FOR
AGENDA

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CONFIDENTIAL

November 12, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Staff Report for the 1990 Article IV Consultation and Review and Modification of Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1990 Article IV consultation with Argentina and a review and modification of its stand-by arrangement. Draft decisions appear on pages 25-28.

This subject will be brought to the agenda for discussion on a date to be announced.

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 1990 Article IV Consultation and 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

November 12, 1990

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I. Introduction

A staff mission 1/ visited Buenos Aires from August 8 to September 12, 1990 to conduct the 1990 Article IV consultation discussions with Argentina, together with discussions for the second review under the 17-month stand-by arrangement that was approved by the Executive Board on November 10, 1989 for the equivalent of SDR 1,104 million or 99.2 percent of quota (70 percent on an annual basis). The first review was concluded on May 25, 1990 at which time the arrangement was modified and access reduced to SDR 920 million or 82.7 percent of quota (58.3 percent on an annual basis). Two purchases have been made to date totaling SDR 368 million. In their letter to the Managing Director dated May 10, 1990 the authorities requested that an amount equivalent to 25 percent of each of the final three purchases under the modified arrangement be set aside to support debt reduction operations.

Following corrective measures taken in the first quarter of 1990, the fiscal performance and the external position improved considerably in the second quarter of 1990. Except for a small deviation with respect to the ceiling for the cash deficit of the nonfinancial public sector, other performance criteria for end-June were observed, with a large margin in the case of the net international reserves (Table 1). However, toward the end of June and during July and August policy slippages recurred and, despite the adoption of additional measures (as described below) in late August and on September 1, on the basis of preliminary data it is clear that although the target for the net official international reserves and the limits on treasury expenditure and the external debt were observed, the other performance criteria for the third quarter were not observed.

In a letter to the Managing Director dated November 9, 1990 and the accompanying Memorandum on Economic Policy, the authorities describe the policies that have been adopted to restore the momentum of the adjustment program and to achieve the objective of reducing inflation. The authorities are requesting a waiver for nonobservance of the above-mentioned performance criterion as of end-September in order to make the purchase that would have been based on performance through June 1990. Moreover, access under the stand-by arrangement would be further reduced to SDR 736 million or 66.1 percent of quota (46.7 percent on an annual basis) by dropping the purchase that would have become available on the basis of end-September performance. On this basis, two equal purchases

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1/ The mission comprised Messrs. A. Linde and A. Wolfe (WHD), Ms. M. Carkovic (ETR), Mr. G. Mackenzie (FAD), and Ms. K. Sturgill (Assistant-SEC). Mr. M. Figuerola, the resident representative in Argentina, assisted the mission. Mr. E. Feldman, Executive Director for Argentina, participated in the policy discussions. The discussions were concluded in Washington during the Annual Meetings and the following week.

would remain available under the arrangement, the first following completion of this review, and the other in February 1991 based on performance in the fourth quarter and completion of a review.

In their letter to the Managing Director, the authorities indicate that negotiations with commercial bank creditors are progressing and that they would like to continue the process of accumulating enhancements for eventual debt and debt service reduction operations. The authorities wish to retain the right to draw the amounts that are to be set aside from the two remaining purchases under the arrangement, subject to observance of the performance criteria for end-December 1990 and upon completion by the Fund of a review pertaining to such debt operations as may be agreed between Argentina and its bank creditors. 1/

On October 31, 1990 total Fund credit outstanding to Argentina, including under the compensatory financing facility, stood at SDR 2,059 million or 185 percent of quota, compared with SDR 2,254 million or 202.5 percent of quota at the beginning of the arrangement. Assuming that purchases and repurchases are made as scheduled, Fund credit outstanding to Argentina at end-March 1991 would be SDR 2,201 million or 197.8 percent of quota (Table 2).

II. Background and Performance Under the Current Stand-By Arrangement

1. Developments through the first quarter of 1990

Immediately after assuming office in July 1989, the Menem Administration launched a broadly based program of adjustment and structural reforms aimed at a rapid reduction in inflation and establishing the basis for a lasting solution to the country's economic problems. Despite early successes, including in particular a sharp reduction of inflation and a buildup of international reserves, the effort could not be sustained. By late November, slippages had developed in wage policy, credit policy was not being implemented sufficiently firmly, and delays had been encountered in introducing tax reform and the program of privatization. An attempt in mid-December to reset the nominal anchors of the program under a fixed exchange rate regime did not take hold, and the economy returned to high inflation.

On December 18 the foreign exchange market was unified under a floating system, but fiscal policy was not tightened sufficiently and outward movements of private capital continued despite rising domestic interest rates which led to large quasi-fiscal losses financed by money creation. To eliminate the domestic component of the quasi-fiscal deficit as a source of monetary expansion, on January 1 the authorities

1/ In accordance with the Summing Up to the Executive Board meeting 90/133 of August 31, 1990 on management of the debt situation.

decreed the compulsory conversion of austral-denominated government bonds and term deposits into long-term dollar-denominated government bonds. 1/ While this measure virtually eliminated the domestic source of central bank losses, it also affected the Government's access for the time being to noninflationary sources of domestic financing.

Economic events in the first quarter of 1990 were shaped by the combination of a restrictive credit policy and the fragility of public confidence in the wake of the domestic debt conversion. Inflation, which had come down abruptly in late January, jumped to 115 percent during February, and economic activity declined sharply. Following a short-lived appreciation of the austral in early January, there was widespread flight from the currency; despite soaring nominal interest rates, the austral exchange rate depreciated to almost ₳ 6,000 per U.S. dollar by the end of February compared with ₳ 1,300 shortly after the debt conversion operation.

Confronted with this situation, the authorities strengthened significantly their fiscal effort with an increase in public sector prices in February and with a package of measures introduced on March 6. This package included measures to raise revenue, to reduce expenditure of the National Administration, and to establish a framework for achieving improvements in the operations of the public enterprises and the official financial institutions. In addition, over the following 60 days there were large increases in taxes on petroleum products and further adjustments to public enterprise tariffs (Chart 1).

2. Developments in the second quarter of 1990

The measures announced on March 6 resulted in a striking turnaround in confidence. After appreciating by some 25 percent (from ₳ 6,000 to ₳ 4,500 per U.S. dollar) during the first half of March, the austral exchange rate fluctuated within a relatively narrow range around ₳ 5,000 per U.S. dollar through June. The Central Bank intervened in the exchange market to purchase US$590 million in March and over US$1,600 million in the second quarter.

Inflation came down from 107 percent during February to 53 percent during March, and the outturn in April was considerably better than had been programmed (11 1/2 percent versus 32 percent). However, inflation in May and June did not decline further. With virtual stability in the nominal exchange rate in the face of continuing inflation, the austral appreciated in real effective terms (see Chart 1) notwithstanding the larger than projected purchases of foreign exchange by the Central Bank. Following a steep decline in economic activity in the early months of 1990, there were some signs of moderate recovery in industrial output in the second quarter. In the agricultural sector there was a

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1/ Additional information on this operation can be found in Appendix I of the Recent Economic Developments paper.

record spring harvest, and exports were up strongly from a year earlier. These developments helped bring to a halt the decline in output that the economy had experienced over the 1988-89 period (Table 3).

As regards fiscal developments, the primary surplus was exceptionally strong in April and May owing to a compression of investment expenditure, an unexpectedly large--though temporary--surplus in the social security system, and the positive effect on revenue of the rapid decline in inflation. These factors tended to offset slippages in wage policy in the Central Administration in May and June and substantial departures from government wage guidelines in the public enterprises, following a period in which real wages had declined to a historical low (see Chart 1). There were also delays in the sale of some secondary oil fields of the state oil company (YPF), and the primary fiscal surplus in the second quarter measured in U.S. dollars was smaller than projected. The program's performance criterion for the cash deficit of the nonfinancial public sector (which is expressed in australes and is part of the combined public sector deficit) was exceeded at the end of June by an even smaller margin (some 0.2 percent of second quarter GDP) as the austral was much stronger than had been assumed and external interest obligations measured in australes were lower than projected. The limits on treasury expenditure and on the combined deficit of nonfinancial public sector and the Central Bank were observed.

After reaching historic lows in February, there was a substantial recovery of real austral-denominated balances during the second quarter. Real M-2 more than doubled and the monetary base grew by about one half in real terms. Furthermore, credit policy remained tight in reflection of a reduction in net indebtedness of the nonfinancial public sector to the Central Bank and a sharp reduction in the real stock of rediscounts, which fell a fifth during April-June. The end-June performance criterion for the cumulative change in the net domestic assets of the Central Bank was achieved with a margin of some 3.5 billion australes, or the equivalent of 18 percent of the monetary base in June.

On the external side, exports were stronger than projected while imports were depressed by the decline in real income. In the first half of the year, the external current account had recorded a surplus estimated at US$350 million compared with a projected deficit of US$780 million. Inflows of private capital further strengthened the overall balance. The end-June performance criterion for the net international reserves was observed with a margin of US$888 million, and the Central Bank's freely disposable reserves stood at US$2 billion on June 30. The performance criteria on external debt and arrears also were observed.

3. Developments in the third quarter of 1990

Substantial progress was achieved during the third quarter in the implementation of the privatization program. 1/ Most of the contracts for the sale of the secondary oil fields of the state oil company (YPF) were ratified in September, and cash proceeds of US$227 million were received by the Treasury in September and October. The adjudication process for the sale of a number of YPF's primary oil areas commenced in August. Agreements for the sale of the telephone company (ENTEL) as separate operations to two consortia was reached in June, and the winning bid for the national airline was announced in July. For these sales to become effective, however, waivers were needed from commercial bank creditors to permit the purchasers of the two companies to tender certificates of foreign debt for part of the purchase price. The waivers for ENTEL were obtained, and with effect from November 8 the company has been operated by its new owners. The two groups that purchased ENTEL have been granted by the Government a three-month extension to accumulate the amount of debt claims on Argentina needed to conclude the transaction. The waivers to permit the transfer of the airline to private hands are still being gathered. The Government also has contracted out the maintenance of major portions of the national highway network.

While progress was being made as regards privatization, the fiscal situation weakened considerably in the third quarter. Revenue fell below target in part because of delays in extending the coverage of the value-added tax to services and in putting into effect measures to improve tax administration, e.g., legislation facilitating the closure of enterprises of delinquent taxpayers was not enacted. Revenue also was affected by the failure of inflation to decline, the acceleration of the phasing out of export taxes, and the inability of YPF to meet its tax obligations on a timely basis. On the expenditure side, there were difficulties in implementing effectively the provisions of Decree 435 of March 6 that aimed at giving the Ministry of Economy control over the public enterprises, and some public enterprises did not observe the Government's wage guidelines. There also were slippages in central administration wages (particularly for the military), pension benefits were set higher than programmed, and legal problems slowed implementation of the employment reduction program. As a result, the primary surplus in the third quarter was about 1 1/2 percent of GDP, compared with a target of 6 percent of GDP (Tables 4, 5, and 6). 1/

On credit policy the Central Bank continued to pursue a policy of recovering rediscounts, but legal reserve requirements were lowered to ease pressure on interest rates. Specifically, the reserve requirements on privately held demand deposits were lowered in July by 4.5 percentage points and legal reserve requirements on certain fixed-term deposits were lowered in August by 2 percentage points. As a result, the ratio of reserves to total deposits fell from around 48 percent in the second

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1/ For further details on the privatization program, see Appendix II of the Recent Economic Developments paper.

1/ The original indicative target has been adjusted downward by the effect of the unexpected growth in money demand on the exchange rate, which has been estimated at 2 3/4 percent of GDP.

quarter to an average of 44 percent in July-August. The process of remonetization came to a halt as real M-2 balances changed little during the quarter (Table 7).

Inflation remained at 11 percent in July and rose to 15 1/2 percent in August, whereas the program had assumed a decline to 2 percent. Following five months of little change in the nominal exchange rate, in late July and in August the austral depreciated about in line with inflation, even though the Central Bank had stopped making purchases of foreign exchange since mid-July. With only small exchange purchases in September and a rise in external arrears, the large margin over the net international reserve target that had been built through June was used up by end-September, but freely disposable reserves rose to US$2.2 billion. External arrears on debt, other than medium- and long-term debt to commercial banks, increased by over US$100 million to US$634 million during July-September 1990, instead of declining as programmed (see Table 1 and Table 8). Of this increase some US$20 million was on account of overdues to the World Bank, which since have been settled. Interest arrears on medium- and long-term debt to banks reached US$7.5 billion in September, as Argentina continued to pay only a portion of interest due. These arrears are expected to decline in the coming months as banks exchange their claims on the Government of Argentina for equity participation in the enterprises that are being privatized.

In response to the weakening situation just described, the authorities undertook strong actions on September 1, which led to an improvement of the primary balance of the nonfinancial public sector in September and stemmed the outflow of private capital. The targets for the net international reserves, treasury expenditure, and external debt for end-September were met, but indications are that the other performance criteria were not observed.

III. Revised Program

The aim of the authorities for the remainder of the year is to bring inflation to a low level and to assure a satisfactory balance of payments; thereby, setting the stage for a resumption of output growth in 1991 after three years of recession. In their view, a recovery in economic activity would help create an environment conducive to continuing the process of structural change that is being sought.

The authorities are aware that achievement of these aims requires an increase in the primary surplus of the nonfinancial public sector and a tightening of credit along the lines of the objectives set in the May revision of the program. A substantial improvement in the public finances is seen as essential because noninflationary domestic financing cannot be counted on in the aftermath of the debt conversion operation at the end of 1989 and access to external financing remains limited. Moreover, the authorities believe that the process of remonetization has run its course for the time being, and the intention is to limit central bank purchases of foreign exchange in line with the Treasury's primary surplus. Purchases of exchange in excess of the primary surplus would work at cross purposes with the objective of reducing inflation.

Accordingly, the primary surplus for the fourth quarter has been targeted to rise to 4.2 percent of GDP. Such a surplus is consistent (at the projected exchange rate) with the foreign exchange purchases that are needed to meet public external obligations, including the settlement of arrears by the end of 1990 except those on medium- and long-term commercial debts, and the target for official reserves. In accordance with this fiscal objective, the authorities issued on September 1, 1990 Decree 1757 which strengthened the hand of the Ministry of Economy in controlling expenditures by the National Administration (including the public enterprises, decentralized agencies, and special funds), established a firmer timetable for the reduction of public sector employment, and provided for sharp adjustments in public sector prices, particularly for fuels. Decree 1757 restated the authorities' previously announced wage policy that limited salary increases for all public sector employees to no more than 7 percent in October, 3 percent in November, and 2 percent in December, in line with the projected decline in inflation. To complete the package, in late September the value-added tax (VAT) was extended to services and in October the VAT rate was raised. On the side of credit, legal reserve requirements were raised and regulations were issued aimed at facilitating the further reduction of the stock of central bank rediscounts.

The latest data suggest that these policies have been yielding positive results. After reaching close to 8 percent in the first week of September in reflection of corrective price adjustments in the public enterprises, the rate of price increase fell to 1 3/4 percent a week through mid-October and to 1 percent a week in the second half of that month. For the whole of October consumer prices rose by 7.7 percent, compared with an average monthly rate of 14 percent in the third quarter. At the same time net exchange purchases by the Central Bank in October amounted to some US$425 million, exceeding the combined total of the previous three months.

1. Fiscal policy

As noted, the policy package that was put in place on September 1 involved measures to bolster revenue and curb expenditure. On the side of revenues, a key measure was an average increase of 30 percent in public sector prices. In particular, the average price to refiners of domestically-produced crude oil was increased from less than US$14 a barrel to about US$21 a barrel, and retail prices of petroleum products were increased by an average of 26 percent, bringing the price of a gallon of gasoline to the equivalent of more than US$3.20 a gallon at the current exchange rate. As a result, YPF would experience an increase in net revenue of about 0.4 percent of GDP on an annual basis, and thus would be able to pay statutory provincial oil and gas royalties without assistance from the Treasury, clear up its tax arrears, and keep up with current tax payments. In addition, the Treasury's tax revenue would rise by 0.5 percent of GDP, and the oil price adjustment also made possible the elimination of a subsidy extended heretofore by the Treasury to YPF to cover the difference between the price paid by YPF for oil produced by private contractors and the administered domestic price. Moreover, the provision of the Economic Emergency Law of August 1989 that reduced the share of the petroleum products tax earmarked for investment projects in the energy and transportation sectors was extended for another year, which should produce expenditure savings of 3/4 of one percent of GDP on an annual basis. Lastly, the rates on fuel taxes earmarked for the social security system were reduced to avoid an increase in benefit payments as a result of the adjustment in oil prices.

On September 28, Congress approved the extension of the VAT to most services. This was followed on October 19 by an increase in the VAT rate from 13 to 15.6 percent, the highest rate permissible under current law. 1/ While cash revenues will not be affected until December, these changes are expected to result in an increase of approximately 3/4 of 1 percent of GDP in tax collections in the coming year, which would offset the effect expected from the phasing out of export taxation in the coming months. These measures are to be supported by the recent hiring of 2,000 new tax inspectors, and by the implementation of an automated system for the processing of the returns of the country's largest taxpayers by February 1991.

Through Decree 1757 the Government intended to improve control over public enterprise spending decisions (including the wage bill) and to reinforce the earlier programs to reduce public sector employment. With respect to the latter, the intention is to implement a major rationalization of ministerial departments and the decentralized entities, with a view toward achieving a more substantial reduction in employment than has been obtained thus far through an early retirement program. A reduction in the staff of the National Administration will be achieved through a reduction in both the number of temporary positions and permanent staff. At present the number of temporary positions is estimated at 80,000 and the aim is to cut this number by 4 percent in the remainder of 1990. These cuts would continue in 1991 by means of reduced treasury transfers to those public sector entities that have been identified as having unauthorized temporary staff. The intention is to reduce the number of temporary employees by about one fourth by the end of 1991.

The total reduction in permanent staff is expected to amount to more than 125,000 positions from the inception of the program to end-1991 and would result from the dissolution of a number of regulatory

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1/ For a summary of recent changes in the tax system see Appendix III of the Recent Economic Developments paper.

agencies which have been made redundant by deregulation, the streamlining of staffing in support and administrative functions, the privatization of certain services, and the transfer of programs in the areas of secondary education and possibly health to the provinces. To mitigate the budgetary costs of the employment reduction program, Decree 1757 reduced the period during which civil servants relieved of their duties (but not actually laid off) receive full pay and modified the provisions regarding severance pay. The World Bank is providing technical and financial assistance for this program. The privatization of the national airline and ENTEL will result in a reduction in the total workforce of the public enterprise sector of about 60,000 employees or 20 percent of the level at end-September. With the expected privatization of three railway lines, the public payroll would be reduced by another 15,000 employees.

The Government aims to achieve control over salary expenditure in the coming months by enforcing tight nominal limits on wage awards in the National Administration and the public enterprises. In the National Administration the wage bill will fall from 3.5 percent of GDP in 1989 to 3.1 percent of GDP in 1990; although this is short of the 2.9 percent envisaged in May, it represents an average decline in wages in real terms exceeding 20 percent. Tight limits have been imposed on expenditure on other goods and services, and a reference price list is to be established to improve procurement practices and avoid overcharging.

Decree 1757 has transferred responsibility for overseeing the operations of the public enterprises from the Ministry of Public Works and the Ministry of Defense (except for those enterprises in the process of being privatized) to the Ministry of Economy. The enterprises were required to submit their budgets for 1991 by the end of October, and are expected to prepare monthly budgets for review by the Ministry of Economy. With the exception of the railways, public enterprises are to achieve a surplus on their operations (exclusive of debt service). Moreover, the extension of credit to customers of the public utilities and other service sector enterprises has been restricted. Also, collective bargaining clauses that promote restrictive practices, such as minimum staffing requirements, have been voided (subject to an appeals process), and indexation clauses have been suspended. The operating margins of the public enterprises will be increased in the fourth quarter of 1990 by the price adjustments made in September and by the application of the Government's wage norms. Indicative targets have been established for the primary surplus of the four largest enterprises, and for tax payments to the Treasury and social security system by these enterprises.

The scope of the Government's program of privatizations has been broadened to include the principal electrical utility (SEGBA), several railway lines, the major petrochemical industrial complex-Bahia Blanca-and several other petrochemical companies, the state steel corporation (SOMISA), the state gas company (Gas del Estado), the National Port Administration, the state shipping line (ELMA), the postal service

(ENCOTEL), the storage elevators of the National Grain Board (Junta Nacional de Granos), the Buenos Aires Metro, the National Mint, the state coal company (YCF), and a number of enterprises operated by the Ministry of Defense. In the petroleum sector, as noted above, the process of tendering bids for YPF's primary areas has been initiated. Contracts taking the form of production-sharing agreements or concessions are expected to be finalized early in 1991. The Government expects to receive in excess of US$1 billion from these transactions at that time.

The Government is planning to take measures to improve the current finances of the social security system and address the structural disequilibrium of the plan for the self-employed. Retirement ages for both employees and self-employed would be increased, and the payment of pensions would be deferred for those receiving some form of unemployment indemnity from their former employers. The Government plans to partially privatize the self-employed fund as a means of effecting a permanent solution to its financial problems.

The authorities are continuing their efforts to control the level of treasury transfers to provincial governments and to rationalize the revenue-sharing arrangement with the provinces. In this regard, the Government will refrain from making any discretionary transfers to the provinces and will redouble its efforts to recover debts owed by the provinces to public enterprises. In addition, educational spending and some road maintenance programs are to be transferred to the provinces early next year, and the authorities are also contemplating the transfer of health services. The provinces are expected to receive financial and technical assistance from the World Bank aimed at improving revenue collection and financial management in connection with a sectoral loan that is being discussed.

Moreover, the Central Bank intends to monitor carefully the lending practices and interest rate policies of the provincial banks, particularly with respect to their relations with provincial governments. The provincial banks from time to time have offered depositors relatively high yields to fund increased lending to provincial governments. Such operations have reduced the availability of loanable funds for private sector credit, have fostered inefficiency in the banking system, and have created imbalances in the finances of some provincial governments.

As indicated, the measures discussed above are projected to increase the primary surplus of the nonfinancial public sector from 1.4 percent of GDP in the third quarter of 1990 to 4.2 percent in the fourth. Both National Administration revenue and expenditure in the fourth quarter are projected to be lower in terms of GDP than were envisaged in the May revision of the program. In the case of revenue, this occurred because of the delay in the extension of the VAT to services, the lowering of export tax rates, and recurring problems in tax administration, including legal challenges to the strengthened penal code for tax offenders. A cutback in investment spending and a decline in transfers to the provinces under the revenue sharing arrangement would be the main factors behind a decline in expenditure. External interest obligations and the central bank losses (in local currency) also are projected to be substantially lower than had been envisaged in May, whereas social security payments are to be higher, notwithstanding the postponement of the traditional December aguinaldo into January (a measure designed to bring the system into equilibrium on a cash basis through the matching of the timing of receipts and outlays). In all, the combined public sector deficit would be about 1 percentage point of GDP below the May target. However, it would not be feasible to reduce the public sector's domestic indebtedness as had been envisaged in May, because external loan disbursements are expected to be smaller and the reduction of external arrears somewhat larger.

For 1990 as a whole, the primary balance would show a primary surplus of 3 percent of GDP, smaller than the 4 percent envisaged in May, but a significant improvement from last year's deficit of 1/2 percent of GDP (see Table 4).

2. Monetary and credit policies

In light of the apparent end in July of the strong remonetization that occurred in the second quarter, the monetary program designed by the authorities is based on a conservative estimate of money demand. Therefore, the program assumes that by end-December 1990 the ratios of M-1 and M-2 to GDP would be at about their July levels (see Table 7). On this basis and consistent with the program's objectives as regards inflation and net international reserves, limits have been set on changes in net domestic assets of the Central Bank (see Table 9).

Because the forced conversion of domestic debt on January 1, 1990 limited the instruments available to the Central Bank for conducting monetary policy, the authorities have relied upon legal reserve requirements as a key monetary policy tool. On September 1, 1990, the monetary authorities reversed the July and August reduction in legal reserve requirements; those on private demand deposits were increased to around the levels that existed in the second quarter and those on government deposits were raised from 88.5 to 100 percent. The ratio of required reserves to deposits has remained around its July/August level, as the composition of private sector financial assets has recently shifted away from high-reserve requirement demand deposits toward low-reserve requirement time and savings deposits. The authorities do not intend to change legal reserve requirements throughout the remainder of the program period and will continue to enforce strictly their observance.

The authorities have taken further steps to ensure that credit is being brought under control. The Central Bank already has made progress in recapturing rediscounts as noted, and the level of new export credits has been reduced considerably over the last twelve months. In line with the objective set forth in Decree 435 that all financial entities settle their debts to the Central Bank by September 30, 1990, in late

August the authorities implemented a debt conversion scheme that allows for the cancellation of such debts at a discount. All banks are free to participate in the debt reduction scheme at a discount that is to be set by the Central Bank on the basis of offers tendered by participating banks. For financial institutions in liquidation, which account for 50 percent of central bank claims on the financial system, Decree 1757 requires that bankruptcy proceedings be initiated if they fail to settle their debt with the Central Bank by December 1, 1990. Also, effective November 1, 1990, the Central Bank will no longer permit banks to apply overdraft balances of the government pension system toward legal reserve requirements.

The authorities intend to build upon the progress that has already been made to reform the official financial system. Following the halting of the retail operations of the National Mortgage Bank (BNH) earlier this year, all remaining branches were closed on September 30, 1990. The authorities also have severely restricted the operations of the National Development Bank (BANADE), and all branches now have become loan collection agencies. The intention is to limit BANADE's operations to the on-lending of funds from multilateral and bilateral agencies to promote small- and medium-sized businesses. The arrangement under which the Central Bank met these banks' severance payments to laid-off workers was terminated in August.

The authorities have allowed the market to determine interest rates which at times have been strongly positive in real terms in reflection of a risk premium for holding austral-denominated assets in periods of financial uncertainty. An objective of the authorities is to develop an efficient capital market to replace the Central Bank as the principal institution for the channeling of domestic savings toward the financing of productive activities. Their efforts to reduce the outstanding balances on subsidized lines of credit and their commitment to allowing the free determination of interest rates are important elements of this policy. The draft reform of the charter of the Central Bank, which has been submitted to the Congress and private sector representatives for review, provides for the granting of enhanced regulatory powers to the Central Bank for overseeing the financial system.

3. External policies

a. Exchange rate and the balance of payments

Since the introduction of a unified freely floating exchange rate system on December 18, 1989, the Government has maintained unrestricted access to the foreign exchange market for both current and capital account transactions. The authorities believe that allowing the exchange rate to reflect market conditions and persevering with the adjustment process will result in price and exchange rate stability, which they see as essential for the resumption of growth on a sustained basis.

As noted, the austral appreciated sharply in real terms in the second quarter, before depreciating about in line with inflation in late July and August. Following the announcement of Decree 1757 on September 1, 1990, the austral appreciated in relation to the U.S. dollar, in part reflecting the near absence of the Central Bank from the exchange market and the continued weakness of import demand. From March to September, the austral appreciated in real effective terms by almost 65 percent.

Notwithstanding a projected deterioration of the terms of trade, the external current account is expected to be almost in balance in 1990 whereas a deficit of US$1.4 billion (2.1 percent of GDP) had been programmed initially (Table 10). As noted, this outturn reflects strong growth in the volume of agricultural exports while the volume of imports is projected to decline by about 6 percent from 1989. The current account overperformance also reflects a downward revision of interest payments, including on obligations to Paris Club creditors and the reduction in foreign debt resulting from the privatizations. As Argentina is only a small net exporter of petroleum products, recent increases in international oil prices have had little effect on the balance of payments.

The capital account surplus is expected to be some US$900 million lower than envisaged earlier, reflecting in part a US$300 million shortfall in disbursements from multilateral agencies. In addition, the fiscal problems experienced in the third quarter affected confidence and led to private capital outflows that are not expected to be fully reversed by year-end. The net effect of the privatizations and the sale of oil fields in the capital account in 1990 is in line with program assumptions. Cash receipts from these sales would amount to some US$600 million in 1990. The debt-reduction operations associated with the privatization of ENTEL and Aerolineas are expected to result in the amortization of government debt to commercial banks at the higher end of the US$5-7 billion range that had been projected earlier.

In all, the overall balance of payments is projected to shift from a deficit of US$6.3 billion in 1989 to a surplus of almost US$100 million in 1990. This will allow the Central Bank to rebuild its disposable reserve position from US$784 million (or 2 months of imports) at end-1989 to US$2.1 billion (5.7 months of imports) at end-1990. Disposable reserves exceeded this level in September of 1990, but some drawdown of gross reserves is expected in the last quarter of the year as arrears are reduced.

Paris Club creditors recently extended the deadlines for the activation of the pull back clause and the bilateral agreements to end-November 1990. Negotiations to finalize rescheduling agreements with most of the 16 countries that participated in the Paris Club rescheduling agreement of December 1989 have been completed or are at an advanced stage. Data reconciliation problems remain with two countries, but the authorities expect these problems to be resolved shortly. After a temporary delay in the settlement of payments due in September under the recent rescheduling, Argentina is now servicing its obligations to official creditors on rescheduled debts and on debts not covered under the 1989 agreement.

b. Medium-term scenario

The medium-term scenario presented below is based on a macroeconomic policy framework that involves no central bank financing of government operations and assumes that the primary surplus of the nonfinancial public sector is sufficient to meet public external obligations, thereby allowing the Central Bank to pursue a monetary policy consistent with low inflation and exchange rate stability. Furthermore, it is envisaged that the Central Bank will continue in its efforts to improve the efficiency of financial markets by eliminating subsidized credit schemes and maintaining the free determination of interest rates. As confidence in the economy strengthens and a remonetization process takes hold, the Central Bank would be able to pursue a more flexible monetary policy, including a gradual reduction of the currently high legal reserve requirements. These policies would be accompanied by structural reforms aimed at improving the economy's efficiency and stimulating private sector investment, which should help foster an improvement in per capita income in the context of balance of payments viability.

Under the medium-term scenarios presented below, output per capita would increase by 1 1/2 percent a year on average during 1991-96 (Table 11). The growth estimate has been revised downward since the time of the last program review because of a growing perception that the economy may take longer to respond to structural changes than had been expected earlier. Nevertheless, the medium-term scenario involves a significant reversal of the decline in output per capita experienced in Argentina in the past decade. Assumptions on the external environment (i.e., world interest rates, inflation, and commodity prices in international markets) are those incorporated in the latest World Economic Outlook.

Table 11 presents two scenarios of the balance of payments in the medium term that differ as regards the assumptions made about external financing. The baseline scenario assumes that Argentina obtains foreign resources by refinancing interest due to commercial banks. The alternative scenario assumes that the debt to commercial banks is reduced through debt equity and other debt conversions carried out at prices similar to those prevailing in the secondary market for Argentine commercial debt.

Under both scenarios, imports would recover in 1991-92 from the low levels of 1989-90 and would continue to grow faster than total output (by as much as 7 1/2 percent a year) during the remainder of the projection period. Exports also would grow faster than GDP (by 4 percent a year on average) as a result of the progressive reduction in the taxation of exports, import liberalization, and the development of the country's oil resources by private companies. The ratio of exports and imports to gross domestic product would rise from 16 percent in 1991 to almost 20 percent in 1996, consistent with the strategy of opening the economy to foreign competition. It is also expected that official capital flows, including partial reschedulings of debt service due to Paris Club creditors in the early years of the projection period, would be complemented by continued high levels of foreign direct investment and an inflow of private capital.

Owing in part to asset sales, gross liquid reserves are assumed to increase by around US$500 million a year during the projection period keeping them at about 5.5 months of imports. Although this level of reserves may appear to be high in comparison with other countries with a floating exchange rate regime, the authorities noted that Argentina remains primarily an exporter of agricultural commodities and that debt obligations, including to the Fund, would remain high over the projection period. Moreover, the authorities are of the view that in the wake of the recent hyperinflationary episodes, maintaining a high proportion of liquid reserves to the money base, while pursuing prudent fiscal and credit policies, is necessary to sustain confidence in the currency and avoid sudden portfolio shifts out of austral-denominated assets.

In the absence of debt reduction operations, the above assumptions would result in a financing gap of as much as US$3 billion a year throughout the projection period. The baseline scenario assumes that these requirements are met through interest refinancing, which even if available would have adverse effects on the stock of commercial debt and debt service burden. For example, interest accrued by the public sector would average about 20 percent of government revenues during the projection period, even allowing for a major improvement in tax administration. Similarly, the ratio of debt service to exports of goods and nonfactor services would average 50 percent during the projection period and external debt would total 56 percent of GDP.

The alternative medium-term scenario is based on the premise that debt reduction operations are necessary if Argentina is to achieve balance of payments viability and improve its growth prospects over the medium term. With the support of prudent fiscal and monetary policies, the alternative medium-term scenario aims at servicing a lower level of external debt at market-related rates.

Based on the Government's program of privatization, the alternative scenario assumes that sizable debt equity conversions continue in 1991 bringing down the outstanding debt to banks by as much as US$5 billion in 1991 and by another US$2 billion in 1992. It is also assumed that enhancement resources of around US$3 billion, including Argentina's own resources, would be used for debt reduction operations to take place at market-related prices. Partial interest payments to banks would be continued. Given the sizable debt reduction achieved through privatization of the telephone and airline companies in 1990 and the Government's emphasis on a continuation of these kinds of operations, the alternative scenario presented here assumes that the enhancement resources needed are lower than in the debt reduction scenario presented to the Board in May.

The alternative medium-term scenario suggests that a phased approach to debt reduction could eliminate the need for exceptional financing toward the end of the projection period. By 1995-96, external debt would be halved to 32 percent of GDP, while the total debt service would decline to 38 percent of exports of goods and nonfactor services from 62 percent in 1990. Similarly, interest due would decline from 62 percent of GDP in 1990 to less than 3 percent of GDP in 1995-96.

Although both medium-term scenarios are highly sensitive to changes in assumptions about the external environment, oil price changes would not significantly affect the balance of payments in the medium term. Argentina is currently self-sufficient in oil and it is expected that with the development of new oil fields the country will become a net exporter by the end of the projection period. Higher interest rates or lower prices of cereals in world markets, however, would have a significant effect on the balance of payments. For example, if LIBOR were to be 1 percentage point higher than assumed in the projections, the balance of payments financing needs would rise by US$830 million a year. Similarly, a permanent one percent deterioration in the terms of trade at the beginning of the projection period would require additional financing of US$311 million a year.

c. External debt, debt service, and financing assurances

At the end of 1989, Argentina's external debt reached US$64 billion, roughly equivalent to 85 percent of GDP, and included US$5.7 billion of interest arrears, mostly to commercial banks (Table 12). Interest due on this debt during 1990 is estimated at US$5.8 billion, which is 44 percent of exports of goods and services and over 6 percent of GDP. Argentina's debt burden is high relative to that in most other countries, and the authorities' aim is to reduce it to a level deemed compatible with external viability in the context of a satisfactory economic growth performance. A significant reduction in debt to commercial banks is being pursued through debt-equity operations. Waivers from creditors for debt retirement have been obtained for the telephone company and have been requested for the airline. These operations would enable Argentina to reduce its foreign commercial bank debt by US$7.3 billion, including US$1.3 billion of interest in arrears (or one quarter of end-1989 interest arrears to banks). The privatization plans for 1991-92 are expected to result in a reduction of external debt of a similar order of magnitude, including a further reduction in arrears to banks.

The authorities have had further discussions with creditor banks in connection with the privatizations. Discussions also have taken place in connection with the more comprehensive proposal for phased debt and debt service reductions that the authorities are developing and that will require broad waivers. A meeting of the steering committee of creditor banks is to take place on November 14, 1990. At this meeting, the authorities intend to seek the endorsement of the committee for their expanded privatization program.

The authorities are of the view that the decision to expand the scope of the privatization program constitutes a useful option in striving to achieve a quicker solution to the problem of Argentina's debt overhang. The expectation is that by putting up physical assets of significant value for debt reduction through exchanges, bank debt would be reduced to a size more amenable to a comprehensive settlement as enhancements for debt and debt service reductions become available and official reserves reach a more adequate level. Argentina could begin to accumulate enhancements upon the completion of this review, as the revised stand-by agreement approved by the Board in May includes set-asides from the Fund. The modified arrangement envisages another purchase to be made early in 1991 that would include a set-aside for debt reduction.

While negotiations with commercial banks are underway and the authorities are developing financing proposals to achieve a lasting solution to Argentina's debt problem, they have made partial interest payments to commercial banks on medium- and long-term debt since June of this year. Thus far these payments have amounted to US$40 million a month, a level that the authorities felt they could confidently sustain and would provide the basis for re-establishing relations with banks. On this basis arrears on external debt to commercial banks increased from US$5.2 billion at end-1989 to US$7.5 billion in September 1990. The Government is committed to continue making partial interest payments on medium and long-term debt to commercial banks and would consider increasing the level of these payments as the improvement in the public finances is consolidated. In addition, short-term debt to commercial banks not eligible for refinancing is being fully serviced.

d. Policies as regards the trade and payments system 1/

Argentina's payments system is free of restrictions except for those that may arise from the external payments arrears on medium- and long-term debt to commercial banks and certain arrears to other creditors, and for 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.

Argentina has notified the Fund under Executive Board Decision No. 144 (1952) that it has imposed restrictions against the Republic of Iraq and Kuwait in compliance with United Nations Security Council Resolution No. 661 (1990).

1/ For a more detailed description on the trade and payments system see Appendix IV of the Recent Economic Developments paper.

In recent years there has been substantial progress in opening the economy to foreign competition. Most quantitative import restrictions have been dismantled, specific tariff surcharges lowered, the level and dispersion of tariffs and export taxes reduced, and administrative restrictions to trade eliminated. 1/ These changes and the introduction of a unified foreign exchange market with unrestricted access are expected to improve resource allocation, foster growth, and move the country toward closer integration with the world market.

Quantitative import restrictions have been progressively reduced by removing goods from the list subject to prior consultation with domestic industry groups. The production coverage of items on this list was reduced from 18 percent in August 1989 to 7 percent in June 1990. Since May, the last time Argentina's trade and payments system was discussed by the Board, quantitative restrictions have been lifted on chemical and pharmaceutical products, paper, and some textile goods. The restrictions that remain on goods other than automobiles and steel are to be eliminated by year-end. For automobiles, the Government is studying a plan to lift existing restrictions over the next few years in consultation with domestic producers. For steel, court action in December 1989 forced the Government to reinstate the prior consultation requirement mandated by the steel supply law dating from World War II; however, the Government is preparing to repeal this law.

Certain other imports are effectively restricted through high specific tariff surcharges. After an increase in the application of specific tariff surcharges at the beginning of the year, they have been progressively reduced in scope to below 5 percent of domestic production. The authorities indicated that the tariff surcharge on consumer electronics could not be totally eliminated by September 30 as intended, but steps are being taken to bring these tariffs down, and further reductions of surcharges on these items are planned for January 1991. Tariff surcharges on textiles and machinery also will be reduced shortly.

The authorities are aiming at an import tariff code with only four rates, in the 10-20 percent range. At present, there are six basic tariff rates that vary between 5 percent and 24 percent, with a production weighted average of 18 percent. In late August, the Government reduced tariff rates on food products and medical equipment which ranged from 13 to 24 percent to a uniform 5 percent. Tariff rates for some 2,400 additional products not imported during 1989 and previously subject to rates in the ranges of 18-24 percent were reduced to a uniform 16 percent. Regarding administrative restrictions on trade, the Government eliminated the "Sworn Declaration of Import Needs" on July 20, 1990 thereby allowing the full automaticity of imports not subject to

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1/ In September 1990, the World Bank approved the release of the second tranche of the Trade Policy Loan of $150 million after Argentina met the criteria specified in the loan agreement.

quantitative restrictions. Also in July, a 3 percent advanced import deposit that had been introduced in 1989 was eliminated.

The extension of the Law of Economic Emergency of September 1989 has resulted in the continued suspension of a number of export promotion schemes aimed at stimulating industrial exports. After eliminating tax rebates for exporters in March 1990, the Government reinstated the rebates in June. Exporters of certain manufactured and agro-industrial products are reimbursed 5-15 percent of the f.o.b. value of exports to compensate for taxes presumed to have been paid in the production process. Rebates for the value-added tax are paid in cash and rebates for other taxes are paid in austral-denominated bonds (BOCREX). The BOCREX can in turn be used by exporters to pay foreign trade taxes on industrial goods. Export taxes have been reduced according to a monthly schedule with the aim of reducing the average rate and dispersion of these taxes. Those on manufactured goods were eliminated in July 1990, while those on agricultural goods were reduced from an average 17 percent in March 1990 to 14 percent in September and are to be reduced further to 11 percent by December.

e. Capacity to repay the Fund

Repurchase obligations to the Fund under previous arrangements increase from SDR 514 million in 1990 to SDR 724 in 1991, before coming down to SDR 638 million in 1992. Obligations falling due in 1991-92 correspond, on average, to 13 percent of projected exports of goods and nonfactor services. On the standard assumption that there will be no further use of Fund resources after the present arrangement, scheduled repurchases decline to an average of SDR 197 million a year in 1993-95, or some 1 1/2 percent of projected exports of goods and nonfactor services. Outstanding use of Fund resources is projected to decline from 3 percent of GDP in 1990 to 0.2 percent in 1995. Gross Fund purchases in 1990 under the present arrangement would amount to 5 percent of total gross financing needs.

Staff reports related to the present stand-by arrangement contained positive assessments of Argentina's capacity to service its obligations to the Fund. Such assessments were based on Argentina's record in maintaining payments to the Fund, and on the premise that the country's economic prospects would be strengthened over the medium term as a result of the stabilization and structural reform programs and a resolution to its debt problem. In particular, it was expected that the external position would be improved by the processes of opening the economy to foreign competition, encouraging nondebt creating capital inflows, and rebuilding the Central Bank's reserve position. Policy actions on these fronts were to be accompanied by the re-establishment of relations with commercial creditors through resolution of Argentina's debt problem over the medium term.

As noted, progress in implementing policies to strengthen the balance of payments have thus far been complemented by a sizable reduction in external debt through the privatization of state enterprises. Moreover, the authorities recent decision to expand the scope of the privatization program constitutes a useful step that should enhance prospects for achieving a lasting solution to Argentina's debt problem. 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.

IV. Performance Criteria and Review Clauses 1/

The modified program contains the quantitative performance criteria as set out in Table 1 of the Memorandum on Economic Policy, and referred to in paragraph 4(a) of the May 1990 stand-by arrangement, regarding the following items:

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.

2. Quarterly austral limits on the net domestic assets of the Central Bank.

3. Quarterly targets in U.S. dollars for the net international reserves of the monetary authorities.

4. The elimination 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.

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.

As indicated in paragraph 26 of the attached Memorandum on Economic Policy, before the end of March 1991 Argentina will review with the Fund the progress made in the implementation of the program and the status of negotiations with the commercial banks.

V. Staff Appraisal

Since July 1989 the Government of Argentina has pursued a program of adjustment and structural reform directed at correcting internal and external imbalances and laying the basis for a lasting expansion of output, employment, and real incomes. The implementation of the program

1/ Quantitative performance criteria are presented in Table 9.

has been affected by setbacks from time to time, which has reflected to a large extent the existence of a deeply entrenched inflationary psychology and the daunting difficulty of the task at hand. But the Government has demonstrated a strong commitment to the program's objectives and broad strategy and has responded to every setback with a deepening of the adjustment effort.

The initial approach based on a fixed exchange rate system, which was supported by the stand-by arrangement approved on November 10, 1989, yielded substantial gains in the early stages, but it could not be sustained because the authorities were not able to consolidate the fiscal and monetary tightening that had been planned. In mid-December 1989 the Government shifted to a freely floating exchange rate regime; in the months that followed it tightened financial policies in a series of steps, and thus led to a marked reduction of inflation and strengthening of the balance of payments. On that basis, on May 25, 1990 the Executive Board approved a modification to the stand-by arrangement.

Except for a small deviation with respect to the limit on the cash deficit of the nonfinancial public sector, performance criteria under the arrangement for end-June 1990 were observed, with substantial margins with respect to the ceiling on the central bank's net domestic assets and the target for net international reserves. Also, a great deal of progress was made in the implementation of the privatization program. However, the fiscal position weakened in the third quarter, credit policy was eased somewhat, and the decline of inflation was first halted and then reversed.

In these circumstances, and faced with the prospect of substantial deviations from the fiscal and credit objectives of the program, in early September the authorities took measures to tighten credit and strengthen the fiscal position. The actions taken included sizable increases in fuel and other public sector prices, further steps in the transfer of control over the public enterprises to the Ministry of Economy, and reductions in the pace of wage increases. In late September Congress approved the extension of the VAT to most services, and in October the VAT rate was raised from 13 percent to 15.6 percent. On the strength of these measures, it has been possible to maintain the basic objectives for the fourth quarter that had been set in the May revision of the program, including a primary fiscal surplus in terms of U.S. dollars that would cover programmed payments to external creditors and the official reserve accumulation that had been planned.

The implementation of the latest measures has been showing positive results. In October, tax revenue improved significantly, inflation fell to its lowest monthly rate in nearly a year, and Central Bank exchange purchases in the market were in line with the program. Success in extending these early results through the end of the year and beyond will depend crucially on the capacity of the authorities to strengthen tax administration, to exercise effective control over the public enterprises and the social security system, to limit the demands on the

Treasury from the provincial governments, and to adhere to the forward-looking wage policy that has been set for public employees.

With the extension of the VAT to services the reform of the tax system that was initiated last year is now largely completed. The reform, however, needs to be complemented without delay with measures to strengthen tax administration. The process of taxpayer registration needs to be pursued vigorously, and the project to enforce compliance by the largest taxpayers needs to be implemented without further delay. Also, early passage of legislation that would facilitate enforcement of the tax code, including the closure of the business premises of delinquent taxpayers, is needed. The staff will examine with the authorities progress made in these areas as part of the third review which is scheduled for January 1991.

A substantial portion of the primary surplus targeted for the fourth quarter is to be generated by the public enterprises, and particularly by YPF. The transfer of control over the public enterprises to the Ministry of Economy can be expected to help in this regard, but it is important that the new monitoring and control procedures be applied effectively. With the increased cash flow arising from the recent increases in fuel prices, YPF should be in a position to settle past tax obligations and meet its future tax liabilities; a test of the adequacy of the new control procedures will be provided by whether YPF discharges these obligations in a timely manner.

To avoid that increases in provincial revenue derived from the revenue-sharing arrangements with the Central Administration gives rise to an increase in total public sector expenditure, it is necessary to accelerate plans to transfer national spending programs to the provinces. It is also essential to keep a close watch over lending by provincial banks to the provincial governments.

Implementation of the authorities' plan to raise the minimum retirement age and to privatize in part the fund for self-employed workers would be a major step towards putting the system's finances on a sound basis for the long term. In the meantime, social security outlays have been growing faster than had been envisaged in May, and to avoid additional pressures on this account, the authorities will need to be firm in their position that pension adjustments in the last quarter are not to exceed government salary norms.

The authorities' success in slowing wage increases in September and October made an important contribution to the recent decline in inflation. Special wage increases for certain groups such as defense personnel, however, are worrisome because of their possible effects on other groups of public employees. While real wages remain low by historical standards, based on the experience of June-August the staff would caution that attempts to raise real wages through catch-up pay awards would jeopardize recent gains on the inflation front. Real wage gains in the public sector depend on the achievement of significant reductions in the size of the public workforce, and the efforts in this area need to be intensified both in terms of scope and speed.

The decision to raise the banks' legal reserve requirements to their pre-July level was a necessary step. Ultimately, however, the aim should be to lower the effective reserve ratios from the current relatively high levels. This process would be fostered and the dampening effect on interest rates accentuated if the public sector were to reduce its net domestic indebtedness. The perseverance of the monetary authorities in resisting pressures to extend credits to exporters, industry, and the housing sector has helped to bring an important improvement in the control over credit.

Since the introduction of a unified freely floating exchange rate system in December 1989, the authorities have maintained unrestricted access to the exchange market. At present, exchange restrictions are limited to those for certain external payments on debt of the public sector and from a bilateral payments agreement with Bolivia. Because of the favorable effects of the fiscal measures taken at the beginning of September and the continued pursuit of tight credit, the austral has been appreciating in recent weeks. While the monetary authorities have been purchasing foreign exchange in the market consistent with the reserve objective, they are reluctant to buy foreign exchange not backed since public sector surpluses because of a fear that the increases in money demand may not be lasting and because rapid monetary expansion could have adverse consequences for wage and price behavior. This underscores the critical importance of achieving the program's fiscal objectives.

Progress has been made in recent years in opening the economy to foreign competition, especially through the reduction in the scope of nontariff import barriers and in the level and dispersion of tariff rates. Continued progress in the area of trade liberalization is essential if efficiency and growth is to be fostered. It is to be welcomed that the authorities plan to maintain the suspension of export promotion schemes, to reduce export taxes on agricultural products while raising taxation on domestic transactions, and to simplify the tariff code and lower the average tariff rate. Finally, it would be desirable if the elimination of the remaining quantitative import restrictions and specific tariffs were accelerated.

Negotiations to conclude bilateral rescheduling agreements under the Paris Club agreement reached last December are expected to be completed with most countries by the end-November 1990 deadline. In relations with commercial bank creditors, a significant reduction in Argentina's debt is to be achieved in connection with the privatization of the state airline and telephone companies, and a further reduction is envisaged as a result of the recent decision to broaden the scope of the privatization program. This approach can be seen as an effective and appropriate complement to the use of borrowed enhancements for debt and debt service reduction operations. Commercial banks have been lending their support to the authorities' strategy as evidenced by the granting of the necessary waivers and through their equity participation in the privatized companies.

The authorities are of the view that further debt and debt service reduction will be needed to deal with the debt overhang, and they have had several discussions with Argentina's creditor banks. A meeting that is to take place on November 14, 1990 will provide a further opportunity to review developments and to consider further possibilities for debt reduction. In the meantime, in the effort to assure an effective working relationship with commercial banks Argentina has been making monthly interest payments of US$40 million since June, a level that the authorities felt could be sustained. Moreover, the authorities have indicated that they would consider increasing the size of these payments as the fiscal adjustment is consolidated and the level of international reserves becomes more adequate.

The authorities have requested that a waiver be granted for the end-September performance criteria that were not observed in order to make the purchase that would have been based on performance through June and upon completion of this review. A modification of the stand-by arrangement is being proposed whereby the purchase that would have become available on the basis of performance through end-September would be dropped. The proposed modifications of the arrangement would allow a final purchase in February 1991 subject to observance of the end-December performance criteria and completion of a third review.

To conclude, after policy slippages in the third quarter, since early September the authorities have taken measures to re-establish the momentum of adjustment. To be sure, Argentina's economic program is subject to considerable risks, given the magnitude of the imbalances it is seeking to correct. Nevertheless, the determination shown by the authorities to reinforce the adjustment effort as indicated by developments augurs well for the success of that effort. The staff believes that the authorities' revised program for the last quarter of 1990 should contribute to a further improvement in economic performance and should provide a good base for continuing the adjustment effort into the coming year, and it thus deserves the support of the Fund.

The authorities' intention to take any additional measures that may be necessary is noted, and the staff recommends Board approval of the purchase requested on completion of this review and of the modification requested by the authorities of the current stand-by arrangement.

It is recommended that the next Article IV Consultation be held on the standard 12-month cycle.

VI. Proposed Decisions

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

A. Argentina: Stand-By Arrangement - Waiver and Modification of Performance Criteria

1. Argentina has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Argentina (EBS/89/199, Supplement 1) and paragraph 4 of the letter of May 10, 1990, from the Minister of Economy, 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 November 9, 1990 from the Minister of Economy and the President of the Central Bank of Argentina shall be annexed to the stand-by arrangement, and the letters of October 12, 1989 and May 10, 1990--with the annexed Memoranda on Economic Policy and tables attached thereto--shall be read as modified and supplemented by the letter of November 9, 1990 with annexed Memorandum on Economic Policy and tables attached thereto.

3. Accordingly, paragraphs 1 and 2(a) 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 736 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 November 15, 1990, and the equivalent of SDR 552 million until February 15, 1991.

4. Moreover, Argentina will not make purchases under the stand-by arrangement for Argentina, 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 November 9, 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 November 9, 1990, or

(iii) the limit on treasury outlays specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(iv) the targets for change in the net domestic assets of the Central Bank specified in Table 1 of the Memorandum on Economic Policy annex to the attached letter of November 9, 1990, or

(v) the targets for change in net international reserves specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(vi) the limit on external arrears of the public sector as specified in Table 1 of the Memorandum on Economic Policy Policy annexed to the attached letter of November 9, 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 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, are not observed or

(b) during any period after February 14, 1990, until the review contemplated in paragraph 26 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 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.

5. The Fund decides that the review contemplated in paragraph 4(c) of the stand-by arrangement is completed and that, notwithstanding the nonobservance as of end-September 1990 of performance criteria set forth in paragraphs 4(a) i, ii, iv, and vi of the arrangement, Argentina may proceed to make purchases under the arrangement.

B. Exchange System

Argentina continues to retain restrictions on payments and transfers for current international transactions, as described in EBS/90/191. In the circumstances of Argentina, the Fund grants approval, under Article VIII, Section 2(a), of the retention by Argentina of the restrictions evidenced by the external payments arrears, except those on payments of interest on medium- and long-term external public debt to commercial banks and on other debt subject to the commercial bank rescheduling, until December 31, 1990, or the completion by the Fund of the review pursuant to paragraph 4(b) of this decision, whichever is earlier.

Table 1. Argentina: Indicators of Performance Under the May 1990 Modification of the November 1989 Stand-by Arrangement

(In billions of australes, except as indicated)

	April-June 1990			April-September 1990		
	Programmed	Actual (Prel.)	Margin (Prel.)	Programmed	Actual (Prel.)	Margin (Prel.)
Limit on the overall cash deficit of the nonfinancial public sector	-3,120	-3,393	-273	3,620	-6,231	-9,851
Limit on the combined overall deficit of the nonfinancial public sector and the Central Bank	-4,050	-3,906	144	-700	-8,550	-7,850
Limit on Treasury outlays	12,600	9,412	3,188	29,900	22,429	7,471
Limit on change in net domestic assets of the Central Bank	9,420	5,966	3,454	10,040	14,480	-4,440
Limit on change in net international reserves of the monetary authorities (in millions of U.S. dollars)	-350	538	888	-90	-69	21
Limit on total outstanding external debt of the public sector (in millions of U.S. dollars)	63,000	54,060	8,940	63,000	54,614	8,386
Limit on net disbursement of short-term debt of the public sector contracted after March 30, 1990 (in millions of U.S. dollars)	1,000	74	926	1,000	122	878
External payments arrears on public sector debt service (in millions of U.S. dollars)	560	500	60	350	634	-284

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

Table 2. Argentina: Projection of Fund Position

	Outstanding 9/30/90	1990 IV Quarter	1991 I Quarter
(In millions of SDRs)			
Purchases		184.0	184.0
Under SBA		184.0	184.0
Under CCFF		--	--
Repurchases		121.0	195.9
Under SBA		56.2	131.1
Under CCFF		64.8	64.8
Total Fund credit outstanding (end of period)	2,150.3	2,213.3	2,201.4
Under SBA	1,398.4	1,526.2	1,579.1
Under CCFF	751.9	687.1	622.3
(In percent of quota)			
Total Fund credit outstanding (end of period)	193.2	198.9	197.8
Under SBA	125.6	137.1	141.9
Under CCFF	67.6	61.7	55.9

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

	1984	1985	1986	1987	1988	1989	Proj. 1990
			(Annual changes in percent)				
GDP deflator	653.6	690.8	77.7	127.7	377.8	3,332.9	1,867.7
Consumer prices (end of period)	688.0	385.4	81.9	174.8	387.5	4,928.6	1,255.9
Real GDP	2.6	-5.2	5.6	2.3	-5.1	-5.3	0.2
			(In percent of GDP)				
Gross Domestic investment	12.5	11.6	11.8	13.2	11.4	9.4	8.3
External savings	3.9	1.6	4.4	6.6	2.5	1.8	0.1
National savings	8.6	10.0	7.4	6.6	8.9	7.6	8.2

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

Table 4. Argentina: Summary of Operations of Nonfinancial Public Sector, Excluding Interest Payments 1/

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 May Prog.	1990 Rev. Prog.	1990 QIII Actual	1990 QIV Rev. Prog.
Revenues	21.2	22.7	21.3	19.8	18.6	23.3	19.6	20.6	22.8
National administration taxes	13.9	14.6	13.8	11.8	11.4	14.9	11.5	11.6	12.4
Social security taxes	3.6	4.0	4.0	4.4	3.5	4.0	4.7	5.7	5.6
Nontax and capital receipts	3.1	2.8	2.3	2.4	2.7	3.1	1.9	2.1	3.1
Operating surplus of the nonfinancial public enterprises	0.6	1.2	1.3	1.2	1.0	1.3	1.5	1.2	1.8
Revenue	10.5	10.8	10.1	10.0	9.5	9.2	8.9	9.3	8.1
Expenditure	9.9	9.6	8.8	8.8	8.5	7.9	7.4	8.1	6.3
Expenditure (excluding interest payments)	20.4	20.9	22.3	20.7	19.0	17.8	16.7	19.2	18.6
National administration wages	4.0	3.4	3.6	3.5	3.5	2.9	3.1	3.5	3.6
Other goods and services	1.2	1.6	1.7	1.4	1.2	1.0	0.9	1.2	1.2
Pensions	5.8	6.0	5.6	5.3	4.7	4.6	5.3	6.9	6.2
National administration	0.4	0.5	0.5	0.5	0.6	0.4	0.5	0.5	0.5
Social security	5.4	5.6	5.1	4.8	4.1	4.1	4.8	6.4	5.7
Transfers to provinces	5.1	5.7	6.5	6.2	6.0	5.9	5.0	5.2	5.5
Other transfers	1.0	1.0	1.1	0.8	0.9	1.1	0.6	0.6	0.8
Capital expenditure	3.3	3.1	3.8	3.4	2.8	2.2	1.8	1.8	1.5
Primary balance	0.8	1.8	-0.9	-1.0	-0.4	5.6	2.9	1.4	4.2
Adjusted primary balance 2/	...	...	...	...	...	4.1	2.9	1.4	4.2

Sources: Ministry of Economy; and Fund staff estimates.

1/ Annual figures are quarterly averages.
2/ Adjusted for current exchange rate path.

Table 5. Argentina: Nonfinancial Public Sector 1/2/

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 Year May Prog.	1990 Year Rev. Prog.
I. Central Government							
Total revenues	11.3	11.8	10.9	9.2	9.8	13.3	9.7
Tax revenues	10.3	10.9	10.3	8.2	8.4	11.8	9.2
Nontax revenues	0.9	0.9	0.6	0.9	1.4	1.5	0.6
Expenditures excluding interest payments and intra public sector transfers	8.1	8.6	8.7	8.4	8.3	7.8	7.1
Wages and salaries	2.4	2.2	2.3	2.2	2.2	1.8	2.0
Goods and services	0.5	0.7	0.6	0.6	0.5	0.4	0.6
Transfers	5.1	5.5	5.3	5.2	5.4	5.3	4.6
Provinces and MBA	4.2	4.6	4.4	4.3	4.6	4.5	3.9
Pensions	0.4	0.5	0.5	0.5	0.6	0.4	0.5
Other	0.5	0.4	0.4	0.4	0.3	0.4	0.3
Extrabudgetary	—	0.1	0.3	0.2	0.1	0.1	-0.2
Capital expenditure	0.2	0.1	0.2	0.2	0.1	0.1	—
Primary balance	3.2	3.2	2.2	0.8	1.5	5.5	2.7
II. Special Accounts							
Tax revenue	2.6	2.8	2.4	2.6	2.0	2.6	1.7
Nontax and capital revenue	0.6	0.9	0.8	0.7	0.7	0.5	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	0.2	0.2
Capital expenditure	0.1	0.2	0.2	0.2	0.2	0.1	0.1
Transfers 3/	1.3	1.5	1.8	1.5	1.5	1.9	1.2
Provinces	0.9	1.1	1.4	1.2	1.0	1.4	0.9
Primary balance	1.4	1.4	0.5	1.0	0.5	0.6	0.5
III. Decentralized Agencies							
Tax revenue	0.9	1.0	1.2	1.0	1.0	0.6	0.5
Nontax and capital revenue	1.2	0.6	0.5	0.5	0.6	0.5	0.6
Wages and salaries	1.4	1.0	1.1	1.1	1.0	0.8	0.9
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	0.3
Transfers 3/	0.2	0.2	0.6	0.7	0.5	0.2	0.2
Provinces	—	—	0.4	0.5	0.3	—	—
Primary balance	-0.5	-0.7	-1.0	-1.1	-0.8	-0.6	-0.6

Table 5. Argentina: Nonfinancial Public Sector 1/2/ (Concluded)

(In percent of GDP)

	1985	1986	1987	1988	1989	1990 Year May Prog.	1990 Year Rev. Prog.
IV. Social Security							
Total revenues	3.8	4.3	4.2	4.5	3.6	4.1	4.8
Tax revenues	3.6	4.0	4.0	4.4	3.5	4.0	4.7
Nontax revenues	0.2	0.3	0.3	0.1	0.1	--	0.1
Total expenditure 3/	5.4	5.6	5.1	4.8	4.1	4.1	4.8
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	9.2	8.9
Wages and salaries	2.8	2.8	2.8	2.6	2.7	1.7	2.4
Other goods and services	7.1	6.8	5.9	6.2	5.8	6.2	5.0
Transfers to provinces	--	--	0.4	0.1	--	--	--
Operating surplus	0.6	1.2	1.0	1.2	1.0	1.3	1.5
Capital revenue	0.2	0.1	0.1	0.1	--	0.5	0.2
Capital expenditure	2.4	2.2	2.8	2.5	2.1	1.6	1.4
Primary balance	-1.6	-0.8	-1.8	-1.4	-1.1	0.2	0.3
Primary balance of nonfinancial public sector	0.7	1.8	-0.9	-1.0	-0.4	5.6	2.9
Adjusted primary balance 4/	...	...	...	...	...	4.1	2.9

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.
4/ Adjusted for current exchange rate path.

Table 6. Argentina: Overall Financial Balance of Public Sector 1/

(In percent of GDP)

	1990						
	QI	QII	(Prel.) QIII	May 2/ Program QIV	Rev. Prog. QIV	May 2/ Program Year	Rev. Prog. Year
Primary balance	2.3	3.7	1.4	4.3	4.2	4.1	2.9
Interest payments, accrual basis	4.9	6.3	3.5	4.8	4.0	4.8	4.7
Deficit on quasi-fiscal operations	-2.2	-0.3	-1.3	-0.7	-0.3	-1.2	-1.0
Overall public sector balance	-4.8	-2.9	-3.3	-1.2	-0.1	-1.9	-2.8
Net external finance	3.5	3.9	2.9	1.5	-0.2	2.4	2.6
Interest not paid	6.2	5.0	3.1	2.6	2.4	3.5	4.2
Net amortization (-)	-2.7	-1.0	-0.2	-1.1	-2.6	-1.1	-1.6
Net domestic financing	1.2	-1.0	0.5	-0.3	0.3	-0.5	0.2

Sources: Ministry of Economy; and Fund staff estimates.

1/ Annual figures are quarterly averages.
2/ Adjusted for current exchange rate path.

Table 7. Argentina: Selected Financial Indicators

(In percent)

	Growth of Aggregates 1/ M-1	M-2	M-1/GDP 2/	M-2/GDP 2/	Monthly Interest Rate 3/	Monthly Inflation Rate 4/	BONEX 89 Market Value 5/
1988							
I	5.2	11.9	4.7	18.2	14.8	12.6	...
II	11.1	14.6	4.1	17.0	17.6	19.2	...
III	18.6	22.6	3.7	16.9	13.7	21.4	...
IV	15.3	12.2	4.8	19.4	9.5	6.0	
1989							
I	12.9	13.2	4.3	19.3	17.0	11.6	...
II	51.6	53.0	2.6	11.3	113.9	86.7	...
III	70.9	63.4	2.4	8.9	18.4	77.7	...
IV	31.6	15.2 6/	3.8	2.7 6/	28.3	17.3	...
1990							
I	31.7	15.7	2.4	3.7	131.1	76.2	35.1
II	30.6	44.3	2.4	4.4	13.0	10.4	46.0
III	11.7	15.5	2.8	5.3	13.9	12.0	57.5
IV (Proj).	11.7	7.0	2.8	5.3	...	3.8	...
1990							
January	34.5	-20.9	3.3	4.9	56.3	70.5	40.8
February	20.7	35.3	2.2	3.6	186.0	74.7	32.4
March	39.8	32.8	1.6	2.7	151.1	83.4	32.1
April	42.3	81.7	2.1	3.8	11.8	9.4	42.1
May	34.5	35.1	2.5	4.5	10.8	10.7	48.2
June	15.1	16.1	2.7	4.8	16.3	11.1	47.7
July	16.5	17.1	3.1	5.4	10.6	7.4	56.6
August	12.4	14.9	2.9	5.2	12.0	16.3	58.9
September	6.1	14.4	2.5	5.2	19.1	12.4	56.9
October (Prel.)	13.2	14.9	2.6	5.4	12.6	5.2	53.1
November (Proj.)	11.7	3.0	2.8	5.4	...	3.0	...
December (Proj.)	10.4	3.0	3.0	5.5	...	2.0	...

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

1/ Average seasonally adjusted monthly increase.
2/ Average M-1 and M-2 during the year.
3/ Seven-day operations, with security of Government of Argentina bonds denominated in U.S. dollars (BONEX).
4/ Average monthly increase of consumer and wholesale prices.
5/ Percent of face value.
6/ Includes the elimination of time deposits effective December 28, 1989 in accordance with the debt conversion scheme of January 1, 1990.

Table 8. Argentina: Outstanding External Arrears

(In millions of U.S. dollars; end of period)

	1987	1988	1989	1990 Mar.	1990 June	1990 Sept.
Total	583	2,927	5,663	6,506	7,355	8,107
Suppliers and commercial creditors	40	236	243	245	237	213
Paris Club	188	532	—	27	70	145
International organizations	107	188	130	133	81	136
Commercial banks 1/	228	1,956	5,165	5,972	6,855	7,473
Other	20	15	125	129	112	140

Source: Central Bank of Argentina.

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

Table 9. Quantitative Performance Criteria and Indicative Targets under Stand-by Arrangement

(In billions of australes, unless otherwise indicated)

	April 1990-December 1990	October 1990-December 1990
I. Performance criteria		
Limit on the overall cash deficit of the nonfinancial public sector	-5,640	
Limit on the combined overall deficit of the nonfinancial public sector and the Central Bank	-9,060	
Limit on Treasury outlays	50,500	
Limit on change in net domestic assets of the Central Bank	19,800	
Limit on change in net international reserves of the monetary authorities (in millions of U.S. dollars)	-126	
Limit on external arrears of the public sector (in millions of U.S. dollars)	--	
Limit on total outstanding external debt of the public sector (in millions of U.S. dollars)	63,000	
Limit on net disbursements of short-term debt of the public sector contracted after March 31, (in millions of U.S. dollars)	1,000	
II. Indicative targets		
Treasury revenue 1/		20,600
Public enterprises 2/		
Tax payments to Treasury		3,100
Tax payments to the social security system		1,960
Primary surplus		1,840

Source: Memorandum on Economic Policy.

1/ Includes taxes deposited in the state oil company's account "A" at the Banco de la Nacion.

2/ Public enterprises included under these targets are the Buenos Aires electric utility (SEGBA), the state oil company (YPF), the state water and energy company (Agua y Energia), and the state gas company (Gas del Estado).

Table 10. Argentina: Summary Balance of Payments

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988	1989	1990 May Prog.	1990 Rev. Prog.
Current account	-2,391	-953	-2,859	-4,238	-1,615	-1,323	-1,415	-138
Merchandise trade	3,523	4,582	2,128	540	3,810	5,374	5,450	6,296
Exports, f.o.b.	8,107	8,396	6,852	6,360	9,134	9,573	10,450	10,622
Imports, c.i.f.	-4,584	-3,814	-4,724	-5,820	-5,324	-4,149	-5,000	-4,326
Nonfactor services (net)	-205	-231	-573	-285	-298	-283	-265	-193
Factor services	-5,712	-5,304	-4,416	-4,485	-5,127	-6,422	-6,600	-6,295
Profits and dividends	-439	-425	-482	-558	-660	-664	-700	-716
Interest payments	-5,537	-5,132	-4,291	-4,145	-4,678	-6,023	-6,172	-5,821
Interest receipts	264	253	357	218	211	265	272	272
Transfers	3	--	2	-8	--	8	--	23
Capital account 1/	647	397	784	138	234	-4,935	962	69
Direct investment 2/	269	919	574	-19 3/	1,147	1,028	943	2,131
Export financing	511	140	-57	111	879	-717	808	2,173
Import financing	-11	-952	-483	-603	-1,564	-1,511	-130	-584
Loans from multilateral organizations	123	182	394	733	386	414	696	377
Other 4/	-245	108	356	84	-614	-4,149	-1,355	-4,028
Overall balance	-1,744	-556	-2,075	-4,100	-1,381	-6,258	-453	-69
Financing	1,744	556	2,075	4,100	1,381	6,258	453	69
Change in assets (increase -)	-207	-1,871	563	1,111	-1,785	1,700	-2,000	-1,236
Arrears	940	-2,445	-1,174	39	2,128	2,927	-5,663	-1,009
IMF position	--	1,007	145	614	18	-485	49	-252
Purchases	--	1,007	547	1,253	541	233	723	424
Repurchases	--	--	-402	-639	-523	-718	-674	-676
Official creditors	600	1,017	897	384	387	1,402	361	371
Paris Club	--	1,617	897	384	387	1,402	361	371
Other	600	-600	--	--	--	--	--	--
Commercial banks 6/	--	3,096	1,207	1,244	454	--	--	--
Other liabilities 7/	411	-248	437	708	199	-714	7,706 8/	177
Memorandum item								
Gross official reserves (months of imports)	6.9	14.6	10.9	1.7 5/	5.5 5/	2.0 5/	4.3 5/	5.7 5/

Sources: *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, US$354 million in 1989, and US$35 million in 1989. The 1990 revised program includes cash payments and funds for debt retirement resulting from the privatization of ENTEL and Aerolíneas Argentinas.

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. The 1990 estimate also includes the reduction in commercial debt (valued at market prices) derived from privatizations.

5/ Excludes illiquid reserves.

6/ New money raised through concerted lending.

7/ Includes valuation, changes in residents' foreign currency deposits, and other adjustments.

8/ This includes unpaid interest to commercial banks.

Table 11. Argentina: Medium-Term Balance of Payments Projections, 1990-96

	1990	1991	1992	1993	1994	1995	1996
	(In billions of U.S. dollars)						
Summary balance of payments							
Current balance 1/	-0.1	-1.0	-1.6	-1.2	-0.4	0.3	0.9
Trade balance	6.3	5.1	4.5	4.9	5.5	5.9	6.2
Exports	10.6	10.6	11.0	12.3	13.7	15.1	16.5
Imports	-4.3	-5.5	-6.5	-7.4	-8.3	-9.2	-10.3
Nonfinancial services	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3
Financial services 1/	-6.3	-5.9	-5.9	-5.8	-5.6	-5.4	-5.0
Of which: interest payments 1/	-5.8	-5.4	-5.4	-5.4	-5.3	-5.1	-4.8
profits and dividens 2/	-0.7	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8
Capital account flows 1/	0.1	-0.5	-0.8	-1.1	-1.5	-1.8	-3.3
Financing	0.1	1.5	2.4	2.3	1.9	1.5	2.4
Gross reserves (increase -)	-1.2	-0.5	-0.4	-0.4	-0.3	-0.5	-0.5
Use of IMF credit	-0.3	-0.8	-0.9	-0.4	-0.4	-0.3	-0.2
Change in arrears	1.0	-6.7	—	—	—	—	—
Residual gap	—	9.5	3.7	3.1	2.6	2.3	3.1
	(In percent)						
Assumptions							
Interest rate (U.S. dollar, 6-month LIBOR)	8.5	8.0	8.0	8.0	8.0	8.0	8.0
Export volumes (annual change)	16.8	2.0	4.0	4.0	5.0	5.0	4.0
Import volumes (annual change)	0.7	20.0	15.0	9.0	7.5	7.5	6.0
Terms of trade (annual change)	-7.1	-7.5	-3.3	2.9	2.8	1.1	-0.5
Real growth (annual change)	0.2	1.5	2.5	3.0	3.5	3.5	3.5
Memorandum items							
Scenario A 1/							
Interest payments/GDP	6.2	5.5	5.2	4.8	4.4	4.0	3.6
External debt/GDP 3/ 4/	64.9	63.7	61.5	58.7	54.9	51.1	47.0
Interest payments/exports 5/	44.1	40.3	38.9	35.0	30.8	27.2	23.8
Total debt service/exports 5/6/	62.0	57.5	48.5	40.9	46.7	40.6	41.8
Gross disposable reserves 7/	5.7	6.1	5.8	5.7	5.5	5.5	5.5
Scenario B 8/							
Interest payments/GDP	6.2	5.3	4.6	3.9	3.4	3.0	2.7
External debt/GDP	64.9	58.1	49.6	42.7	38.6	34.5	30.2
Interest payments/exports 5/	44.1	38.9	34.3	28.1	23.7	20.7	17.9
Total debt service/exports 5/6/	62.0	57.7	49.3	42.7	40.4	36.3	39.4
Gross disposable reserves 7/	5.7	6.1	5.2	4.7	5.3	5.5	5.5

Source: Staff estimates.

1/ Assuming no debt or debt service reduction.
2/ Including on-debt/equity conversions.
3/ Including export prefinancing.
4/ Includes export pre-financing.
5/ Exports of goods and nonfactor services.
6/ After rescheduling of principal due to commercial banks and official creditors and interest refinancing from banks.
7/ In months of merchandise imports.
8/ Assuming phased market-based debt and debt service reduction operations 1991-93, as described in text, financed by debt equity swaps in connection with privatization and enhancement resources of $3 billion obtained from a variety of sources.

Table 12. Argentina: External Debt and Debt Service

	1984 1/	1985 1/	1986	1987	1988	1989	Est. 1990
	(In millions of U.S. dollars; end-year)						
Total disbursed debt 2/	46,171	49,326	51,422	58,324	58,473	63,361	59,124
By borrowing sector							
Public sector	35,527	40,869	44,726	51,793	53,488	58,444	...
Private sector	10,644	8,458	6,696	6,531	4,985	4,917	...
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	8,448	8,142	8,269
Official creditors	2,018	2,961	5,132	6,007	6,786	7,598	7,861
Banks	32,740	33,777	33,695	36,848	37,277	38,339	34,133
Bondholders	4,307	3,922	3,638	3,528	2,915	5,907	5,386
Other	4,288	4,097	3,352	3,621	3,047	3,375	3,475
	(In percent of total)						
Disbursed debt by type of creditor	100.0	100.0	100.0	100.0	100.0	100.0	100.0
International organizations	6.1	9.3	10.9	14.3	14.4	12.9	14.0
Official creditors	4.4	6.0	10.0	10.3	11.6	12.0	13.3
Banks	70.9	68.5	65.5	63.2	63.8	60.5	57.7
Bondholders	9.3	8.0	7.1	6.0	5.0	9.3	9.1
Other	9.3	8.3	6.5	6.2	5.2	5.3	5.9
	(In millions of U.S. dollars and in percent)						
Debt service 3/	9,858	9,301	9,645	6,412 4/	...	...	...
Amortization	4,321	4,169	5,354	2,267 4/	...	...	...
Interest	5,537	5,132	4,291	4,145	4,678	6,023	5,821
Exports of goods, nonfactor services and transfers	10,050	10,259	8,738	8,472	11,378	11,978	13,222
Interest ratio to exports	55.1	50.0	49.1	48.9	41.1	50.3	44.0
	(In percent of GDP)						
Debt outstanding	75.8	82.2	79.1	85.3	89.8	85.1	62.6
Debt service	16.2	15.5	14.8	9.4	...	...	...
Interest	9.1	8.6	6.6	6.1	7.2	8.1	6.2

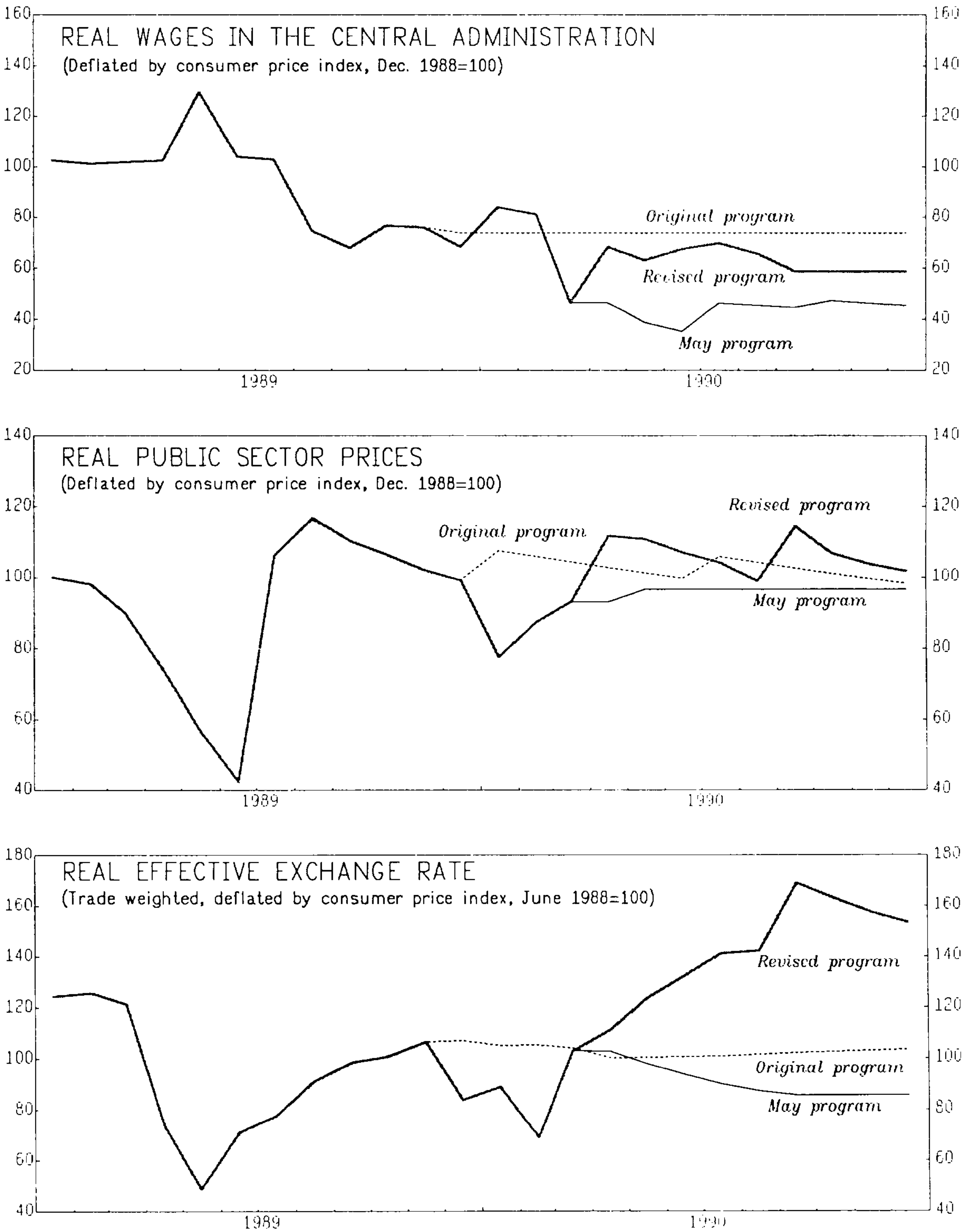
Sources: Central Bank of Argentina; and Fund staff estimates.

1/ Based on data from debt reporting system for 1983 and data from balance of payments flows.
2/ Includes arrears on interest.
3/ Includes amortization on loans with an original maturity of more than one year, and all interest payments. Includes both public and private debt.
4/ After 1987 rescheduling of commercial bank debt.

CHART 1

ARGENTINA

COMPARISON OF PROGRAMS



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

Fund Relations with Argentina
(As of October 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	3,171.8	285.0
(c)	Fund credit	2,058.8	185.0
	Credit tranches (ordinary resources)	390.2	35.1
	Enlarged access resources	981.5	88.2
	CFF	687.1	61.7

III. Recent Stand-By Arrangements and Special Facilities

(a) Stand-by arrangements

Duration	Amount Drawn (SDR million)	Status
Nov. 25, 1989-March 31, 1991	368.0	Operational
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 105.7 million or 33.2 percent of net cumulative allocation.
(c) Current Designation Plan: not applicable

V. Financial Obligations Due to the Fund

See attached Table.

B. Nonfinancial Relations

VI. Exchange Rate

From October 1, 1988 to April 13, 1989 the official exchange rate was subject to frequent adjustments, and by April 13 (when exchange markets were unified under a floating exchange rate regime for all external current and capital transactions of the private and public sectors) 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, exchange controls were re-introduced and the free exchange market was banned; 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 mid July. In August, the exchange rate depreciated by around 13 percent to just over ₳ 6,000 per U.S. dollar; however, it appreciated to around ₳ 5,800 per U.S. dollar in September and to about ₳ 5,600 per U.S. dollar in October. As of November 1, 1990, the exchange rate was ₳ 5,550 per U.S. dollar.

V. Financial Obligations Due to the Fund

Argentina: Projected Payments to the Fund

(In millions of SDR's)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Remaining Period	Total
A. Obligations from outstanding Use of Resources												
1. Principal Repurchases	121.1	723.8	637.7	275.1	225.4	90.5	61.4	15.3	—	—	—	2,150.3
2. Charges and interest 1/	34.9	195.4	126.8	79.6	55.7	36.3	27.8	22.1	19.6	19.6	—	617.8
Total	156.0	919.2	764.5	354.7	281.1	126.8	89.2	37.4	19.6	19.6	—	2,768.1
(percent of quota)	14.0	82.6	68.7	31.9	25.3	11.4	8.0	3.4	1.8	1.8	—	248.7
B. Obligations from prospective Use of Resources												
1. Principal Repurchases	—	—	—	—	141.3	397.7	377.4	253.0	165.3	33.3	—	1,368.0
2. Charges and interest 1/	—	29.0	98.4	130.3	128.4	109.8	73.2	41.7	19.5	4.2	—	634.5
Total	—	29.0	98.4	130.3	269.7	507.5	450.6	294.7	184.8	37.5	—	2,002.5
(percent of quota)	—	2.6	8.8	11.7	24.2	45.6	40.5	26.5	16.6	3.4	—	179.9
C. Cumulative (outstanding and prospective)												
1. Principal Repurchases	121.1	723.8	637.7	275.1	366.7	488.2	438.8	268.3	165.3	33.3	—	3,518.3
2. Charges and interest 1/	34.9	224.4	225.2	209.9	184.1	146.1	101.0	63.8	39.1	23.8	—	1,252.3
Total	156.0	948.2	862.9	485.0	550.8	634.3	539.8	332.1	204.4	57.1	—	4,770.6
(percent of quota)	14.0	85.2	77.5	43.6	49.5	57.0	48.5	29.8	18.4	5.1	—	428.6

1/ Projections are based on current rates of charge, including burden-sharing adjustments where applicable, for purchases in the GRA; current interest rates for ESAF/SAF and Trust Fund; and current SDR interest rate to net use of SDRs.

VII. Last Article IV Consultation

The 1989 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, June and October 1990. Currently, a mission is in Argentina to review the general design of the new system for controlling large taxpayers. 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 Governments'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. The Trade Policy Loan, after some delay because of compliance with certain conditions, was approved for full disbursement in October 1990.

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 in early 1991, 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 September 30, 1990)			
Fully disbursed loans	2,111.12	2,111.12	--
Loans in process of disbursement			
Agricultural and rural developments	106.5	90.34	16.16
Industry and industrial credit	125.0	43.65	81.35
Power and hydrocarbon	922.0	577.70	344.30
Public sector management	25.0	15.67	9.33
Transport and municipal development	270.0	102.01	167.99
Water supply	60.0	12.71	47.29
Trade policy	496.37	495.97	0.40
Social sector	328.0	21.38	306.62
Total loans	4,443.99	3,470.55	973.44
Repaid 1/	1,153.79	--	--
Outstanding	3,290.20	--	--

II. IFC Operations (as of September 30, 1990)

	Loans	Equity	Total
Commitments	664.9	32.4	697.3
Total held by IFC	349.5	29.4	378.9
Total undisbursed (including other participants)	32.9	10.7	43.6

III. IBRD Loan Transactions

	Actuals				Estimate
	1986	1987	1998	1989	1990
Disbursements	408.0	794.7	486.7	316.4	376.0
Repayments	134.4	133.1	187.8	220.7	246.1
Net lending	273.6	661.6	298.9	95.7	129.9

Source: World Bank.

1/ Includes repayment to third parties.

Statistical Issues

In recent years, statistical information in Argentina has been subject to considerable problems, which have hampered the evaluation of economic policies and the monitoring of developments. In some areas, the data base is poorly developed and statistics are based on rough estimates. In other areas, while reporting systems are in place, coverage is sometimes incomplete and the data become available with substantial lags.

In the course of 1983, it became apparent that the external debt statistics did not adequately record debt movements during a period of payments disruption, and the existing reporting system was discontinued. A new survey of the stock of debt at the end of 1983 was completed, but the new system for collecting debt statistics did not become operational and estimates of the stock of debt after 1983 were based on end-1983 data and flow data from the balance of payments. A registration of private and public debt was completed in 1987 and debt estimates are now available for December 1986.

The difficulties with the external debt data affect the measurement of the borrowing requirements of the nonfinancial public sector. Data on domestic financing of the nonfinancial public sector also present some problems. There are delays in the reporting of public sector deposits with the banking system, while information on financing received by provincial governments, particularly in the form of debt issues or floating debt, is not gathered on a systematic basis. Moreover, there is a lack of information on changes in credits from domestic suppliers to the public enterprises.

On the revenue and expenditure of the nonfinancial public sector, monthly data are available in a timely fashion for the Central Administration, the social security system, and a number of public enterprises. However, a cash accounting of the operations of other segments of the nonfinancial public sector on a quarterly basis was begun only in 1983, and problems remain, particularly as regards other public enterprises and the provinces; it may be noted that there have been discrepancies between estimates of the deficit of the nonfinancial public sector from above and below the line. Furthermore, there is a lack of up-to-date information on fiscal operations on a budget execution basis, which are prepared only on an annual basis. As a result, a close monitoring of nonfinancial public sector revenue and spending is not possible, which makes it difficult to analyze fiscal trends and to exercise budgetary control. During a two-year period that ended in mid-1988 technical assistance was provided by the Fiscal Affairs Department to improve the provision of fiscal information.

There are also difficulties in obtaining information on the Central Bank's outstanding rediscounts and detailed data on the interest accrued and capital adjustments on outstanding credits have not been available. The World Bank has been providing technical assistance to improve the quality timeliness of information on rediscounts.

In the area of monetary statistics, information is available with less than a month's lag on the monthly averages of the monetary aggregates, based on data on the required reserves of financial institutions. However, comprehensive information from this source is only available since the end of 1983 and does not distinguish between public and private holdings. Data on the monetary aggregates on an end-of-month basis (from the accounts of the financial institutions) have a longer historical reach and distinguish between public and private deposits, but this information is subject to a delay of three months or more.

There are shortcomings in the Central Bank balance sheet, including delayed recording of external transactions. Purchases of foreign exchange by the Central Bank are reflected in the accounts at the exchange rate of the date of each operation, while sales of foreign exchange are recorded at the average exchange rate of past transactions; consequently, the net stock of foreign exchange is accounted for at an average exchange rate that historically has differed substantially from the end-of-period rate. In addition, there is no breakdown available for Central Bank claims on commercial banks and claims on other financial institutions, or a breakdown of investment with the Central Bank between commercial banks and financial institutions.

The statistical base for certain important series on prices and output is outdated. The index of industrial production is based on an establishment survey conducted in 1970, and does not take account of the changes in the structure of the industrial sector since then, which are believed to have been important; this may have led to a considerable underestimation of industrial production in the National Accounts. A new industrial census was undertaken in 1984 and is now being used to revise the establishment survey; figures for industrial production on this new basis should be available by end-1989. The employment index would be revised at the same time. A new consumer price index was introduced in 1989, with weights based on a family expenditure survey of 1985-86.

The situation as regards the data published in Fund publications is as follows:

1. Government Finance Statistics Yearbook (GFSY)

The 1989 issue of the GFSY includes data in the statistical and derivation tables through 1987 for the consolidated central government. Preliminary data for provincial governments also are included through 1987. No data are available for local governments.

2. International Financial Statistics (IFS)

The data published in IFS are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Argentina. The currentness and coverage of data published in the country page for Argentina in the October 1990 issue of IFS are shown below:

Real Sector	- National Accounts	1983
	- Prices: wholesale prices	January 1990
	consumer prices	January 1990
	- Production: manufacturing	Q2 1987
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1989
	- Financing	1989
	- Debt	1989
Monetary Accounts	- Monetary Authorities	Q1 1990
	- Deposit Money Banks	Q3 1989
	- Other Financial Institutions	Q3 1989
	- Interest Rates: deposit rate	May 1990
	lending rate	May 1990
	bond yield	n.a.
External Sector	- Merchandise Trade: value	December 1989
	prices	December 1989
	- Balance of Payments	Q1 1990
	- International Reserves	March 1990
	- Exchange Rates	July 1990

Argentina--Basic Data

Area and demographic indicators	
Area	2,766.9 thous. sq. km.
Population (1989)	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
	US$65,834 million
	₳ 25,512,922 billion
GDP per capita (1989)	SDR 2,026

	1985	1986	1987	1988	1989	Proj. 1990
			(percent)			
Origin of GDP						
Agriculture, livestock and fishing	15.8	14.5	14.6	14.9	15.3	15.3
Mining	2.7	2.4	2.4	2.7	2.9	2.8
Manufacturing	22.5	24.1	23.4	22.4	21.7	21.3
Construction	3.2	3.3	3.7	3.2	2.3	2.3
Electricity, gas, and water	4.6	4.7	4.9	5.3	5.5	5.5
Commerce	14.0	14.4	14.3	13.9	13.4	13.4
Transport and communications	11.7	11.6	11.7	11.6	11.8	11.5
Finance and banking	7.8	7.9	7.9	8.1	8.3	8.8
Other services	17.7	17.0	17.0	17.8	18.9	19.1
Ratios to GDP						
Exports of goods and nonfactor services	17.1	13.4	12.4	16.5	16.0	14.0
Imports of goods and nonfactor services	9.8	11.0	12.0	11.4	9.2	7.5
Factor services (net)	-8.8	-6.8	-6.6	-7.5	8.6	6.7
Current account of the balance of payments	-1.6	-4.4	-6.6	-2.5	-1.8	-0.1
Central government revenues 1/	11.3	11.8	10.9	9.2	9.8	9.6
Central government expenditures 1/2/	8.1	8.6	8.7	8.4	8.3	6.9
Primary balance of public enterprises	-1.6	-0.8	-1.8	-1.4	-1.1	0.3
Primary balance of nonfinancial public sector	0.7	1.8	-0.9	-1.0	-0.4	3.0
External debt (end of year)	82.2	79.1	85.3	89.8	85.1	62.6
Gross national savings	10.0	7.4	6.6	8.9	7.6	8.2
Gross aggregate investment	11.6	11.8	13.2	11.4	9.4	8.3
Financial system liabilities to private sector (average)	13.8	18.4	19.4	20.2	12.7	2.3
Annual changes in selected economic variables						
Real GDP per capita	-5.7	4.0	0.7	-4.5	-6.0	-1.3
Real GDP at 1970 prices	-5.2	5.6	2.3	-5.1	-5.3	0.2
GDP at current prices	649.7	87.7	133.0	353.4	3,151.0	1,871.6
GDP deflator	690.8	77.7	127.7	377.8	3,332.9	1,867.7
Wholesale prices (annual average)	662.5	63.9	122.9	412.5	3,434.0	1,643.5
Consumer prices (annual average)	672.2	90.1	131.3	343.0	3,082.4	2,280.8
Financial system liabilities to private sector	320.0	100.6	149.0	356.5	474.1	331.8
Monetary liabilities	596.2	85.5	124.9	337.6	4,108.0	323.2
Other liabilities	248.8	108.1	158.8	361.8	273.4	369.1
Net domestic assets 3/4/	317.1	116.6	209.2	398.2	381.5	361.2
Credit to private sector 3/	196.6	67.3	122.9	232.5	476.2	227.7
Credit to public sector 3/4/	126.3	48.7	106.4	295.1	534.9	-0.1
Other 3/	-5.8	0.6	-20.1	-129.4	-629.6	133.6
Merchandise exports (f.o.b. in U.S. dollars)	3.6	-18.4	-7.2	43.6	-1.3	16.8
Merchandise imports (c.i.f. in U.S. dollars)	-16.8	23.9	23.2	-8.5	-22.7	0.7

	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	9.5	10.6
Merchandise imports, c.i.f.	-3.8	-4.7	-5.8	-5.3	-4.2	-4.3
Interest payments	-5.1	-4.3	-4.2	-4.7	-6.0	-5.8
Other factor income (net)	-0.2	-0.1	-0.3	-0.4	-0.4	-0.5
Other services and transfers (net)	-0.2	-0.6	-0.3	-0.3	-0.3	-0.2
Balance on current account	-1.0	-2.9	-4.2	-1.6	-1.3	-0.1
Direct investment	0.9	0.6	--	1.1	1.0	2.1
Loans from international organizations	0.2	0.4	0.7	0.4	0.4	0.4
Other capital (net)	-0.7	-0.2	-0.4	-1.3	-6.4	-2.5
Overall balance	-0.6	-2.1	-4.1	-1.4	-6.3	-0.1
Change in official assets	-1.9	0.6	1.1	-1.8	1.7	-1.2
Change in arrears	-2.4	-1.2	--	2.1	2.9	1.0
Other	4.9	2.7	3.0	1.1	1.7	0.2

	December 31					June 30,
	1985	1986	1987	1988	1989	1990
International reserve position			(billions of SDRs)			
Central Bank (gross)	4.2	3.5	2.1	3.7	2.6	3.5
Central Bank (net)	-5.6	-6.5	-8.6	-10.3	-14.3	-14.0
Central Bank and Treasury (net)	-7.7	-8.3	-10.1	-11.7	-17.9	-17.4

1/ Data are on a cash basis.
2/ Excludes interest payments.
3/ Change as a percentage of liabilities to the private sector at the beginning of the period.
4/ Includes credit to the nonfinancial public sector and the operating losses of the Central Bank.

Buenos Aires
November 9, 1990

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

Dear Mr. Camdessus:

The attached Memorandum on Economic Policy contains a description of the economic policies the Government of Argentina intends to pursue in the period through the end of 1990. These policies constitute a further effort to keep the economy on a path of adjustment towards low inflation and a viable external payments position, conditions which are essential to foster capital formation and thus establish the basis for sustained growth of output and employment opportunities.

As is described in the memorandum, the economic performance in the second quarter was satisfactory and, except for a very small deviation with respect to the target for the deficit of the nonfinancial public sector, other performance criteria under the stand-by arrangement for end-June 1990 were observed. In the third quarter, a number of problems were encountered in the implementation of fiscal policies and, although the external objectives of the program were achieved, there were deviations with respect to other performance criteria.

In response to these developments, efforts were made to set the program back on course and, as described in the memorandum, the Government took important policy actions to improve the fiscal situation, control credit, and bring inflation down to low levels. The strengthened policy stance has begun to bear results, as evidenced by the substantial decline in inflation during the past several weeks. In this light, the Government requests that an appropriate waiver be granted to facilitate the release of one purchase upon completion of the second review under the stand-by arrangement. Moreover, the Government requests that the stand-by arrangement be amended by the Fund to set access at SDR 736 million, under a suitable phasing of purchases, for the period through March 1991.

Discussions with Argentina's commercial bank creditors are continuing towards a solution that would allow for phased market-based debt and debt service reduction. An important start has been made in this regard with the transfer to new owners on November 8, 1990 of the telecommunications company, a transaction which, with the approval of bank creditors, involves a substantial reduction in the stock of external public debt and interest arrears. The Government would like to count on the continued support of the Fund for the financing strategy outlined in this memorandum including the provision that the equivalent of 25 percent of each of the two remaining purchases under the present stand-by arrangement be set aside for debt reduction operations.

The Government of Argentina is of the view that the modified policies set forth in the attached memorandum are adequate to achieve the objectives of the economic program but it will take any further measures that may be appropriate for this purpose. In this regard, the Government will review with the Fund before the end of March 1991 the progress made in the implementation of the program. As progress is achieved in stabilizing the economy and normalizing relations with external creditors, the Government would be interested in seeking further support from the Fund in the form of an extended arrangement.

Sincerely,

/s/

Antonio Erman Gonzalez
Minister of Economy

Attachment

Argentina: Memorandum on Economic Policy

1. Since taking office in July 1989, the Government has sought to implement an economic program aimed at dealing with high inflation, chronic stagnation, and weak balance of payments that have characterized the Argentine economy for many years. As was indicated in the memoranda attached to the letters of intent dated October 12, 1989 and May 10, 1990, the Government's strategy has been to pursue financial policies directed to the achievement of financial stability and to complement these actions with a program of reforms designed to improve the efficiency of the tax system, to reduce the size of the public sector, to set up a more competitive wage-determination process, to do away with price controls, to remove external trade and exchange restrictions, and to restore relations with external creditors. The economic policy package introduced in mid-1989, which included a major realignment of the exchange rate and public sector prices, initially succeeded in reducing inflation sharply and rebuilding the international reserve position. The program of structural reform also advanced on a number of fronts. The legal framework for the Government's privatization program was adopted, prices were decontrolled, exchange and trade restrictions were reduced, and a partial reform of the tax system was approved by Congress.

2. As was noted in the memorandum of May 10, 1990, however, problems emerged in the implementation of the program in the latter part of 1989 as inflation began to accelerate and outward movements of private capital again became strong. In an effort to re-establish the momentum of adjustment, the Government undertook a series of corrective measures beginning on December 18, 1989 when it eliminated most exchange and payments restrictions, unified the foreign exchange market under a freely floating system, and reached agreement on the refinancing or rescheduling of debt maturities owed to official creditors. On January 1, 1990, all austral-denominated bonds and time deposits were converted into ten-year dollar-denominated Government of Argentina bonds to counter the effect of rising domestic interest rates on the fiscal position. Furthermore, credit policy was tightened in the first quarter of 1990 and sharp adjustment to public sector tariffs were made in February 1990. On March 6, 1990 the Government issued omnibus Decree 435 which included a comprehensive set of measures aimed at increasing the yield of the tax system, controlling the wage bill, reducing public sector employment, and establishing a framework for achieving improvements in the operations of the public enterprises. Further adjustments were made to public sector prices, including for petroleum products, in the remainder of March and April. Concurrently, the Central Bank continued to reduce the level of outstanding central bank rediscounts, and steps were taken to push forward with the privatization of state enterprises and asset sales.

3. The above measures led to a strong remonetization process starting in mid-March 1990 and to an improvement in the public finances in the first two months of the second quarter, which also reflected in part a temporary large surplus in the social security system and compression of investment expenditure. The response in the exchange market was an immediate appreciation of the austral, which was followed by a further strengthening, notwithstanding larger than planned purchases of foreign exchange by the Central Bank. Tenders were solicited in March for the sale of the state airlines (Aerolineas Argentinas), the state telephone company (ENTEL), and the "marginal" oil fields (i.e., high-extraction cost oil areas) of the national oil company (YPF). The monthly rate of inflation (on the basis of weekly estimates) fell from 107 percent during February to 53 percent during March and to around 13 percent during April and May. However, slippages developed in certain aspects of the fiscal program. The legislation extending the VAT to the services sector and increasing the authority of the tax department to deter tax evasion was not passed in June as had been expected, and wage awards in some public enterprises exceeded government guidelines. Inflation in June continued at approximately the pace of April and May rather than declining as projected. Developments in respect of the performance criteria for the second quarter of 1990 were generally favorable. The performance criterion for the overall public sector deficit was exceeded by a small margin, while all other end-June performance criteria were observed, with wide margins in the cases of net international reserves and net domestic assets of the Central Bank.

4. The fiscal situation weakened in July and August 1990 as a result of continued delays in the passage and implementation of tax legislation, and administrative problems that emerged thwarted the efforts to bring the public enterprises under the full control of the Ministry of Economy as envisaged in Decree 435. As a result there were deviations from announced government wage aims in a number of public enterprises. At the same time, with the economy in a slump, legal reserve requirements were reduced to ease pressure on interest rates. Inflation continued to be high in August, and the process of remonetization came to a halt. Although these unfavorable developments resulted in deviations from the program's fiscal, external arrears, and credit targets for the third quarter of 1990, the limit on Treasury expenditure and the objective for the net international reserves were met.

5. The Government recognizes that the economic program and its implementation needs to be reinforced if the problem of inflation is to be dealt with in a decisive manner. To this end, it has adopted a series of measures, including those contained in Decree 1757 (issued on September 1, 1990), to strengthen substantially the public finances. As described in the paragraphs that follow, the decree reinforces the expenditure control measures of Decree 435, in particular by providing the Ministry of Economy with strengthened authority and the regulatory means to ensure public enterprise compliance with government policy. At the same time a resolution issued by the Ministry of Economy called for

substantial increases in public sector prices, particularly for public utilities and fuels. These measures are expected to help raise the primary surplus of the nonfinancial public sector to around 4.2 percent of GDP in the fourth quarter of 1990, compared with 1.4 percent in the third quarter. At the projected exchange rate and expected availability of external financing, this surplus would allow the Government to make programmed debt service payments, including a continuation of current policy as regards partial interest payments to commercial banks on refinanced public debt, and to eliminate remaining external arrears to other creditors. The surplus that has been targeted should be seen in the light of seasonal influences that normally increase expenditure and reduce revenue in the fourth quarter. About one half of the increase in the primary surplus from the third to the fourth quarter would result from increases in tax collections and capital revenue from the sale of assets and in the operating surpluses of the public enterprises; the remainder would come from the exercise of restraint over wages and from cuts in capital expenditure and transfers to the provinces.

6. In reflection of the major public enterprise price adjustments on September 1, the rate of inflation rose to 8 percent in the first week of September; however, the rate of increase fell to less than 2 percent in recent weeks and the expectation is that it will decline to lower levels in the remaining weeks of 1990. The performance criteria for end-December 1990 have been set out in Table 1. The cumulative ceilings for the net domestic assets of the Central Bank, the overall deficit of the nonfinancial public sector and the combined public sector deficit have been revised upward by an amount equal to the estimated deviations at the end of September. The cumulative ceiling on the net international reserve of the Central Bank has been revised on account of revisions on accrued external arrears to banks. The ceiling on Treasury expenditure, external debt of the public sector, and the limit on external arrears have not been changed from the program presented on May 10, 1990. In addition, to strengthen controls in key areas of the fiscal plan, indicative targets have been established for government revenue and for the primary surplus, tax payments, and social security contributions of the four largest public enterprises for the quarter ending December 1990, as set out in Table 2.

7. The Government remains committed to the goal of achieving a simplified and more equitable tax system. To this end, in February 1990 the coverage of the value-added tax was broadened to include virtually all goods, and effective from October 1990 the tax was extended to most services. The Government's focus for the very near term is on increasing the yield of the tax system. Revenues from the VAT and other domestic sources need to increase substantially to offset the effect of the scheduled reduction in export taxes that will take place in the fourth quarter and to contribute to the required fiscal adjustment. Several revenue measures were enacted recently. First, on October 19 the rate of the VAT was increased from 13 to 15.6 percent which should begin to affect Treasury receipts starting in mid-December. Second, in addition to the generalization of the VAT, the Omnibus Tax Bill passed

on September 28 included an adjustment to the procedure for collecting the value-added tax from the agricultural sector, and increases in the excise taxes on alcoholic beverages and the tax on exchange transactions.

8. The Government has been working with technical assistance from the Fund's Fiscal Affairs Department to put in place a special system for monitoring and controlling the filing and payment of the VAT by the country's largest taxpayers. A Fund technical assistance mission will arrive in mid-November to complete the implementation of the system. In order to make the threat of closure of business premises of delinquent taxpayers a credible and effective deterrent to tax evasion, the Government is also seeking means of speeding up the judicial hearing process that taxpayers now threatened with closure may follow. The penal code for tax offenders that was passed in February is currently being tested in the courts. In addition, provision has been made in the national budget for increases in the Tax Department's staff. Finally, progress has been made in eliminating tax incentives granted under the program of industrial and regional promotion.

9. The adjustment in domestic oil prices on September 1, under which crude petroleum prices were increased by about 50 percent and the average price of derivatives by 26 percent will yield a large dividend for the Treasury. Prior to the adjustment and as a result of increased spending, the national oil company (YPF) experienced a reduction in its gross operating margins and was unable to meet the payment of the petroleum products tax and other taxes. In addition to increasing the tax component of the price of petroleum products, the recent price adjustment allows YPF to settle its outstanding tax arrears and meet its current obligations in full. Also, the adjustment in prices has meant the elimination of Treasury subsidies to private petroleum producers and to petroleum producing provinces. Moreover, the decision to maintain the Treasury's share of the tax on petroleum products and telephone services at 50 percent, instead of reducing it to 20 percent on October 1 as originally intended, together with the elimination of Treasury subsidies to the special funds, will result in reduced spending by the decentralized agencies.

10. With the re-emergence of high inflation in the first quarter of 1990, there was a sharp decline in real wages, particularly in the month of March. In the following months, there were slippages in the application of the Government's norms for wage increases, and the strengthening of the fiscal adjustment effort that is being undertaken requires adherence to a strict wage policy, particularly in the public enterprises. Accordingly, nominal increases in the public sector wage bill for the last three months of 1990 will be set in line with targeted rates of inflation. Automatic indexation clauses in wage contracts have been suspended, and the Government's wage norms are to override provisions in current contracts that conflict with them. The Government is also starting a comprehensive review of salary scales and the structure of the compensation package to avoid a further loss of

qualified personnel. The aim is to achieve greater differentiation of pay in favor of better qualified and better performing personnel.

11. The Government's aim is to reduce significantly the level of employment in the public sector. The privatization of Aerolineas Argentinas and ENTEL will result in a reduction in the workforce in the public enterprise sector of about 60,500 employees or 20 percent of its level as of September 30, 1990. A further reduction of 15,000 is expected from the privatization of three railway lines. In the National Administration, however, despite the retirement program and other measures taken earlier in the year, the achievement of substantial reductions in staff has proven more difficult than had been expected. In the short term, the Government will focus its efforts on reducing the large number of temporary staff positions. During 1991, the Government will seek to reduce the permanent staff by approximately 20 percent of the current workforce through contracting out certain services to the private sector, the elimination of regulatory agencies, transfers of governmental functions to lower levels of government, and layoffs. The regulations governing the status of civil servants relieved of their duties (for positions that have been declared redundant) and severance pay have been modified to reduce the budgetary costs of employment reductions, and the Executive Committee that is responsible for the examination of public sector employment policy will review the norms pertaining to employment security, with a view to fostering the development of voluntary early retirement plans. These efforts, which are being supported by technical and financial assistance from the World Bank, are not expected to achieve significant budgetary savings in the immediate future, but should reduce public sector labor costs in the years to come.

12. Substantial progress has been achieved in the implementation of the Government's privatization program, and the scope of the program has been broadened to include a number of additional public sector entities and activities. The program in the petroleum sector is well advanced. The successful bidders for the marginal areas of the national oil company (YPF) auctioned earlier in the year were announced in late August, and the sales were completed on September 14 and 28 for a cash payment of US$169 million. Bids for four of YPF's central areas have been received and completion of the operation (which would take the form of production sharing arrangements or concessions) is expected to take place in early 1991. In all, these transactions will result in an important reduction in the role of the state in the petroleum sector. Moreover, the increase in domestic petroleum prices described above will greatly enhance the incentives for exploration and production and will be a step towards the complete deregulation of the petroleum market. Successful bidders for the telephone company (ENTEL) and for the national airline (Aerolineas Argentinas) also have been announced. The transfer of ENTEL took place on November 8, 1990, and the sale of the airline will proceed once the necessary waivers from commercial bank creditors have been obtained and other legal requirements have been fulfilled. Part of the payment is to be made with foreign commercial

banks' claims (principal and interest) resulting in debt reduction of approximately US$7.3 billion and the balance in the form of cash receipts for the government amounting to US$344 million. Progress has been made in the privatization of maintenance of the national highway network, with some 10,000 kilometers having been contracted for by private operators. The Government is now extending the privatization effort. Decree 2074, issued October 3, 1990, establishes the framework for the privatization of the petrochemical industrial complex of Bahia Blanca, the national steel company (SOMISA), the major electric utility (SEGBA), the state gas company, the National Port Administration, the state shipping line (ELMA), the postal service (ENCOTEL), the National Mint, the State Coal Company (YCF), the National Grain Board (storage elevators), the Buenos Aires Metro, and a number of enterprises managed by the Ministry of Defense. The Decree also paves the way for the second stage in the process of granting concessions for the exploitation by the private sector of additional marginal oil fields, and for association with YPF for the development of the central oil areas.

13. To address the difficulties experienced by the Government in improving its control over the public enterprises, the Ministry of Economy has been granted a strengthened supervisory authority over the operations of the enterprises. Specifically, the public enterprises have been required to prepare monthly budgets on both a cash and accrual basis that will be reviewed with Ministry of Economy officials to ensure their consistency with the macroeconomic framework. Ex-post reviews will be conducted to ensure that the budgets have been adhered to. The Government has appointed performance-oriented managerial teams in most of the enterprises and is taking measures to improve control over their spending decisions. The extension of the wage norm for the National Administration to the public enterprises also is expected to contribute to a better financial performance. Improved control over enterprises' purchases is expected from the establishment of a reference price service for standard commodities. These various measures, in combination with the rounds of tariff adjustments that took place in August and September, are expected to yield surpluses in the operations of all the enterprises (excluding the railroad) in the fourth quarter. In particular, a large surplus is projected in YPF, where prices were increased by substantially more than the average.

14. The revenue-sharing agreement between the National Government and the provinces results in an automatic transfer of 57.6 percent of the collections of most domestic taxes to the provinces. The level of transfers to the provinces has recovered from its first quarter low and, with the improvement that is expected in domestic tax collections, transfers under the revenue-sharing arrangement can be expected to increase further. In this regard, the Government will continue its effort to recover debts owed by the provinces to public sector enterprises, and will not make discretionary transfers to the provinces. The transfer of educational spending programs to the provinces is to be effected with the new school year, and some road maintenance programs also are to be transferred to the provinces. It is

expected that the provinces will receive financial and technical assistance from the World Bank aimed at improving both their own revenue effort and financial management.

15. The revenues of the social security system benefited from the slowing of inflation in the second quarter, and the higher revenues permitted an increase in the real value of the average pension. Despite an expected deficit in the third quarter, the system can be expected to achieve financial balance for the year as a whole on the basis of a small surplus in the fourth quarter. The basic pension was raised by 8 percent in September, and subsequent adjustments will not exceed the Government's salary norms. As noted in the Economic Memorandum attached to the Letter of Intent of May 1990, the major problem with the system is the structural imbalance of the fund for the self-employed. The Government is about to submit to Congress a proposal for the partial privatization of this fund, under which participants will be able to join private savings plans, with contributions being freely transferable between plans. To improve the financial position of both the plans for the employed and the self-employed several steps are being considered, including raising minimum retirement ages and suspending unemployment compensation payments to those already receiving pensions.

16. The general public's real holdings of austral-denominated deposits reached historic lows in March of this year, but they recovered substantially in real terms during the period April-June in reflection of increased confidence in the Government's stabilization effort. However, the rate of recovery slowed in July and real holdings fell in August. Therefore, the Government is of the view that it is best to assume that there will be no further remonetization. The limit on the expansion of the net domestic assets of the Central Bank for the remainder of 1990 has been set on this basis, after taking into account the effects of achieving the net international reserve objective and in line with the goal of lowering the rate of inflation.

17. To ensure that the limit on the net domestic assets is observed, the Central Bank is concentrating on areas which in the past have been important sources of credit expansion, mainly rediscounts, temporary Central Bank financing of government pension outlays, and export credit. As required by Decree 435, there has been a severe tightening on the extension of new rediscounts. In effect, from March to July the level of outstanding rediscounts fell by around 3 percent despite a rise in prices of around 150 percent during this period. The Government intends to build on these results, and a scheme was announced in late August aimed at reducing further outstanding rediscounts owed to the Central Bank. Moreover, Decree 1757 requires that bankruptcy proceedings be accelerated against those financial institutions in liquidation that fail to settle their debts with the Central Bank by December 1, 1990; these debts represent about one half of central bank claims on the financial system. The Central Bank has allowed the banking system to apply the social security system's overdrafts (OPPs) toward legal reserve requirements, but Decree 1757 establishes that,

effective November 1, 1990, OPPs will no longer be accepted to satisfy legal reserve requirements. Finally, the level of export credits in net terms has declined since late October 1989 and the Government is committed to further reductions while discontinuing the past practice of extending government to government loans. Moreover, it envisages no further export financing by the Central Bank.

18. As noted earlier, legal reserve requirements were lowered in July and August, and the ratio of reserves to total deposits fell from around 48 percent in the second quarter to an average of 44 percent in those two months. To reverse this situation, on September 1, 1990, minimum reserve requirements on private demand deposits were increased to around the levels that existed in the second quarter and those on government deposits were raised from 88.5 to 100 percent.

19. To facilitate the development of an efficient capital market capable of channeling domestic savings toward the financing of productive activities, the Government will continue to promote market determination of interest rates. Recently, efforts have been undertaken to ensure the clearance of accounts of financial institutions at the Central Bank that are more than two days past due, a measure that has particular importance in respect of provincial banks which had been accumulating overdrafts. A draft of the reform of the charter of the Central Bank has been completed and sent to the Congress and representatives of the private sector for consideration. Important elements of the draft reform are the prohibition of interest-bearing reserve requirements, the elimination of direct financing to the public sector except through open market operations, and the strengthening of the regulatory powers of the Central Bank over the financial system.

20. The Government intends to continue with the reform of the official financial system. The retail operations of the National Mortgage Bank (BNH) were halted on March 5 and the operations of the National Development Bank (BANADE) have been severely curtailed. All branches of the BNH were closed by September 30, 1990; branches of BANADE have been turned into loan recovery agencies. The Government aims at limiting BANADE's operations to the on-lending of funds from multilateral development banks and other official credit agencies through the financial system. The Central Bank initially incurred substantial costs as a result of the restructuring of these official banks, as it extended credit for continued salary and indemnization payments to displaced employees, but this arrangement was terminated in August 1990. Currently, outlays to displaced workers are funded solely through the recovery of the banks' portfolio.

21. The Government is committed to liberalizing Argentina's trade and payments system while maintaining a unified floating exchange rate with unrestricted access to the exchange market, which includes the elimination of the obligation to surrender export proceeds for small and medium-size exporters and a draft decree pending action which would extend the elimination of the surrender requirement to all other

exports. Progress made to date in opening the economy to foreign investment and trade has helped to improve the country's external position. The production coverage of quantitative restrictions has been reduced from 18 percent in August 1989 to 9 percent in March 1990 and to 7 percent in June 1990. During the second and third quarters of 1990 quantitative restrictions on chemical, pharmaceutical, paper, and some textile goods were removed. In addition, the Sworn Declaration of Import Needs (Declaracion Jurada de Necesidades de Importacion) was eliminated in June 1990, thereby allowing for full automaticity of imports not subject to quantitative restrictions, and a 3 percent advance import deposit that had been introduced in 1989 was eliminated in July. Progress also has been made in reforming the import tariff schedule. In August, tariff rates on food products and medical equipment previously in the range of 13 to 24 percent were reduced to a uniform 5 percent, and at present there are six basic tariff rates ranging from 5 percent to 24 percent. Steps will be taken during the remainder of 1990 to achieve the medium-term goal of a tariff structure with only 3 to 4 rates ranging from 10 percent to 20 percent. All quantitative import restrictions, except for steel and automobiles, are expected to be eliminated by December 1990. Specific tariff surcharges on consumer electronics were reduced in July, and further reductions of these surcharges and on those applied to textiles and machinery are envisaged. As a result, the coverage of specific tariff surcharges would be reduced from their present level of about 5 percent of domestic manufacturing production.

22. The overall balance of payments and current account deficits for 1990 are now expected to be smaller than originally programmed. The current account deficit is expected to be of the order of US$140 million as a result of a strong growth in the volume of exports and weak growth in imports. Despite substantial inflows of foreign direct investment in connection with the privatizations, the capital account is expected to be weaker than projected initially in part because of shortfalls in external credit disbursements, and net reductions in trade financing exposure. However, the program envisages a rise in the Central Bank's liquid reserves of over US$1 1/4 billion during 1990. In line with the objective of lowering inflation and consistent with the target for the primary fiscal surplus, the Central Bank will make exchange purchases in the market to meet the international reserves objective of the program and to cover the public debt service and other government obligations in foreign exchange.

23. Resolution 132 issued by the Ministry of Economy on May 14, 1990 raised export taxes between 3 percent and 7 percent for the principal agricultural exports, but these taxes have been subsequently reduced in accordance with a monthly schedule established under the World Bank Trade Policy Loan. Thus, export taxes on manufactured goods were eliminated by July 1990, and the average rate and dispersion of export taxes on agricultural goods is being reduced gradually. The average tax rate on exports of agricultural goods stood at 17 percent in July and is to be reduced to 11 percent by December. To strengthen export

competitiveness, in April the Government reinstated the automaticity of rebates for value-added taxes for exporters of manufactured and agro-industrial products. The Government believes that growth and diversification of exports will be achieved by allowing resources to move in response to market signals. It therefore does not intend to introduce any new export promotion programs and has eliminated or rephased existing ones.

24. With the introduction of the freely floating exchange system, exchange restrictions were drastically reduced. In line with the performance objectives established in the Memorandum of Economic Policy dated May 10, 1990, arrears on external debt other than arrears on medium- and long-term refinanced external debt to commercial banks were reduced during the first half of 1990 and are expected to be eliminated by December 1990.

25. Argentina has begun to restore relations with foreign creditors. In December 1989 it reached a rescheduling agreement with Paris Club creditors covering maturities until March 1991, and in June 1990 it initiated partial interest payments to commercial banks on previously refinanced medium- and long-term debt. The authorities intend to finalize bilateral agreements with the Paris Club creditors by the end of this year. To help create conditions for sustained growth in the medium term, the Government believes that a comprehensive agreement with commercial banks will need to incorporate debt and debt service reductions. While negotiations with commercial creditors are underway, Argentina expects to reduce its debt to commercial banks through the privatization program. The agreements to privatize the telecommunications and airline companies are expected to reduce the stock of foreign commercial debt by US$7.3 billion, including US$1.3 billion of interest arrears. For 1991, as noted in paragraph 11, the Government plans to extend its privatization program in order to reduce further its foreign commercial debt. Parallel to the privatization effort, the Government plans to continue making partial payments to commercial banks, while negotiating the necessary waivers to permit phased debt and debt service reduction operations as enhancements to support such operations become available over a three to four year period. It should be noted that all transactions concerted after 1983 with banks and other foreign creditors have automatic access to the present unrestricted foreign exchange market.

26. Progress to correct the serious macroeconomic imbalances and structural problems that the present administration encountered upon assuming office has not been without difficulties, in part reflecting delays in policy implementation and the deeply embedded distortions in the Argentine economy. Nevertheless, the Government remains determined to maintain the medium-term objective of reducing the role of the public sector in the economy and the immediate objective of achieving a low rate of inflation. The Government believes that its present policies are consistent with the achievement of 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 to insure that any departures from the program are identified and corrected promptly. In any event, the Government performance under the program will be reviewed again with the Fund before the end of March 1991.

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, Treasury Outlays, Public Sector External Arrears, Public Sector External Debt and Targets for Changes in Net International Reserves and Net Domestic Assets of the Central Bank

Limit or Target	April - December 1990
	(In billions of australes)
Overall cash deficit of the nonfinancial public sector (-)	5,640
Combined deficit of the nonfinancial public sector and the Central Bank (-) 1/	9,060
Treasury outlays 2/	50,500
Change in the net domestic assets of the Central Bank 3/	19,800
	(In millions of U.S. dollars)
Change in net international reserves of the Central Bank 4/	-126
External arrears of the public sector 5/	--
External debt of the public sector 6/	
Total outstanding disbursed external debt 7/	63,000
Cumulative net disbursements of short-term debt 8/	1,000

1/ Includes interest payments due by the official banks and SOMISA.

2/ Excluding interest payments.

3/ 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 1.19, is representative of the ratio projected for the fourth quarter of 1990 of the monetary base (currency issue plus deposits of financial institutions in the Central Bank) to M1. 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 Nación 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.

4/ This target implies maximum loss of net reserves. For measuring balance of payments performance, changes in international reserve assets and liabilities in currencies other than the U.S. dollar will not be affected by changes in cross rates and gold will be valued at US$325 per fine troy ounce. The net international reserve target will be adjusted for any changes in the value of reserve assets and liabilities that result from factors other than balance of payments flows. This target will be adjusted downward by up to the equivalent of 25 percent of purchases subject to set-asides to the extent that Argentina's net international reserves are used to finance debt reduction operations.

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

6/ 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 1989 exchange rates.

7/ 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.

8/ Includes accumulated 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.

Table 2. Argentina: Indicative Fiscal Targets

Target	October - December 1990
	(In billions of australes)
Treasury Revenue 1/	20,600
Public enterprise tax payments to Treasury 2/	3,100
Public enterprise tax payments to the social security system 2/	1,960
Primary surplus 2/	1,840

1/ Defined as the sum of domestic taxes subject to sharing arrangements with the provinces; other taxes not shared with the provinces; and fuel taxes including those deposited by YPF in account "A" in Banco Nacion.

2/ Public enterprises included under this target are the Buenos Aires electric utility (SEGBA), the state oil company (YPF), the state water and energy company (Agua y Energía), and the state gas company (Gas del Estado).