time in the foreign exchange market around the end of October, giving rise to a sizable loss of reserves. In mid-November the Government acted to intensify the fiscal effort through an emergency revenue package. When this failed to restore confidence, further action was

taken on December 11 in an attempt to reinforce the economic program: the austral was devalued by 35 percent (to ₳ 1,010 per U.S. dollar from ₳ 655 per U.S. dollar); a free market was established for capital and certain service transactions; export taxes were increased; and public sector prices were adjusted by 65 percent on average. At the same time, principal obligations on domestic public debt--which had been reprogrammed on an emergency basis in July--were unilaterally rescheduled for a two-year period. In the event, the measures did not change expectations and exchange market pressures continued. To prevent further losses of reserves, on December 18 the foreign exchange market was unified under a freely floating system without limitation on access to the market (except for payment of certain external debt service obligations subject to rescheduling), while the earlier decision to increase export taxes was rescinded and the scheduled elimination of the existing taxes was accelerated.

4. These measures did not restore calm to the financial markets as had been intended. The economic situation deteriorated rapidly during the final days of 1989 and clear signs appeared that the economy was again moving toward hyperinflation. The value of the austral fell by almost 50 percent during the last week of December despite a sharp rise in interest rates, which gave rise to large quasi-fiscal deficits of the Central Bank financed by money creation. To deal with the quasi-fiscal deficit as a source of monetary expansion, on January 1, 1990 the Government decreed that all austral-denominated bonds and term deposits in the banking system (which were generally of seven days' maturity) would be converted into ten-year dollar-denominated Government of Argentina bonds at LIBOR. This exchange and rescheduling eliminated the domestic component of the quasi-fiscal deficit of the Central Bank by transferring the remunerated domestic liabilities of the Central Bank to the Treasury. The measure temporarily reduced interest payments on the public domestic debt and halted the creation of monetary liabilities to finance the quasi-fiscal deficit, but it also substantially reduced financial assets intermediated by the commercial banks and imposed new restrictions on fiscal policy; in practice, the measure precluded government access to noninflationary domestic financing. After an initial appreciation of the austral and a drop in inflation, pressure on the currency resumed as the public demonstrated its unwillingness to hold austral-denominated assets. By late February, the value of the austral was falling sharply (to almost ₳ 6,000 per U.S. dollar by month-end compared with around ₳ 1,900 at the end of January), notwithstanding a resetting of public sector tariffs by some 92 percent earlier in the month to strengthen the fiscal position. Prices were again rising very rapidly, and economic activity was on the decline.

5. In these circumstances and in line with its commitment in the October 12, 1989 letter of intent to take corrective actions as needed to achieve the program's basic objectives, the Government embarked in early March on a renewed effort to put the adjustment program back on course. The Government is pursuing financial policies aimed at achieving a swift reduction of inflation to low levels in the second half of

1990, which the Government believes essential to lay the basis for a sustained recovery of output. At the same time, the Government stepped up the pace of structural reforms aimed at improving the efficiency of the economy through a permanent reduction in the size of the public sector; privatization of many of the functions that had been taken over by the state; streamlining of remaining public sector operations, including the restructuring--and in some cases the elimination--of loss-making public financial institutions; the re-establishment of the Central Bank's ability to implement noninflationary monetary and credit policies; increased competition in the financial system; and the opening of the economy to foreign competition. By these measures, which are described in more detail in the following sections, the Government reaffirms its commitment to the basic strategy underlying the program supported by the stand-by arrangement from the Fund.

Fiscal policy

6. Fiscal policy in 1990 is aimed at achieving a rapid decline in inflation and consolidating the structural reforms of the public sector begun last year. In setting its fiscal targets for the remainder of the year, the Government recognizes that in present circumstances any domestic financing to the public sector would in all likelihood unsettle financial markets and lead to a further intensification of inflation. Accordingly, with the availability of external financing being limited, in the last three quarters of 1990 the Government will aim at an overall deficit of the public sector of not more than 1 percent of GDP. Quarterly targets for the overall public sector balance are presented in Table 1, together with quarterly limits on central administration expenditure which are consistent with the programmed overall public sector balance.

7. To strengthen the financial position of the public sector, on March 6 the Government issued omnibus decree 435 that included measures to increase the yield of the tax system, reduce expenditures of the National Administration, and establish a framework for achieving operational improvements in the public enterprises. At the same time, fuel prices were raised substantially, and it was announced that henceforth these prices would be adjusted as circumstances require so as to maintain their value in real terms. The tax measures included in Decree 435 comprised an increase in the rate of tax on corporate net worth for the tax year 1989 from 1.5 percent to 3.0 percent; an increase of 5 percentage points in the taxes on agricultural and major agro-industrial exports; measures to reduce the collection lag for domestic taxes and to establish a regime of indexing revenues from several taxes; extension of the Emergency Law's suspension of various tax incentive programs; and the elimination of the exemption from the value added tax (VAT) for firms supplying goods and services to promoted regions. In addition, tax refunds to exporters were suspended for 90 days, and it was announced that the refund system would be reformed. Furthermore, an assessment of 5 percent was imposed on the sales of public sector enterprises.

8. As was just noted, Decree 435 also included a series of measures to reduce expenditures. In respect of wages and salaries, the Government is committed to a policy consistent with a sharp decline of inflation. As regards other measures to contain expenditures on wages and salaries, the holding of two or more jobs in the public service has been disallowed, payment of overtime has been suspended, and a freeze has been placed on the filling of vacancies and on promotions. Altogether, these measures are resulting in a substantial compression of the wage bill in real terms. In respect of expenditures on other goods and services, those contracts that have not yet been signed will be temporarily suspended until a more effective procurement process can be established; the process that is envisaged would include supervision by the Secretary of Commerce to ensure that bids are awarded in accordance with market prices.

9. The March 6 measures were subsequently reinforced by additional steps to raise additional revenue and to improve the financial position of the public enterprises. First, public sector tariffs were adjusted by a further 166 percent in the March-April period, bringing them to historically high levels, adequate to improve substantially the operating results of the public enterprises. This level will be maintained in the future through further timely adjustments, as necessary. Secondly, the Treasury's receipts from taxes and levies on petroleum products were boosted by an increase on April 10 on the tax applied to those products, and a further adjustment was made on May 8. The real value of the tax will be maintained through further periodic adjustments. Moreover, legislation is before the Congress to reform the administration of the petroleum products tax, including the earmarking arrangements. Finally, the Government has committed itself to increasing the rate on the value-added tax up to the maximum permitted under the tax reform legislation, if the yield of that tax is less than programmed.

10. The Government is determined to reduce significantly the size of the public sector, which is overstaffed. Decree 435, which cut back the number of subsecretariats to 50 from 150 and which eliminated 56 of 64 secretariats, reflects the serious and firm decision to initiate reductions in the size of the bureaucracy and in public sector employment. The measures apply to the national administration as well as the public enterprises and the official banks and include the immediate retirement of all personnel who are already of retirement age, as well as those who are within two years of the normal age of retirement. These measures involve immediate reductions in staffing through retirements and initiate the separation of employees in positions that are being eliminated. For this latter category of staff, training and development programs have been prepared to facilitate their transition into the private sector. However, as a result of expenditures associated with pensions, severance pay, and indemnities, these measures are

not expected to result in net savings in the current year. Nevertheless, these steps should result in lower personnel expenditures in future budgets and facilitate the needed restructuring of the salary scale of the public service.

11. Under the current revenue sharing arrangements, 57.6 percent of all domestic tax revenues collected by the Central Administration are automatically transferred to the provinces. These shared revenues and other budgetary support for the provinces, which have amounted to around 6 1/4 percent of GDP in the past three years, are expected to rise to close to 7 percent of GDP following tax reform and the abatement of inflation in 1990. At a time when the National Administration is making every effort to reduce its own expenditures, it is considered appropriate that the provinces share in the burden of adjustment. Accordingly, the Government intends to seek ways of reducing provincial transfers in 1990 without putting in jeopardy the basic social expenditure programs that are financed by these transfers. In particular, the Treasury has begun recovery of overdue loans, and other advances whose repayment was guaranteed in the revenue sharing arrangement by withholding revenues to be transferred to the provinces. At the same time, the transfer to the provinces of expenditure programs--including those for secondary education, housing, and highways--is being implemented; these are expected to result in a considerable budgetary saving in 1990. The provinces' own adjustment efforts are being aided by technical assistance from the World Bank in the areas of tax administration and budgetary control procedures.

12. The Government is committed to consolidating the reform of the tax system enacted in December 1989. Its basic goals are the achievement of a more broadly based and equitable tax system and a reduction in the cost of administering the tax system and in its complexity. In addition to eliminating a number of low-yielding and administratively complex taxes, the tax reform achieved a substantial broadening of the base of the value added tax at a single rate. Virtually all goods are now subject to the VAT, with the only major exceptions being final sales of bread, milk and powdered milk, and sales of books, newspapers, and other periodicals. In May, legislation will be submitted to Congress that will extend the VAT to virtually all services, and the Government expects passage by Congress in short order.

13. The Government took a number of steps to improve tax administration and to increase the degree of taxpayer compliance in late 1989 and early 1990. The status of tax administration in the Ministry of Economy was upgraded in November 1989. A new penal code, which established stiff penalties for offenders, was signed into law by the President in February; the law will strengthen the hand of the authorities in prosecuting tax evasion and fraud, mainly by reducing the burden of evidence required before the government may proceed with indictment. The internal tax department (DGI) has also been given the authority to close temporarily the operations of delinquent enterprises, although the

application of this penalty may be delayed by taxpayers availing themselves of the right to appeal. The Government is committed to submitting legislation to Congress shortly that will speed up application of the penalty of closure. In addition, the DGI has made progress in improving its filing system for the country's major VAT payers. Nonetheless, much remains to be done to improve tax administration if the yield of the value added tax and other taxes are to approach their full potential. At present, the DGI is concentrating its efforts on establishing an up-to-date and fully automated master file of registered VAT payers, before turning to developing procedures to allow the timely monitoring of the submission of monthly VAT returns and the detection of persons who have stopped filing returns. Subsequently, the DGI will develop procedures for automatic cross-checking of returns with information available from the utility companies and other sources, as well as procedures for the automatic selection of taxpayers for further investigation. An automated current account file for each taxpayer will also be developed together with a system under which banks will process returns and remit funds automatically to the Treasury. Finally, the DGI is establishing a lottery-type system that uses the receipts issued by retailers as tickets; by these means, the DGI expects to acquire additional information that could be used to improve tax enforcement. These various efforts are being supported by technical assistance from the Fund's Fiscal Affairs Department and the World Bank.

14. The Government places special emphasis on its program to improve financial control over the public enterprises and to increase the profitability of the enterprises whose operations will remain in the public sector. The Ministry of Economy has assumed responsibility for the supervision of the enterprises' financial operations and for the general control of contracting procedures and labor practices. With the March adjustments discussed above, tariffs of the public sector have recovered to levels that in most cases permit the attainment of economic rates of return, and the real value of these tariffs will be maintained by periodic adjustments. To prevent the higher revenues from being used to finance additional expenditure by the enterprises, the Government will reinforce its audits of the enterprises' monthly returns, and will ensure that any balance owed to the Government is remitted to the Treasury. A subsecretariat for public enterprises has been established within the Ministry of Economy that will permit more thorough control of the financial operations of the public enterprises as well as the implementation of measures to improve resource allocation. With the adoption of Decree 589 at the end of March, a number of additional measures have been taken, including the billing of public services at a frequency of not less than once per month, and the imposition of limits on the volume of debt that public enterprises may contract with one another. In addition, comptrollers appointed by the Ministry of Economy will be assigned to each enterprise, with responsibility for the personnel, purchasing, and treasury departments; bids will be solicited no later than July 1, 1990 for concessions for the metering of the public utilities; and commercial advertising has been prohibited.

15. The privatization and divestiture of operations of a number of public enterprises remain an integral part of the Government's program of structural reform. Legislation was passed in 1989 to facilitate the privatization process, over which the Ministry of Public Works and Services exercises responsibility. Two publicly owned television stations were sold late last year. Tenders have been solicited for the sale of concessions to some 40 secondary areas owned by the state oil company, the bids are to be opened in June, and the sales completed in September 1990. Tenders also have been solicited for the sale of the national airline, with a deadline for submission of bids by May 30; and announcement of the successful bid by the end of August. The sales contract for the state telephone company, whose rates were increased by some 350 percent in March to put the company on a sound financial footing, is to be awarded by June 28, with the sale to be completed by October 8, 1990. An agency responsible for liquidating public assets (Instituto Movilizador de Activos) recently has been created, which will be granted wide powers to sell physical assets, especially goods and real estate that belong to the public enterprises, the central administration, and the decentralized agencies. The agency will also arrange for the sale of certain buildings that were acquired by the Central Bank as a result of the liquidation of many financial institutions in recent years. The contracting of road maintenance by the private sector began on March 14, when bids for certain roads were received, and by May 10 bids were to have been received for the maintenance of approximately 900 kilometers of highways. Moreover, it is expected that concessions will be granted on roughly 10,000 kilometers of secondary roads by the end of July. Altogether, the Treasury's cash proceeds from privatization and asset sales are expected to exceed 1.2 percent of GDP in 1990. In addition to reducing the public sector's borrowing requirement, those measures are expected to contribute to improving the overall efficiency of the economy.

16. In mid-1989 the social security system suffered a drop in real income from contributions owing to the sharp acceleration of inflation, and it was necessary to reduce the real value of old-age pensions and retirement payments in order to minimize the system's cash deficit. The abatement of inflation in September-October permitted a strong recovery in real revenues and benefits, but the reacceleration of inflation in early 1990 again put strain on the system. Nevertheless, the real value of pensions is presently above the low point of July 1989, and the expected decline of inflation in the remainder of the year should lead to an improvement in the ratio of pensions to salaries. This process should be aided by increased efficiency in collections of social security contributions that is to result from the recent establishment of the National Institute for Social Security, created by Law 23769. In the course of the current year, reform of the contributions system for the self-employed will be prepared with a view to achieving financial autonomy of the system for this group of contributors. The proposed reform will result in a partially privatized pension system in which participants have a wider range of options. As the system's short-term difficulties are alleviated, the Government will address the system's

structural problems: a high rate of evasion; the high cost of special regimes; and various administrative difficulties with the benefits programs. It will place special emphasis on programs to reduce the rate of evasion with a view to making possible a further increase in average benefits.

Monetary policy

17. Holdings of austral-denominated financial assets in real terms have exhibited a long-term declining trend. After recovering somewhat immediately after mid-1989, the ratio of money to GDP again turned sharply downward beginning in December. On the basis of this experience, the Government considers it important that the monetary program of the Central Bank for the coming quarters be based upon especially conservative estimates of the demand for broad money; accordingly, the demand for money is envisaged to recover only moderately from the low levels recorded in the first quarter of this year in the aftermath of the forced conversion of term deposits. On this basis, and consistent with the balance of payments targets, limits have been set on the expansion of the net domestic assets of the Central Bank for the remainder of 1990 (see Table 2).

18. To achieve these targets, the program is counting on a reduction in central bank net claims on the nonfinancial public sector in the remainder of 1990. In addition, an austere policy on the extension of rediscounts to financial entities is being implemented; the omnibus Decree 435 restricted rediscounts by requiring the prior approval of the Minister of Economy for all new discounts extended by the Central Bank. At the same time, the Central Bank plans to continue its policy of collecting outstanding rediscounts. Following a net recovery of rediscounts in the first months of this year, it was announced on March 5 that financial entities would have to repay their remaining debts to the Central Bank by September 30, 1990.

19. Over the years, the bulk of savings intermediated by the financial system has been used to finance large fiscal deficits. As a counterpart to these developments, banks' reserve and investment requirements at the Central Bank have risen steadily, crowding out the private sector and undermining monetary management by linking high interest rates to monetary expansion through the quasi-fiscal deficit. In the light of the conversion of time deposits into government bonds decreed on January 1 and the elimination of the banks' investment requirements at the Central Bank, a major restructuring of the financial system is expected to take place and banks will need to become more cost effective. The Government intends to support this process with a view to developing a modern and stable financial system, capable of channeling domestic savings toward the financing of productive activities in accordance with market criteria. To ensure that the restructuring is carried out in an effective manner, the Government is committed to

continue its policy of permitting interest to be determined by the market, to eliminate subsidies in central bank credit, and to strengthen the supervisory powers of the Central Bank.

20. The Government is committed to reform of the official financial system. To give effect to the Government's policy, the retail operations of the National Mortgage Bank were discontinued on March 5, with management of that institution's portfolio assumed by the Banco de la Nacion Argentina. On the same date, it was announced that the Ministry of Economy would intervene in the operations of the National Development Bank with a view to streamlining that institution's operations and improving its loan recovery performance. In addition, a new charter of the Central Bank is being prepared to establish strict limits on central bank financing of the public sector. Moreover, a restructuring of the Central Bank has been initiated to separate that institution from activities (such as quasi-fiscal and commercial operations) that are not germane to the implementation of monetary policy. The financial position of the provincial banks has been weakened as a result of lending to provincial governments on the basis of credit from the Central Bank. The Central Bank started to recover rediscounts that had been granted to the provincial banks. These banks, in turn, expect to reduce their credit to the provincial governments whose position should be strengthened by increased transfers from the Central Administration under the revenue sharing arrangement.

External policies

21. The Government has taken important steps to liberalize Argentina's exchange and trade system in recent months, including most notably the introduction of a unified freely floating exchange rate with free access to that market and the elimination of most exchange restrictions including those on the remittance of profits and dividends. The Government remains strongly committed to the opening of the economy to foreign trade and investment (as described in more detail below), the progressive elimination of the anti-export features of fiscal and industrial policies, and the re-establishment of relations with foreign creditors on a basis that would be consistent with the achievement of medium-term viability.

22. Continued expansion of exports is expected to be offset by a partial recovery in imports from the compressed levels of 1988-89, and thus the external current account deficit is expected to change little from 1989 to 1990. An increase in disbursements from international agencies and bilateral creditors, together with a reflow of private capital during 1990, would contribute to a substantial reduction in the overall balance of payments deficit, from an estimated US$4.4 billion in 1989 to US$0.5 billion in 1990, and there would be a build up of liquid gross reserves. Quarterly targets for the net international reserves through end-1990 are specified in Table 3.

23. The Government recognizes the importance of an exchange rate system that, in the context of stable financial policies, promotes medium-term balance of payments viability while the economy is being opened to foreign competition, and does not introduce distortions at a time of continued uncertainty about how quickly the stabilization effort will yield results. To this end, the Government intends to maintain the freely floating exchange rate system introduced on December 18, 1989. Exchange management will be guided by balance of payments objectives and, as described above, the Government's fiscal targets make room for central bank purchases of foreign exchange in the market as necessary to meet public debt servicing and other government obligations, and the official international reserve objective of the program, without excessive monetary expansion.

24. As noted above, a temporary increase in export taxes was included in the package of measures implemented in early March. Nevertheless, it remains the Government's intention to pursue policies that will foster exports, and the Government is committed to a fiscal policy that is consistent with a reduction in the level of export taxes. In the context of a World Bank Trade Policy Loan, the Government intends to eliminate gradually the export taxes on industrial goods. It also intends to lower the average rate of tax on agricultural goods and to reduce the dispersion of tax rates across goods so as to assure that exports develop in response to market signals.

25. The Government has continued with its program of reducing quantitative import restrictions, which now apply to goods with a production coverage of only 9 percent, about half the level existing when the Government took office in July 1989. These restrictions will continue to be reduced in coming months, with a view to their elimination by end-1990. In order to ensure that these measures have the desired effect in terms of increased competition and improved resource allocation, in early 1990 the Government eliminated administrative restrictions on the granting of import licenses and it is committed to maintaining the full automaticity of imports that are not subject to quantitative restrictions. Substantial reductions in tariff rates and their dispersion were implemented in late 1989 and early 1990, reducing the maximum basic tariff to 24 percent, and the number of tariff rates to six. At the end of March 1990, the intermediate tariff rates were increased while the maximum rate remained at 24 percent. In addition, the number of customs items exempt from import taxes was reduced. The Government intends to take further steps during 1990 toward its medium-term goal of a tariff structure with only three or four rates, ranging from 10 to 20 percent. It also intends to implement further reductions in specific tariffs applied to certain goods, notably electronics. Moreover, the 15 special import regimes are currently under review with a view to eliminating distortions and opening these sectors to external competition.

26. Exchange restrictions have been drastically reduced in the context of the unification of the exchange markets. The Government was, however, unable to meet its original program target of eliminating by March 1990 all external payment arrears other than arrears on public medium- and long-term debt to commercial banks. Remaining nonbank arrears (which are mainly to suppliers) will now be eliminated during 1990, in accordance with the limits set out in Table 4.

27. The Government attaches importance to re-establishing relations with foreign creditors, and to setting the stage for a resumption of capital inflows. In December 1989, the Government reached agreement with Paris Club creditors on a rescheduling of arrears and current payments due through March 31, 1991 on debt contracted before the cutoff date of December 10, 1983. Disbursements from the World Bank and the Inter-American Development Bank are projected to rise this year. Nevertheless, Argentina still faces a residual external financing gap estimated at about US$8.5 billion (of which US$5.2 billion is related to arrears with banks outstanding at the end of 1989) in 1990, and the gap is expected to remain substantial over the medium term on the basis of current obligations. To help create the conditions for investment and sustained growth over the medium term, the Government believes that it will be necessary to incorporate debt and debt service reduction in its agreements with commercial banks. Accordingly, the Government intends to seek understandings with its commercial bank creditors that would allow for phased market-based debt and debt service reduction, as enhancements to support such operations become available over a three- to four-year period. Also, during this period, Argentina will be in a position to make only partial payments of interest on the medium- and long-term bank debt of the public sector. It thus intends to seek understandings with banks on the resumption of such payments, in conjunction with the negotiation of waivers to permit debt and debt service reduction operations and to proceed with the privatization program. Consistent with the balance of payments projections, limits for total and short-term external debt of the public sector have been established through December 1990, as set out in Table 5.

28. Developments over the past year have shown clearly the difficulty in eradicating entrenched inflationary behavior and correcting the deep-rooted imbalances in Argentina's economy. The Government believes that its present policies will be sufficient to achieve the objectives outlined in this memorandum, but it stands ready to undertake any further measures that may prove necessary to secure the basic objectives that have been set. Developments will be monitored carefully in order to ensure that any departures from the program are identified and corrected promptly, before they endanger the underlying aims of the program. The Government will review with the Fund before the end of August 1990 the progress made in the implementation of the program and in the negotiations with Argentina's foreign creditors.

Table 1. Argentina: Limits on the Cash Deficit of the Nonfinancial Public Sector, the Combined Deficit of the Nonfinancial Public Sector and the Central Bank, and Treasury Outlays

(In billions of australes)

Period	Overall Cash Deficit of the Nonfinancial Public Sector (-)	Combined Deficit of the Nonfinancial Public Sector and the Central Bank (-)	Treasury Outlays 1/
April-June 1990	-3,120	-4,050	12,600
April-September 1990	3,620	-700	29,900
April-December 1990	3,130	-3,210	50,500

1/ Excluding interest payments.

Table 2. Argentina: Targets for Change in the Net Domestic Assets of the Central Bank 1/

(In billions of australes)

April-June 1990	9,420
April-September 1990	10,040
April-December 1990	13,460

1/ The change in the net domestic assets of the Central Bank is defined as the change in M-1 multiplied by a factor k minus the change in net international reserves of the monetary authorities valued at the projected average exchange rate for each period. The factor k, which equals 1.205, is representative of the ratio in March 1990 of the monetary base (currency issue plus deposits of financial institutions in the Central Bank) to M-1. M-1 is measured as the monthly average of the sum of currency in circulation and sight deposits (excluding the treasury accounts with the Banco de la Nacion and the Unified Fund on a net basis). Net international reserves for each month are the average of the net international reserves at the end of the previous and current month, as defined in Table 3. Targets have been set on the basis of estimated M-1 for March 1990 and will be adjusted to allow for the difference between the preliminary and the definitive estimate of M-1.

Table 3. Argentina: Targets for Change in Net International Reserves of the Monetary Authorities 1/

(In millions of U.S. dollars)

April-June 1990	-350
April-September 1990 2/	-90
April-December 1990 2/	-250

1/ For measuring balance of payments performance, changes in international reserve assets and liabilities in currencies other than the U.S. dollar will be converted to U.S. dollars at the market exchange rates of September 30, 1989, and gold will be valued at US$325 per fine troy ounce. The net international reserve targets will be adjusted for any other changes in the value of reserve assets and liabilities that result from factors other than balance of payments flows.

2/ These targets will be adjusted downward by up to the equivalent of 25 percent of each purchase available after mid-August 1990 under this stand-by arrangement to the extent that Argentina's net international reserves are used to finance debt reduction operations.

Table 4. Argentina: Limits on External Arrears of the Public Sector 1/

(In millions of U.S. dollars)

June 30, 1990	560
September 30, 1990	350
December 31, 1990	--

1/ Excludes debt service arrears on medium- and long-term public sector debt to commercial banks and related debt.

Table 5. Argentina: Limits to the External Debt of the Public Sector During the Program Period 1/

(In millions of U.S. dollars)

Limit to the total outstanding disbursed external debt of the public sector 2/	63,000
Limit to cumulative net disbursements of short-term debt of the public sector contracted after March 31, 1990 3/	1,000

1/ Data on external debt that will be used for the monitoring of external debt developments will originate from a Comprehensive Debt Reporting System and from the balance of payments data. The stock of debt should be valued at end-December 1988 exchange rates.

2/ The definition of total outstanding disbursed external debt of the public sector includes all external obligations of the public sector, including the Central Bank of the Republic of Argentina (BCRA) and the official banks. However, this definition excludes all external indebtedness related to the agreement on COGASCO, bonds and notes issued in lieu of providing foreign exchange to meet principal payments falling due on private sector debt covered by exchange rate guarantees, obligations deriving from the assumption by the public sector of debt of private domestic borrowers, and those categories of obligations not subject to the Central Bank's debt registration system as of September 15, 1984. It includes loans covered by swap arrangements undertaken by the Central Bank.

3/ Includes cumulated disbursements, net of repayments, of debt with a maturity up to one year, contracted by public sector entities after March 31, 1990, other than obligations classified as reserve liabilities.