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AGENDA**

EBS/83/11

CONFIDENTIAL

January 11, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Use of Fund Resources - Compensatory
Financing Facility

Attached for consideration by the Executive Directors is a paper on a request expected to be received from Argentina for a purchase equivalent to SDR 520.1 million under the compensatory financing facility. A draft decision appears on page 19.

This subject, together with the staff report for the 1982 Article IV consultation with Argentina and the request from Argentina for a stand-by arrangement (EBS/83/8, 1/10/83), has been tentatively scheduled for discussion on Monday, January 24, 1983.

Att: (1)

INTERNATIONAL MONETARY FUND

ARGENTINA

Use of Fund Resources--Compensatory Financing Facility

Prepared by the Research Department and the Western Hemisphere Department

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

Approved by Wm. C. Hood and Eduardo Wiesner

January 10, 1983

The Managing Director has been informed that the Argentine authorities will shortly request a purchase of SDR 520.1 million (equivalent to 64.8 per cent of quota) under the compensatory financing decision. The request, the first by Argentina since March 1976, is being made with respect to a shortfall in export earnings for the 12 months ended September 1982. Earnings for the last month (September) of the shortfall year are estimated. This paper is expected to be considered by the Executive Board concurrently with a request for a 15-month stand-by arrangement in the amount of SDR 1.5 billion (equivalent to 187 per cent of quota). If both of these requests are approved and the resources fully utilized, Fund holdings of the member's currency would be raised from 100 per cent of quota to 352 per cent of quota. A waiver of the limitation in Article V, Section 3(b)(iii) of the Fund's Articles of Agreement is required and is being proposed.

This paper, which is being circulated in advance of the formal request from Argentina, is presented in five sections and an annex. The sections deal with: (1) balance of payments position and cooperation with the Fund; (2) estimation of the export shortfall; (3) causes of the shortfall and earnings prospects; (4) repurchase; and (5) staff appraisal and proposed decision. The relations of Argentina with the Fund are summarized in the annex.

1. Balance of payments position and cooperation with the Fund

a. Balance of payments position

After recording substantial surpluses in the three years through 1979, Argentina faced increasing balance of payments difficulties over the following three years. The overall balance of payments deteriorated steadily from a surplus of more than SDR 3 billion in 1979 to a deficit of almost SDR 5 billion in 1982. A marked decline in the trade balance was an important factor underlying the deterioration in the overall position in 1980, but thereafter, the trade balance improved steadily to an estimated surplus equal to 3.8 per cent of GDP for 1982. The fundamental sources of Argentina's recent balance of payments difficulties include mounting interest payments

Table 1. Argentina: Balance of Payments, 1978-83

	1978	1979	1980	1981	1982 Prel.	1983 Proj.
- - - - - (In millions of SDRs) - - - - -						
A. Current account	1,464	-415	-3,663	-3,894	-2,023	-890
Merchandise	2,050	859	-1,935	-201	2,359	2,812
Exports, f.o.b.	(5,112)	(6,045)	(6,163)	(7,754)	(7,349)	(8,903)
Imports, c.i.f.	(-3,062)	(-5,186)	(-8,098)	(-7,955)	(-4,990)	(-6,091)
Services	-624	-1,301	-1,745	-3,675	-4,396	(-3,702)
Of which:						
Travel (net)	(-245)	(-772)	(-1,112)	(-897)	(-83)	(--)
Interest payments	(-575)	(-909)	(-1,671)	(-3,265)	(-4,565)	(-4,161)
Transfers	38	27	18	-19	14	(--)
B. Capital account	998	3,703	1,680	827	-2,867	422
Banking system <u>1/</u>	-26	-135	-398	33	454	--
Trade finance <u>2/</u>	-338	602	-88	-2,972	-2,182	80
Other public sector	1,109	946	2,272	3,846	-594	--
Other private sector <u>3/</u>	254	2,290	-105	-79	-544	342
C. SDR allocation	--	56	56	56	--	--
D. Valuation adjustment <u>4/</u>	-61	-4	28	150	-61	--
E. Overall balance	2,401	3,339	-1,899	-2,861	-4,952	-468
F. Financing	-2,401	-3,339	1,899	2,861	4,952	468
Net use of Fund credit	-345	--	--	--	--	1,720.5
Other <u>5/</u>	-2,056	-3,339	1,899	2,861	4,952	-1,252.5
- - - - - (As per cent of GDP) - - - - -						
Memorandum items:						
Trade balance	5.3	1.9	-3.8	-0.4	3.8	3.9
Current account	3.8	-0.9	-7.2	-6.7	-3.2	-1.2
Overall balance	6.7	7.7	-4.1	-5.8	-8.0	-0.7
- - - - - (In millions of SDRs) - - - - -						
Gross official reserves, end of year	4,072	7,351	5,437	3,005	2,978 <u>6/</u>	...
Arrears, end of year	--	--	--	--	1,860 <u>6/</u>	--
- - - - - (In months of imports) - - - - -						
Gross official reserves/imports	16.0	17.0	8.1	4.5	7.2 <u>6/</u>	...

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

1/ Includes changes in Central Bank foreign assets not considered part of international reserves.

2/ Includes trade-related leads and lags, as well as identified trade credits.

3/ Includes errors and omissions.

4/ Changes in net international reserves due to exchange rate movements.

5/ Net international reserves of Central Bank of Argentina and U.S. dollar-denominated Government of Argentina bonds issued in lieu of providing foreign exchange.

6/ End-November.

on the external debt, large short-term capital outflows and, from the second quarter of 1982, the drying up of external sources of finance. Between 1979 and 1982 Argentina's interest payments rose from SDR 900 million to SDR 4.6 billion, and over that same period the capital account balance shifted from a surplus of SDR 3.7 billion to a deficit of SDR 2.9 billion.

While initially Argentina could finance these deficits by running down its substantial disposable reserves, the SDR 5 billion deficit recorded in 1982 was financed almost entirely by the accumulation of external payments arrears, by Central Bank swap operations, and by issuing U.S. dollar-denominated bonds in lieu of providing foreign exchange for certain payments and transfers.

The trade balance improved substantially in 1982, despite a drop in export earnings, as imports contracted by almost 40 per cent. Controls imposed during the conflict in the South Atlantic and difficulties encountered in opening letters of credit once payments arrears had begun to mount contributed to this contraction. However, the timing of the adjustment would indicate that exchange rate changes over 1981-82 were the most important factor. Exchange rate policy shifted course several times during 1982--from a free float, to an adjustable peg, to a dual market with one rate adjusted daily and the other initially floating and then pegged, to a system of mixed rates, and finally to a unified exchange market in which the rate is adjusted daily. Over the course of the year the peso depreciated by about 470 per cent in terms of pesos per U.S. dollar, compared to an increase of 320 per cent in the Argentine wholesale price index, and by the end of 1982 the real effective exchange rate had been restored to the level prevailing in 1978, the last year in which Argentina registered a large trade surplus.

Substantial short-term capital outflows began in 1980 and accelerated in 1981, as it became increasingly apparent that the peso was substantially overvalued. Such outflows virtually came to a halt in the first quarter of 1982, when the peso was allowed to float. Thereafter, however, they accelerated sharply again in response, first, to the uncertainties surrounding the conflict in the South Atlantic and, subsequently, to the imposition of a structure of interest rates that was sharply negative in real terms. Total short-term outflows during the second and third quarters of 1982 are estimated to have exceeded SDR 4 billion.

Argentina's balance of payments position is expected to improve in 1983. The deficit on current account is projected to narrow to 1.3 per cent of GDP, reflecting mainly a recovery in export earnings and lower interest payments on the public debt. The shift in the course of economic policy and the easing of access to normal foreign trade credits in the aftermath of the war is expected to stem the net capital outflow in evidence in 1982. As a result, the overall deficit is projected to be reduced to the equivalent of SDR 468 million and external payments arrears, multiple currency practices, and exchange restrictions are scheduled to be eliminated.

b. Cooperation with the Fund

Since the proposed purchase by Argentina, which is equivalent to 64.8 per cent of quota, would raise outstanding CF purchases above 50 per cent of quota, the request may be approved only if the Fund is satisfied that Argentina has been cooperating with it in efforts to find appropriate solutions for Argentina's balance of payments difficulties. The staff considers that this requirement is met by the adoption by Argentina of a financial program in support of which the authorities are requesting use of Fund resources under a stand-by arrangement. Argentina maintains multiple currency practices and exchange restrictions that have so far remained unapproved. The staff is recommending in the accompanying stand-by paper (EBS/83/8) approval of all but one of these practices until July 31, 1983, by which time the mandatory review of the exchange and trade system scheduled for May 1983 is expected to be completed. Approval has not been proposed for a system of minimum financing requirements for imports which discriminates among members; the phased elimination of this restriction is, however, a performance criterion under the proposed stand-by arrangement.

2. Estimation of the export shortfall

The Argentine authorities have requested that the 12 months ended September 1982 be treated as the shortfall year and have provided actual data on export receipts for the first eleven months of that year. The staff, in conjunction with the authorities, has estimated earnings for September, a month of seasonally low export earnings, at SDR 514 million. This estimate for September 1982 compares with a monthly average of SDR 594 million for export earnings during the first eleven months of the shortfall year. For September 1981, export receipts amounted to SDR 600 million, compared with a monthly average of SDR 665 million for earnings in the preceding eleven months.

Table 2. Argentina: Estimation of the Export Shortfall

(In millions of SDRs)

	Years Ending September				Projected Exports 1/ 1983 1984
	1980	1981	1982		
Exports	5,927	7,913	7,050 <u>2/</u>	8,355	9,000
Shortfall			520.1		
Proposed purchase			520.1		

1/ Based on judgmental forecasts of earnings given in Table 3.

2/ Earnings estimated for September 1982.

Following sluggish performance in the year ended September 1980, Argentina's export earnings rose by 34 per cent to SDR 7.91 billion in 1980/81, but in the shortfall year, they are estimated to have dropped by 11 per cent to SDR 7.05 billion. In the post-shortfall period, earnings are projected to average SDR 8.67 billion per year, implying an average annual rate of growth of 15 per cent. On the basis of these movements, the shortfall in export receipts for the year ended September 1982 is estimated at SDR 520.1 million, which is the amount of the proposed purchase (Table 2).

3. Causes of the shortfall and earnings prospects

The calculated shortfall of SDR 520 million consists largely of shortfalls in cereals (SDR 245 million), "other" exports (SDR 151 million), and fats and oils (SDR 111 million). Smaller shortfalls are estimated for other agricultural products: meat and animal by-products (SDR 54 million), sugar (SDR 24 million), and fruit (SDR 21 million). Export excesses are calculated for metals (SDR 97 million), hydrocarbons (SDR 77 million), and fish (SDR 2 million).

During the shortfall year, Argentina's exports faced generally weak foreign demand and declining world prices, and poor weather reduced agricultural output. In addition, the hostilities in the South Atlantic, which occurred toward the middle of the shortfall year, resulted in severe dislocations to normal trading patterns, as well as trade sanctions imposed against Argentina. The growth of the export sector, which had been retarded during 1979-80 on account of an overvalued currency, revived in 1981, partly as a consequence of a substantial devaluation in real effective terms. The unification of the exchange system at the end of 1981 further buoyed export growth in the first quarter of 1982, but this trend was interrupted when the war began in April. The subsequent reintroduction of multiple exchange rates after the end of hostilities and the attendant uncertainties about the direction of policy inhibited the recovery of exports in the closing months of the shortfall year. The reunification in November 1982 of the financial and commercial rates at a devalued level is expected to stimulate export growth in the two post-shortfall years.

a. Cereals

Export earnings from cereals, which account for 23 per cent of total export earnings in the shortfall year, grew at an average annual rate of over 28 per cent from 1979 to 1981 before declining by 31 per cent in the shortfall year. The decline resulted from falls in both volume (22 per cent) and price (12 per cent). World cereal prices have been depressed during 1982 as a result of the record level of world supplies and some of Argentina's markets were temporarily lost because of the disruptions caused by the war. In the post-shortfall period, receipts are projected to recover at an average annual rate of 26 per cent, reflecting exceptionally large 1982/83 crops and a return to normal marketing patterns. The shortfall for cereals is estimated to be SDR 245.2 million.

Table 3. Argentina: Export Earnings and Shortfalls by Major Commodities

	Years Ending September							Shortfall	
	1977	1978	1979	1980	1981	1982	1983	1984	Geometric Arithmetic
(In millions of SDRs)									
Total exports	4,775.7	5,180.0	5,721.7	5,926.7	7,912.6	7,050.0	8,355.0	9,000.0	520.1 598.9
Cereals	1,299.2	924.4	1,115.3	1,127.8	2,321.7	1,591.6	2,224.7	2,255.1	245.2 312.6
Wheat	489.7	143.9	389.6	593.0	710.2	617.5	1,012.1	852.7	124.1 139.5
Corn	464.7	496.9	480.2	376.2	1,081.8	514.9	715.7	895.9	154.5 202.0
Sorghum	344.8	283.6	245.5	158.6	529.7	459.2	496.9	507.0	-63.4 -28.9
Fats and oils	439.7	642.5	864.4	805.2	884.0	708.0	870.5	839.8	111.0 113.5
Soybeans	146.6	365.4	545.3	404.5	575.3	344.7	534.3	465.3	112.3 120.1
Sunflower oil	75.0	76.0	108.4	146.3	116.7	177.1	164.7	180.6	-21.9 -20.0
Other edible oils	218.1	201.1	210.7	254.4	192.0	186.2	171.5	193.9	11.6 13.4
Meat and animal by-products	724.1	856.5	1,191.2	1,103.9	1,151.3	1,130.1	1,217.4	1,330.8	53.9 56.6
Wool	185.3	198.6	179.7	206.8	269.8	231.7	303.5	321.4	31.4 34.9
Meat	377.6	476.5	708.7	625.9	619.1	604.9	598.6	674.7	19.2 19.7
Skins and tanned leather	161.2	181.4	302.8	271.2	262.4	293.5	315.3	334.7	0.7 1.9
Sugar	106.9	75.2	51.9	97.3	337.7	113.1	90.4	146.0	24.3 43.8
Fruit	144.0	170.8	163.4	126.4	154.0	138.5	182.8	207.8	20.7 23.4
Metals	50.9	107.9	93.0	136.3	211.2	367.3	374.5	365.4	-96.9 -76.4
Seamless tubes	14.7	45.0	58.9	44.4	109.3	192.0	196.7	200.7	-62.2 -43.4
Iron plates	36.2	52.3	8.5	3.8	10.8	52.6	52.6	49.4	-30.2 -18.8
Aluminum pigs	--	10.6	25.6	88.1	91.1	122.7	125.2	115.3	-15.4 -14.2
Hydrocarbons	28.9	38.4	52.7	179.3	473.5	459.2	467.8	448.2	-76.8 -53.6
Fuel oil	7.8	18.0	18.6	108.8	292.2	217.1	219.3	223.6	-14.8 -4.9
Gas oil	0.4	--	--	20.7	122.5	176.2	178.0	155.1	-71.5 -45.7
Aromatic hydrocarbons	20.7	20.4	34.1	49.8	58.8	65.9	70.5	69.5	-3.5 -3.0
Fish	56.0	106.3	152.6	121.8	97.7	157.2	201.2	235.8	-2.4 5.5
Others	1,926.0	2,258.0	2,037.2	2,228.7	2,281.5	2,385.0	2,725.7	3,171.1	150.7 173.4
(Percentage change)									
Total exports	8	10	4	34	-11	19	8		
Cereals	-29	21	1	106	-31	40	1		
Wheat	-71	171	52	20	-13	64	-16		
Corn	7	-3	-22	188	-52	39	25		
Sorghum	-18	-13	-35	234	-13	8	2		
Fats and oils	46	35	-7	10	-20	23	-4		
Soybeans	149	49	-26	42	-40	55	-13		
Sunflower oil	1	43	35	-20	52	-7	10		
Other edible oils	-8	5	21	-25	-3	-8	13		
Meat and animal by-products	18	39	-7	4	-2	8	9		
Wool	7	-10	15	30	-14	31	6		
Meat	26	49	-12	-1	-2	-1	13		
Skins and tanned leather	13	67	-10	-3	12	7	6		
Sugar	-30	-31	87	247	-67	-20	62		
Fruit	19	-4	-23	22	-10	32	14		
Metals	112	-14	47	55	74	2	-2		
Seamless tubes	206	31	-25	146	76	2	2		
Iron plates	44	-84	-55	184	387	--	-6		
Aluminum pigs	--	142	244	3	35	2	-8		
Hydrocarbons	33	37	240	164	-3	2	-4		
Fuel oil	131	3	485	169	-26	1	2		
Gas oil	-100	--	--	492	44	1	-13		
Aromatic hydrocarbons	-1	67	46	18	12	7	-1		
Fish	90	44	-20	-20	61	28	17		
Others	17	-10	9	2	5	14	16		

Table 4. Argentina: Value, Volume and Unit Value Indices by Major Commodities
(1982=100; in terms of SDRs)

	Value Share in	Years Ending September								Shortfall in
	Total Exports									Per Cent of
	in 1982	1977	1978	1979	1980	1981	1982	1983	1984	Level in
	(In Per Cent)									Shortfall Year
Value	59.3	59	61	76	76	124	100	123	127	8.0
Cereals	22.6	82	58	70	71	146	100	140	142	15.6
Wheat	8.8	79	23	63	96	115	100	164	138	20.1
Corn	7.3	90	97	93	73	210	100	139	174	30.0
Sorghum	6.5	75	62	53	35	115	100	108	110	-13.7(excess)
Fats and oils	7.4	43	85	125	106	133	100	134	124	18.6
Soybeans	4.9	43	106	158	117	167	100	155	135	32.5
Sunflower oil	2.5	42	43	61	83	66	100	93	102	-12.3(excess)
Meat and animal by-products	11.9	67	81	106	100	106	100	108	119	6.4
Wool	3.3	80	86	78	89	116	100	131	139	13.5
Meat	8.6	62	79	117	103	102	100	99	112	3.1
Sugar	1.6	95	66	46	86	299	100	80	129	21.6
Fruit	2.0	104	123	118	91	111	100	132	150	14.9
Metals	5.1	14	29	25	37	58	100	102	100	-26.2(excess)
Seamless tubes	2.7	8	23	31	23	57	100	102	105	-32.5(excess)
Iron plates	0.7	69	99	16	7	21	100	100	94	-57.5(excess)
Aluminum pigs	1.7	--	9	21	72	74	100	102	94	-12.6(excess)
Hydrocarbons	6.5	6	8	11	39	103	100	102	98	-16.7(excess)
Fuel oil	3.1	4	8	9	50	135	100	101	103	-6.8(excess)
Gas oil	2.5	--	--	--	12	70	100	101	88	-40.5(excess)
Aromatic hydrocarbons	0.9	31	31	52	76	89	100	107	105	-5.3(excess)
Fish	2.2	36	68	97	77	62	100	128	150	-1.7(excess)
Volume		84	88	97	80	110	100	118	115	3.6
Cereals		120	82	100	75	129	100	134	128	10.7
Wheat		151	44	97	112	110	100	159	130	20.5
Corn		107	126	124	69	182	100	134	151	20.5
Sorghum		92	85	76	30	95	100	101	101	-21.9(excess)
Fats and oils		34	90	126	119	124	100	133	118	18.3
Soybeans		32	113	164	134	156	100	155	130	33.3
Sunflower oil		36	46	51	88	61	100	90	95	-14.4(excess)
Meat and animal by-products		104	131	124	91	94	100	99	104	-2.5(excess)
Wool		106	122	93	93	114	100	125	125	10.6
Meat		104	134	135	91	86	100	89	96	-7.7(excess)
Sugar		121	119	79	63	143	100	90	120	-0.5(excess)
Fruit		124	132	118	86	91	100	115	125	2.4
Metals		23	59	57	51	69	100	100	95	-19.7(excess)
Seamless tubes		23	71	85	51	82	100	104	104	-14.7(excess)
Iron plates		82	138	19	9	21	100	95	85	-56.7(excess)
Aluminum pigs		--	8	29	68	66	100	95	85	-18.4(excess)
Hydrocarbons		13	21	18	48	104	100	98	92	-14.8(excess)
Fuel oil		8	21	18	67	130	100	100	100	-2.7(excess)
Gas oil		1	--	--	12	78	100	95	80	-41.1(excess)
Aromatic hydrocarbons		61	77	70	82	89	100	100	96	-6.9(excess)
Fish		76	111	143	106	73	100	120	130	3.8
Unit value		70	69	78	95	112	100	104	110	4.0
Cereals		68	71	70	95	113	100	104	110	4.2
Wheat		53	53	65	86	105	100	103	106	-0.3(excess)
Corn		84	77	75	106	116	100	104	115	8.0
Sorghum		81	73	70	113	121	100	107	110	10.0
Fats and oils		127	94	100	89	107	100	101	105	0.2
Soybeans		133	94	96	88	107	100	100	104	-0.4(excess)
Sunflower oil		117	94	120	93	107	100	103	107	1.9
Meat and animal by-products		65	62	86	109	113	100	109	115	9.1
Wool		76	70	84	96	103	100	105	111	2.9
Meat		60	59	86	114	119	100	111	117	12.0
Sugar		78	56	58	137	209	100	89	107	22.2
Fruits		84	94	100	106	122	100	115	120	12.3
Metals		58	49	44	73	84	100	103	105	-7.9(excess)
Seamless tubes		33	33	36	45	69	100	99	101	-20.9(excess)
Iron plates		84	72	86	79	98	100	105	110	-2.2(excess)
Aluminum pigs		0	106	72	105	112	100	107	111	6.9
Hydrocarbons		49	40	61	81	99	100	104	106	-2.4(excess)
Fuel oil		43	39	47	75	104	100	101	103	-4.1(excess)
Gas oil		38	0	0	100	90	100	106	110	1.0
Aromatic hydrocarbons		52	40	73	92	100	100	107	109	1.4
Fish		47	61	68	73	85	100	107	115	-5.3(excess)

(1) Wheat

Export earnings from wheat grew at an average annual rate of about 40 per cent from 1979 to 1981, reflecting a strong production response to an almost tripling of producer prices and improved yields because of the introduction of the wheat/soybean rotation system. In the shortfall year, however, earnings fell by 13 per cent, on account of both a 9 per cent decline in volume--from 4.2 million tons to 3.9 million tons--and a 5 per cent decline in price. The drop in export volume was caused primarily by a smaller crop due to bad weather, which coincided with a relatively small carryover of supplies from the previous year. The 5 per cent decline in the price of wheat (11 per cent in U.S. dollar terms) was caused mainly by a record high level of world wheat production in 1982.

Argentina's exports of wheat in 1982/83 are forecast to amount to 6.1 million tons, 59 per cent higher than in 1981/82, while initial forecasts had expected a 1982/83 crop outturn of about 10 million tons (compared with 8 million in 1981/82), recent indications are that the crop, which is currently being harvested, may exceed 12 million tons. Wheat acreage in 1982/83 is estimated to be 15 per cent higher in 1981/82, mainly because of a switch of a part of the pasture acreage to wheat. In addition, exceptionally favorable growing conditions are expected to cause a sharp increase in yields. Export contracts have already been signed for shipment of over 5 million tons in 1983, and the contract prices suggest a 3 per cent increase in unit values during the first post-shortfall year. In 1984, the volume of shipments is projected to decline because of a lower 1983/84 crop following a return to average yields. This expectation, however, could be invalidated and exports in 1984 could be maintained, if stock accumulation from the bumper 1982/83 crop should turn out to be larger than presently expected. Prices are projected to increase moderately, reflecting the gradual coming into balance of world supply and demand.

As a result of the above export movements, a shortfall of SDR 124.1 million is estimated, caused primarily by relatively low volume in the shortfall year but also by low prices.

(2) Corn

Earnings from corn exports, after reaching a record level of SDR 1,082 million in 1981, more than twice the level of preceding years, declined by 52 per cent in the shortfall year. The major factor causing the decline was a 45 per cent drop in volume. Several factors were responsible: (i) although acreage was roughly unchanged, adverse weather conditions reduced yields by about 26 per cent; (ii) as in the case of wheat, the carryover from the previous year was relatively low; (iii) world trade in corn declined by 8 per cent and the demand from Argentina's major customer, the Soviet Union, was down from the previous year; and (iv) trade patterns were disrupted because of the hostilities in the South Atlantic. Moreover, world production reached a record high level and global stocks increased by about 47 per cent. Argentina's export unit values have dropped by 14 per cent (19 per cent in U.S. dollar terms), in line with the fall in international prices.

With the return of normal weather, the crop which is being harvested now is expected to realize higher yields and the export volume for 1982/83 is projected to recover by about 34 per cent; the projected level would still be 26 per cent below the record level exported in 1981. With prices forecast to increase by 4 per cent, earnings are expected to rise by 39 per cent to SDR 716 million. In 1984, export volume is expected to increase by a further 13 per cent, still 17 per cent below the 1981 level. Demand for Argentina's corn is expected to strengthen in the post-shortfall period, in part because of the continued sluggish growth of domestic output in Argentina's major trading partner. Prices are expected to increase by 10 per cent as production adjustments in the major exporting country, the United States, are likely to reduce the imbalance between world supply and demand. Earnings are projected to increase by 25 per cent. A shortfall of SDR 154.5 million is estimated for corn.

(3) Sorghum

Sorghum is a relatively recent addition to Argentina's grain cultivation, but production expanded rapidly during the 1970s. It is grown mostly in the marginal areas of the corn belt and competes for acreage with sunflower seed, the source of Argentina's preferred vegetable oil. The major cause of declining sorghum earnings in 1979-80 was a transfer of acreage to sunflower seed, partly in response to a drop in sorghum producer prices, but in 1981 this trend was reversed.

Earnings in the shortfall year declined by 13 per cent, solely as a result of lower prices as volume increased by 5 per cent. Earnings are projected to increase by 8 per cent in 1982/83 and by 2 per cent in 1983/84, mainly on account of projected price increases. Prices in 1984, however, are still expected to be about 9 per cent below the 1981 level. As a result of these export movements, an excess of SDR 63.4 million is estimated for sorghum.

b. Fats and oils

Argentina exports a wide variety of oilseed grains and complexes, the most important of which are soybeans and sunflower oil. Earnings from these products, which had changed only slightly from 1979 to 1981, declined by 20 per cent in the 12 months ended September 1982. Earnings in the post-shortfall period are projected to recover at an average annual rate of 13 per cent, and the export shortfall for the 12 months ended September 1982 is calculated at SDR 111.0 million.

(1) Soybeans

Between 1977 and 1981, earnings grew at an average annual rate of over 40 per cent, reflecting the implementation of the soybean/wheat rotation system. Argentina accounted for over 4 per cent of world soybean production and 10 per cent of world exports in the shortfall year. The shortfall in earnings in 1982 is estimated at SDR 112.3 million.

After increasing by 42 per cent in the year ended September 1981, earnings declined by 40 per cent in the shortfall year, owing to a 36 per cent drop in export volume and a 7 per cent fall in export unit value. World soybean production increased by over 7 per cent in 1981/82 as a result of larger U.S. output, and this, combined with weak growth in consumption, resulted in lower world prices. In addition, Argentina's sales were adversely affected, in part, by increased competitiveness from other suppliers which were able to provide more favorable export financing than was Argentina. The major cause of the drop in export volumes, however, was a surge in unrecorded trade as a result of the shipping difficulties caused by the war and the sanctions imposed against Argentina by major European trading partners. The introduction of multiple exchange rates in mid-1982 and the divergence between the financial exchange rate and the rate at which the proceeds from soybean exports had to be surrendered further stimulated the shift to unrecorded exports through neighboring countries and may have led to some speculative withholding of supplies.

Export earnings are projected to recover by an average of almost 28 per cent per annum to an average of about SDR 500 million in the post-shortfall period. The reunification of the exchange system at a substantially devalued rate is expected to lead to an increase in recorded trade. Moreover, output from the 1982/83 crop is expected to reach record levels based on a significant increase in acreage already planted. Export sales in the post-shortfall period are projected to average about 40 per cent more than in the shortfall year, returning to the average level of shipments realized in the two pre-shortfall years. World prices are expected to remain depressed, and Argentina's export price is projected to rise at less than 3 per cent per year in the post-shortfall period.

(2) Sunflower oil

Sunflower oil exports have been rising rapidly since 1977, averaging about 25 per cent per annum until 1981. Argentina is the third largest producer of sunflower seed in the world, but most of the seed is crushed to produce oil and meal, and exports of seeds are minimal. The country is now the largest exporter of sunflower oil, accounting for over 38 per cent of world exports in the shortfall year.

After falling sharply in 1981, acreage planted to sunflowers increased nearly 33 per cent in the shortfall year, resulting in an increase of 31 per cent in the production of sunflower seed. In the shortfall year, the production of sunflower oil increased by 23 per cent, and the volume of exports rose by 64 per cent as stocks, which had been accumulated the year before, were partially drawn down. Export earnings increased by over 50 per cent in 1982 to reach a record level of SDR 177 million.

Production of sunflower seed in the post-shortfall period is projected to decline, as some lands were shifted to soybean cultivation. Despite a further stock decumulation, the volume of oil exports is projected to average some 8 per cent less than that realized in the shortfall year. The reduction in volume is projected to be partially offset by modest price increases. Sunflower oil is calculated to have an export excess of SDR 21.9 million.

(3) Other fats and oils

This group of products includes a number of edible and industrial fats and oils, the most important of which is linseed oil (accounting for over 45 per cent of earnings from this group in 1982), followed by soybean oil, groundnut oil, tung oil, olive oil, and cottonseed oil. Export earnings from these products increased by 21 per cent in 1980, but declined by 25 per cent in 1981 as a result of substantial falls in earnings from soybean oil, cottonseed oil, and groundnut oil. In 1982 earnings declined by a further 3 per cent despite a strong recovery in exports of soybean oil.

Average export earnings in the post-shortfall years are projected at SDR 182 million, which is slightly below the shortfall year level. A decline in earnings of 8 per cent is projected for the first post-shortfall year mainly because of a drop in production of soybean oil as more unprocessed soybeans are shipped. A recovery in earnings of 13 per cent is projected for the second post-shortfall year as a result of increased export volume (8 per cent) and higher export unit value (5 per cent). A shortfall of SDR 11.6 million is calculated for this group of products.

c. Meat and animal by-products

Meat and animal by-products (namely, wool, skins and leather) are estimated to account for 16 per cent of total export earnings in the shortfall year. After increasing by 39 per cent in 1979, earnings from these products stagnated at an annual level of about SDR 1.1 billion; they declined by 2 per cent in the shortfall year. The growth in earnings is projected to recover in the post-shortfall period, partly because of benefits from the substantial currency devaluation combined with more restrictive demand management and because of the easing of the recession in industrial countries. The shortfall for meat and animal by-products is calculated at SDR 53.9 million.

(1) Wool

Argentina produces both high quality fine wool from Merino sheep and medium and coarse wools from crossbred sheep. The largest, and rapidly expanding, market for this wool has been the U.S.S.R. In recent years, production and export have been highly responsive to changes in Argentina's economic policy. The overvaluation of the peso in 1979-80 reduced the real return to the producer and led to both a reduction in production and stock accumulations in anticipation of a realignment of the exchange rate. Exports recovered in the 12 months ended September 1981 mainly in response to the restoration of profit margins with the substantial real effective devaluation of the peso. At the same time, worldwide availabilities of fine wool tightened and Argentina's export unit price rose. In the shortfall year, however, international prices declined, reflecting weaker textile demand, and Argentina's unit price fell by 3 per cent in terms of SDRs (9 per cent in U.S. dollar terms). Despite an acceleration of the rate of currency devaluation, export sales in the shortfall year were adversely affected by war-related market disruptions and by sluggish foreign demand.

By mid-1982, the reintroduction of a multiple exchange rate system with a steady divergence among the rates, and the imposition of an export tax on "nonpromoted" exports may have led to some shift to unrecorded trade. Earnings in the shortfall year are estimated at SDR 232 million, a drop of 14 per cent from the previous year.

In the post-shortfall period, earnings are projected to recover, averaging SDR 312 million per annum. World prices are forecast to recover gradually as textile demand strengthens and as no substantial increase in world supplies is anticipated. The recovery in foreign demand and the reunification of the exchange system at a depreciated level in November 1982 are expected to promote trade through normal channels, and the volume of exports is projected to advance at an average annual rate of 16 per cent. As a consequence of these movements, the shortfall on account of wool is calculated at SDR 31.4 million.

(2) Meat

After reaching their peak in 1979, meat exports (mostly beef) declined by 12 per cent in 1980, one per cent in 1981, and 2 per cent in the shortfall year. The large decline in 1980 was caused by a 33 per cent fall in volume due to a sharp cutback in beef exports to the EEC, the major market, reflecting in part the effects of an overvalued exchange rate. Argentina had difficulty in replacing the lost EEC market, and in 1981 volume fell by a further 5 per cent. In the shortfall year, export volume increased by 16 per cent as the real effective exchange rate depreciated and Argentina penetrated new markets in the U.S.S.R., Africa, and the Middle East. Since the export unit value of beef declined by 16 per cent in the face of weak world demand, earnings declined by 2 per cent.

Exports are forecast to decline marginally in 1983 as an expected 11 per cent decline in volume more than offsets a similar increase in price. The volume decline is expected to occur because Argentina intends to begin rebuilding its herd from the present very low level. Beef prices, which reversed their downward trend in the last quarter of 1982, are expected to be higher in 1983 as the world herd rebuilding phase of the beef cycle limits supplies in the face of increasing demand. In 1984, exports are expected to rise by 13 per cent, reflecting expected increases in prices (5 per cent) and volumes (8 per cent). A shortfall of SDR 19.2 million is estimated for beef.

(3) Skins and tanned leather

Since they are by-products of beef production, exports of skins and tanned leather experience volume movements similar to those of beef exports. Accordingly, after reaching their peak in 1979, exports of skins and tanned leather declined by 10 per cent in 1980 and by 3 per cent in 1981, owing to volume declines of 16 and 5 per cent, respectively. In the shortfall year, however, earnings increased by 12 per cent as volume recovered by 11 per cent--corresponding to a 16 per cent increase in the volume of beef production--and prices remained virtually unchanged.

Earnings from skins and tanned leather are forecast to grow by 7 per cent and 6 per cent, respectively, in 1983 and 1984 as prices resume their upward trend in response to an expected recovery in demand. As a result of the above export movements, a small shortfall of SDR 0.7 million is estimated for skins and tanned leather.

d. Sugar

Production of sugar has fluctuated around 1.5 million tons since the early 1970s, but about two thirds is sold locally to meet domestic needs. Export earnings in the two pre-shortfall years averaged SDR 181 million when world prices were relatively high and the 1980/81 crop was exceptionally large. Despite a return to a normal production level and the interruption in marketing owing to the imposition of economic sanctions, the volume of exports in the shortfall year, at almost 500 thousand tons, exceeded traditional levels. But, because of sharply lower world prices, earnings in the 12 months ended September 1982 fell to SDR 113 million, 40 per cent below the average realized in the two pre-shortfall years.

Drought conditions which prevailed in early 1982 have reduced the sucrose content of the cane, and sugar production from the 1982/83 crop is expected to fall to 1.3 million tons, but to return to normal the following year. Consequently, the volume of exports in the post-shortfall period is projected to average only about 4 per cent higher than in the shortfall year. Thus, the ISO quota is not expected to be a binding constraint on Argentina's exports. 1/ The major market for Argentina's exports has been the United States, but the recent imposition of quotas by that country has limited market access to 109 thousand tons 2/ for the first post-shortfall year, although at prices substantially higher than those prevailing on the free market. Average realized export unit values are projected to be 11 per cent lower in the first post-shortfall year, but to rise by 20 per cent in the second. Earnings in the post-shortfall period are projected to average SDR 115 million per year, almost unchanged from those of the shortfall year. As a result of these movements, the shortfall on account of sugar is calculated at SDR 24.3 million.

1/ Argentina is a member of the International Sugar Agreement (ISA) and its exports are subject to quota limitations. Argentina's basic export tonnage for 1982 was set at 737 thousand tons, but was reduced by 15 per cent to 626.4 thousand tons because of the low level of world prices, and by a further 64.1 thousand tons to 562.5 thousand tons because shipments in 1981 had exceeded quota limitations. As a member, Argentina is obligated to constitute 74 thousand tons of special sugar stocks prior to December 31, 1983, and as of June 1982 had accumulated 30 thousand tons, the minimum stocking obligation.

2/ Argentina has been allocated a 4.3 per cent share of the total U.S. sugar quota.

at a slower rate, and are estimated to amount to SDR 65.9 million. Earnings are projected to average SDR 70 million in the post-shortfall period, or 6 per cent more than in the shortfall year. An excess of SDR 3.5 million is estimated for these products.

h. Fish

Argentina's fishing sector has expanded significantly during the last half of the 1970s as investment was stepped up. Earnings from fish exports declined substantially between 1979 and 1981 (averaging 18 per cent per annum), but recovered in the shortfall year, stimulated, in part, by the substantial devaluation of the Argentine peso at the end of 1981. Fish catches and exports were, nonetheless, hampered by the war in the South Atlantic.

Earnings are projected to average SDR 218 million per year in the post-shortfall period, as both volume and unit price are projected to increase. The projected increases are based on larger volumes and better quality resulting from the addition to the fishing fleet of a number of freezing boats, factory ships, processing ships, and deep-sea trawlers. An export excess of SDR 2.4 million is estimated for fish products.

i. "Other" exports

Argentina exports a wide range of other agricultural products (e.g., rice, tobacco, milk and milk products, timber, tea), metals and minerals (e.g., coal, precious and semiprecious gems, steel and specialty steel products), and manufactured products. This latter group includes both producer goods (such as cement, offshore oil platforms, petrochemicals, machinery and equipment, and spare parts) and consumer goods (such as small appliances, automobiles, processed food products, and furs) for which the largest markets are other members of the Association for Latin American Integration (ALADI). Earnings from "other" exports are estimated to account for about one third of total export earnings in the shortfall year and to contribute SDR 150.7 million to the overall shortfall.

The virtual stagnation in the growth of earnings from "other" exports, in evidence since 1978, occurred because of the major dislocations suffered by the Argentine economy in recent years: export growth was stifled in 1979-80 by inappropriate exchange rate policies, rising wage rates and accelerating inflation. The high level of business failures as a result of the domestic recession, record levels of interest rates and a heavy burden of foreign and domestic debts prevented this sector from benefiting immediately from the acceleration in the rate of currency depreciation during 1981. By late 1981, however, the reunification of the financial and commercial exchange rates at a substantially devalued level appeared to have given the needed impetus to this group of exports. The outbreak of hostilities in the South Atlantic in early 1982, and the concomitant interruption in shipping--and, to a lesser extent, the economic sanctions imposed against Argentina--set back the incipient recovery. Moreover, multiple currency rates were reintroduced and the difference between the

financial and commercial rates quickly widened. Uncertainties surrounding the course of domestic policy after the cessation of hostilities and speculation about exchange rate policy is thought to have impeded export recovery. Despite these difficulties, export earnings in the shortfall year are estimated to have risen by 5 per cent and to amount to SDR 2.4 billion.

Earnings in the post-shortfall period are projected to average SDR 2.9 billion per year, an average annual growth rate of 15 per cent. The reunification of the exchange rates at a much depreciated level in November 1982 has helped to reduce speculation and to improve Argentina's international competitiveness, and the continued adjustment of the exchange rate in line with domestic inflation is expected to give a further boost to "other" exports. New contracts have already been signed for the equivalent of about SDR 400 million for the shipment of offshore oil platforms, cars and ships to North American and European markets in 1983-84. In addition, a sizable expansion in the productive capacity of Argentina's petrochemical industry is scheduled to come on stream in 1983, and export contracts have already been negotiated for about SDR 100 million in new sales in 1983-84.

4. Repurchase

In accordance with paragraph 7 of the compensatory financing decision, the Argentine authorities are expected to represent that they will make a prompt repurchase of any outstanding part of this purchase, if the amount purchased on the basis of the estimated data for September 1982 exceeds the amount that could have been purchased on the basis of actual data for the entire shortfall year. The amount to be repurchased would be equivalent to the excess amount purchased by using partly estimated, rather than actual, data for the entire shortfall year.

5. Staff appraisal and proposed decision

Argentina is expected to request a purchase of SDR 520.1 million, equivalent to 64.8 per cent of quota, under the compensatory financing decision in respect of an export shortfall of that amount calculated for the 12 months ended September 1982. The shortfall is calculated on the basis of actual data for the first eleven months and estimated data for September 1982. In accordance with paragraph 7 of the 1979 CF decision (No. 6224-(79/135)), the request is expected to include a representation that Argentina will make a prompt repurchase of the amount, if any, by which the proposed purchase exceeds the amount that could have been purchased on the basis of actual, rather than estimated, data for the entire shortfall year.

Argentina has faced increasing balance of payments difficulties since 1980, and in 1982 the overall balance of payments deficit is estimated to reach SDR 5 billion, compared with an overall surplus of more than SDR 3 billion realized only three years earlier. Although the current account deficit was reduced in 1982, this improvement reflected mainly lower imports as a result of the sharp devaluation of the peso, as well as the imposition of trade restrictions in connection with the war. Export

earnings declined and interest payments on debt rose strongly. The improvement in the current account balance was more than offset by a sharp deterioration in the capital account. As a result, reserves were drawn down and substantial arrears were accumulated. In 1983, the balance of payments is expected to strengthen, with the overall deficit expected to shrink to less than SDR 0.5 billion and arrears to be eliminated. The staff believes that the balance of payments need of Argentina justifies the proposed purchase.

Argentina's export earnings, which had exhibited only slow growth for several years, rose by 34 per cent in the 12 months ended September 1981, but declined by 11 per cent in the shortfall year. In the post-shortfall period, they are projected to recover, increasing at an average annual rate of 15 per cent. The calculated shortfall of SDR 520 million mainly reflects shortfalls for cereals (SDR 245 million), "other" exports (SDR 151 million), and fats and oils (SDR 111 million); smaller shortfalls are calculated for meat and animal by-products (SDR 54 million), sugar (SDR 24 million), and fruit (SDR 21 million). Export excesses are calculated for metals (SDR 97 million), hydrocarbons (SDR 77 million), and fish (SDR 2 million).

The growth of Argentine exports was depressed during 1979-80 by an increasingly overvalued currency, as well as by accelerating inflation and rising wages. During 1981, however, there was a shift in policy and the peso was devalued substantially in real effective terms, which helped to restore Argentina's international competitiveness. Moreover, bumper agricultural crops as a consequence of exceptionally good weather and an increase in the supply of products for export because of sluggish domestic demand were favorable factors responsible for the 34 per cent growth in 1980/81 earnings. For the following year (October 1981-September 1982), the favorable impact of the reunification of exchange rates in late 1981 on export earnings during the first half of the year was more than offset by less favorable crop outturns and generally weaker international markets. Moreover, the overall revival of the export sector was halted by the outbreak of hostilities in the South Atlantic in early 1982. Normal shipping was disrupted and economic sanctions were applied against Argentina by a number of its major trading partners. In addition, uncertainties about the course of economic policy and the reintroduction of multiple exchange rates in mid-1982 as an emergency solution to a rapidly deteriorating situation hindered the recovery of exports when sanctions were lifted and, besides encouraging a shift to unrecorded trade, may have led to some speculative withholding of supplies in the closing months of the shortfall year. In summary, the decline in Argentina's export earnings in the shortfall year can be ascribed to the following factors: (1) the impact of bad weather on the 1981/82 crops; (2) the weakness of international markets for Argentina's major exports; (3) the dislocations caused by the war; and (4) the subsequent unfavorable effects of measures, specifically those concerning the exchange rate, which discouraged export activity in the closing months of the year. The recovery in export earnings forecast for the two post-shortfall years reflects the favorable effects of the reunification of the exchange rate in November 1982 at a much depreciated level and the adoption of an adjustment program which is supported by a 15-month stand-by arrangement. In addition,

exportable supplies of agricultural crops, particularly wheat, are projected to rise sharply as a consequence of good growing conditions for the 1982/83 crop. Considering the unusual circumstances faced by Argentina during the shortfall year, including the effects of the war, the staff considers that the shortfall in total export earnings is largely attributable to factors beyond the member's control. The staff also considers that the shortfall in earnings is of a temporary nature in light of the projected recovery in the two post-shortfall years.

The staff believes that Argentina has been cooperating with the Fund in efforts to find appropriate solutions for its balance of payments difficulties as evidenced by the adoption of a financial program supported by a stand-by arrangement which is to be considered by the Board concurrently with this request. The request is expected to include a statement that Argentina will cooperate with the Fund in efforts to find, where required, appropriate solutions for its balance of payments difficulties. In the stand-by paper (EBS/83/8), the staff is recommending approval of all but one of the multiple currency practices and restrictions maintained by Argentina on payments and transfers for current international transactions. Approval has not been sought for one restriction which discriminates among Fund members; however, the phased elimination of that restriction is a performance criterion under the proposed stand-by arrangement.

The staff considers that the request by Argentina under the compensatory financing decision will meet all the requirements set forth in that decision. Accordingly, the following draft decision is proposed for adoption by the Executive Board, after a duly authenticated request has been received:

1. The Fund has received a request by the Government of Argentina for a purchase of SDR 520.1 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).
2. The Fund notes the representations of Argentina and approves the purchase in accordance with the request.
3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Fund Relations with Argentina

Date of membership: September 1956.

Status: Article VIII.

Quota: SDR 802.5 million.

Fund holdings of Argentine pesos:	<u>As of January 6, 1983</u>	<u>Millions of SDRs</u>	<u>Per Cent of Quota</u>
Total currency holdings		802.5	100.0
Holdings from outstand- ing purchases		None	None

Special Drawing Rights
Department (as of
November 30, 1982): Holdings are zero per cent of net cumulative
allocation of SDR 318.4 million.

Transactions with
Fund: Argentina has had nine stand-by arrangements, the
last of which expired on September 15, 1978.
Argentina made no purchase under that arrangement.

Direct distribution
of profits from
gold sales (July 1,
1976-July 31, 1980): US\$69.9 million.

Gold distribution: 376,565 fine ounces in four distributions.

Exchange rate: On July 5, 1982, the foreign exchange market was
split into a commercial market for trade transac-
tions and a financial market for other permitted
transactions. The rate in the commercial market
was set initially at \$a 20,000 per U.S. dollar,
representing a 21 per cent devaluation of the
peso from its last quotation on the unified mar-
ket. On November 1, 1982, the two markets were
unified at a rate of \$a 39,000 (selling) which
represented a depreciation on that date of the
exchange rate for commercial transactions of
about 13 per cent. Since November 1, the
unified exchange rate has been adjusted daily.
On December 15, 1982 the exchange rate was \$a
45,730 per U.S. dollar (selling).

Last consultation
(Article IV): Discussions August 27-September 16, 1981 and
January 18-27, 1982; consultation completed by
the Executive Board on March 12 and 15, 1982
(SM/81/233, 12/2/81; and Sup. 1, 2/25/82; and
SM/81/239, 12/8/81).