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Supplement 1

CONFIDENTIAL

November 16, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Argentina agreed at Executive Board Meeting 89/145, November 10, 1989.

Att: (1)

Stand-By Arrangement--Argentina

Attached hereto is a letter with an annexed memorandum, dated October 12, 1989 from the Minister of Economy and the President of the Central Bank of the Republic of Argentina, requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Argentina intend to pursue for the period of this stand-by arrangement, and understandings of Argentina with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that Argentina will pursue for the period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

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 1,104 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 February 15, 1990, the equivalent of SDR 368 million until May 15, 1990, the equivalent of SDR 552 million until August 15, 1990, the equivalent of SDR 736 million until November 15, 1990, and the equivalent of SDR 920 million until February 15, 1991.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Argentina' 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.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 2, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

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

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

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

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

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

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

(vi) 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 4 of the Memorandum on Economic Policy annexed to the attached letter,

are not observed; or

(b) if Argentina fails to carry out

(i) the intention regarding the elimination by the end of 1990 of the remaining import prohibitions and restrictions referred to in paragraph 28 of the Memorandum on Economic Policy annexed to the attached

(ii) the intention regarding the reduction of external payments arrears on public sector debt and the elimination of all such arrears by end-March 1990 as described in paragraph 29 of the Memorandum on Economic Policy annexed to the attached letter; or

(c) during any period after February 14, 1990, until the review contemplated in paragraph 31 of the Memorandum on Economic Policy annexed to the attached letter has been completed and understandings on additional measures that may be needed to attain the program's objectives have been reached, or after such understandings have been reached, while they are not being observed; or

(d) during the entire period of this stand-by arrangement, if Argentina

(i) imposes new or intensifies existing restrictions on payments and transfers for current international transactions, or

(ii) introduces new or modifies existing multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensified import restrictions for balance of payments reasons.

When Argentina is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Argentina and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Argentina will not make purchases under this stand-by arrangement during any period of the arrangement in which Argentina has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Argentina's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally, or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Argentina. When notices of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Argentina and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and

procedures of the Fund, and may be made in SDRs if, at the request of Argentina, the Fund agrees to provide them at the time of the purchase.

8. The value date for purchases under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Argentina will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

9. Argentina shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

10. (a) Argentina shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Argentina's balance of payments and reserve position improves.

(b) Any reductions in Argentina's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that the repurchases will be completed not later than seven years from the date of purchase.

11. During the period of the stand-by arrangement Argentina shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Argentina or of representatives of Argentina to the Fund. Argentina shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Argentina in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

12. In accordance with the last paragraph of the attached letter, Argentina will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the stand-by arrangement and while Argentina has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Argentina's balance of payments policies.

Buenos Aires,
October 12, 1989

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

Dear Mr. Camdessus,

The attached Memorandum on Economic Policy contains a description of the economic polices the Government of Argentina intends to follow in the period through the end of 1990. These policies are aimed at restoring price stability and introducing major structural reforms in the Argentine economy as a means of laying the basis for sustained growth of output, incomes, and employment, in the context of a strengthened external position.

In support of its economic program, the Government of Argentina would like to count on the cooperation of the International Monetary Fund, and accordingly requests a stand-by arrangement for the period through March 1991 in an amount equivalent to SDR 1,104 million.

The Government of Argentina believes that the policies set forth in the attached memorandum are adequate to achieve the objectives of its economic program but it will take any further measures that may be appropriate for this purpose. The Government will discuss with the Fund the adoption of any measures that may be appropriate, in accordance with the Fund's policies. As sufficient progress is made toward achieving the program stabilization objectives, the Government intends to design in a longer-term context a set of economic policies for which it would seek further Fund support in the form of an extended arrangement.

Yours sincerely,

/s/
Javier Gonzalez Fraga
President of the Central Bank
of the Republic of Argentina

/s/
Nestor Rapanelli
Minister of Economy

Memorandum on Economic Policy

1. On July 8, 1989, when President Menem assumed office, the Argentine economy was in a state of acute crisis, which was the culmination of a prolonged period of poor growth performance and high inflation caused by basic structural deficiencies and inadequate macroeconomic policies. By June 1989 the monthly rate of inflation had reached an unprecedented 124 percent, while liquid official international reserves were virtually exhausted notwithstanding a sizable accumulation of payments arrears, including trade arrears. At the same time, a deep recession had taken hold that affected most sectors of the economy. A basic factor underlying those difficulties was a marked weakening of the public finances, as government revenue was adversely affected by generalized tax evasion and by the inflation-caused erosion of the real value of taxes that are collected with a lag. In addition, the public enterprises were severely handicapped by a level of public prices that at the end of June was some 65 percent lower in real terms than that prevailing on average in 1988, while the Central Bank's quasi-fiscal losses ballooned in reflection of a substantial rise in domestic interest rates in real terms.

2. To deal with the deep-rooted imbalances of the economy, the Government has put in place a rigorous program of structural and macroeconomic policy reforms, for which there is a great degree of social support in Argentina. This support springs from the ravages caused by the recent bout of hyperinflation, and is based on a widespread belief that the lack of fiscal discipline was at the root of that problem. There also is broad support for the view that the inflationary psychology and behavior that are so imbedded in Argentine society cannot be dealt with gradually but require instead a bold attack. The objective is to lay the basis for an economy without inflation and to open the way to a process of sustained growth of output, income and employment, to make possible an improvement of the standard of living of the population over time and particularly the satisfaction of the basic needs of the less privileged.

3. As has been repeatedly indicated by President Menem, the strategy that has been adopted involves the withdrawal of the state from activities that can be undertaken by the private sector. The size of the public sector will thus be scaled down, while efforts will be made to improve the efficiency of the state in its natural spheres of activity. The Government will work toward the creation of an environment in which markets function freely, with the elimination of both public and private monopolies and a reduction of the scope of Government regulations, including those that limit competition from abroad.

4. The above principles have been given content through two basic laws already passed by the National Congress. One is the Law of Reform of the State enacted in August, which allows the privatization or liquidation of public enterprises and the sale of other publicly-owned

assets. The other is the Economic Emergency Law enacted in the second half of September for a period of 180 days--with the possibility of an extension for an additional 180 days--which provides for measures to improve the fiscal position in the very short term (referred to in paragraph 7 below) and calls for a number of structural policy changes. These include a modification of the charter of the Central Bank with a view to granting the Bank independence from the executive branch and strictly limiting its financing to the public sector, thereby facilitating its basic function of preserving the value of the national currency. The Fund has been asked to provide technical assistance in connection with this reform. The Economic Emergency Law also provides for a reexamination of subsidies and of the regimes of industrial and mining promotion, with the processing of requests of assistance under these regimes being suspended in the interim; the waiving of requirements for the approval of foreign direct investments; the limitation of the price margin accorded to local suppliers in public sector procurement to 5 percent; and the elimination of restrictive regulations affecting the functioning of capital markets.

5. A basic objective of the economic program for the near term is to bring inflation down to a monthly rate of less than 2 percent by the end of 1989 and further towards international levels by the end of 1990. Such a reduction in inflation is a necessary condition for a lasting recovery of saving and investment, and thus for the resumption of economic growth on a sustained basis. With inflation under control, the structural reforms on which the Government is embarked may be expected to stimulate private sector activity and raise the rate of economic growth to a level that would permit a significant increase in real income per capita over the medium to longer term. Indications of an incipient recovery from the deep recession of the first half of 1989 already have become apparent, and for 1990 as a whole output may be expected to rise by 5 percent or more.

6. A fundamental policy objective of the Government is to restore fiscal discipline without delay. Achievement of this objective is an essential condition for the success of the stabilization effort, and particularly for the restoration of price stability. To that end, policies will aim at reducing the overall deficit of the nonfinancial public sector from 16 percent of GDP in 1989 to 1 1/4 percent of GDP in 1990; at the same time, the operational result would shift from a deficit of 6 1/4 percent of GDP to approximate balance. These improvements would represent a significant step toward the Government's objective of eliminating the public sector deficit, and would obviate any net domestic financing of the public sector in 1990.

7. To give effect to its fiscal policy objectives, on July 10, 1989 the Government raised public enterprise tariffs by an average of 690 percent, which substantially improved the operating position of the public enterprises as a group. Concurrently, the Government announced that the general export taxes of 20 percent on industrial products and

of 30 percent on agricultural products that had been established in the second quarter of 1989 would be retained for some time. Moreover, the Economic Emergency Law included a number of measures which are expected to have a favorable effect on the fiscal position in the latter part of 1989 and into 1990, including the temporary suspension of subsidies and of a substantial part of the tax exemptions under the regimes of industrial and mining promotion, and a temporary change in the sharing arrangements for the petroleum tax that raises the proportion that accrues to the Treasury at the expense of the special funds. In the fourth quarter of 1989, these measures--together with a new one-time 4 percent capital levy on holdings of certain financial assets--are estimated to have a deficit-reducing effect for the combined public sector equivalent to 2 percent of GDP. In addition, the Economic Emergency Law provided for the forced rescheduling at longer terms of outstanding short-term government paper. The public finances also are benefitting from a recovery in tax revenues in August-September from their depressed level in earlier months, which reflected the decline in inflation as well as a program adopted by the internal tax office aimed at strengthening control over the largest 15,000 taxpayers. The recovery of revenue has provided substantial relief to the provinces through their share in taxes collected by the National Government, which is expected to permit the elimination, starting in October, of direct Treasury transfers to the provinces.

8. The Government believes that the complex tax system currently in place has distortionary effects and that the prevalence of high marginal tax rates coupled with a proliferation of tax exemptions is inimical to both the equity and the efficiency of the tax system. An important medium-term objective is to modify the tax system in order to make it more responsive to the development needs of the country, while ensuring an adequate level of resources to cover the financial needs of a streamlined public sector. A tax reform bill will thus be submitted to the National Congress in October to modify the tax structure in a fundamental way, and it is expected that the new tax legislation would become effective before the beginning of 1990.

9. A key element of the tax reform bill will be the broadening of the base of the value added tax to include all goods and services, at a single rate of 15 percent, with the elimination of all exemptions that are in effect at present. To limit the initial impact on prices, however, the Executive Branch would be authorized to phase in the tax for sectors newly included in the base over a period not exceeding six months; in the course of this transition period the 15 percent value added tax will be extended to sales by agricultural producers, which in the meantime will continue to be subject to the special sales tax introduced in June 1989. Special regimes would apply to insurance and to banking. As regards other taxes, a minimum tax on profits in the form of a 1 percent tax on the value of gross corporate assets will be introduced, and the rate of the existing tax on profits will be reduced from 33 percent to 20 percent. The personal income tax will be

simplified, limiting deductions to those for the taxpayer and his dependents and, for the self-employed, to expenses deemed necessary to generate gross income; also, the maximum rate will be reduced from 35 percent to 30 percent, and the number of brackets will be reduced to 5, with the lowest one starting at 10 percent. For wage earners the income tax will become a monthly withholding tax, and there will be no end-of-year filing requirement. A number of taxes, including those on capital gains, corporate net assets, and personal net worth will be eliminated when the reform becomes effective. The rate of the tax on bank debits will be reduced from 7 per thousand to 3 per thousand as a first step towards its elimination, but the payments will no longer be deductible for the purpose of assessing income tax liabilities. Several other taxes also are slated for elimination but will be retained for budgetary reasons until the positive effects of the tax reform--which together with social security contributions is expected to result in a ratio of tax revenue to GDP on the order of 22.6 percent in 1990--are assured. If it should become evident that the revenue expected from the extension of the base of the value added tax and the other tax measures is not materializing, additional measures will be taken to assure achievement of the program's fiscal objectives.

10. Over the past several years there has been a progressive deterioration in Argentina's tax administration capabilities and a marked increase in the incidence of tax evasion. The Government is determined to reverse this trend to ensure that the effects of the tax reform do materialize. The internal tax office, with technical assistance under a loan from the World Bank, is currently in the process of improving control over tax compliance through the creation of a data bank for the largest 2,000 taxpayers and increasing its capability in areas such as tax enforcement, internal auditing and data processing, by means of the implementation of training programs, the hiring of qualified personnel, the acquisition of hardware and software, and the development of better inspection and audit systems. In addition to the plan to identify and collect overdue tax liabilities of the largest 15,000 taxpayers referred to above, the internal revenue service has put in place a plan to establish effective control before the end of 1989 over 400,000 taxpayers subject to the value added tax. Another plan now being implemented aims at surveying taxpayers who claim deductions under promotional regimes to verify the extent of their entitlements. With a view to expanding the taxpayers' rolls, the Economic Emergency Law includes a provision that reduces the surcharges and penalty rates for firms and individuals who declare their overdue tax liabilities spontaneously. The Government intends to overhaul the tax collection machinery to improve further its effectiveness, including steps to make the tax agencies free from political interference, to upgrade the quality of their personnel, and to provide them with adequate resources. These efforts are to be supported by technical advice from the Fund's Fiscal Affairs Department.

11. The proposed tax reform legislation will increase penalties for tax evasion. These would include prison terms for failure to register as

taxpayer and to report a significant source of income; keeping two sets of accounts; failure to transfer taxes withheld from third parties; underinvoicing or overinvoicing of exports and imports; the obtention of subsidies, tax exemptions, tax rebates, tax reimbursements, and the like on the basis of investments that were not actually carried out; and certain other fraudulent actions, such as false customs declarations. The Government also intends to introduce certain other changes including provisions for closure of the taxpayer's establishment for offenses such as the failure to issue a sales receipt or file a tax return; a requirement that taxpayers submitting an appeal post a bond equal to at least one-half of the contested tax liability (including adjustments and penalties); the interdiction to litigate for relatively small sums; the consolidation of all steps of collection of late payments in the tax departments, except in special cases; and an arrangement under which the commercial banks would be authorized to accept both tax returns and payments, with an obligation to remit them to the tax office on a daily basis.

12. The Government is convinced that attaining balance in the public finances on a sustainable basis will require a major effort to restrain expenditure, an objective that is consistent with the reduced role that is to be given to the public sector in the economy. Spending by the nonfinancial public sector (excluding interest payments and putting the public enterprises on a net basis) would shift from 20.7 percent of GDP in 1988 to 19.8 percent of GDP in 1989 and to 21.6 percent of GDP in 1990. However, adjusted for the effect of the decline of inflation on the real value of expenditure, in 1990 the ratio of expenditure to GDP would decline slightly. In the short run, the Government's efforts on the expenditure side are to focus on a strict execution of the budget, the freezing of public sector employment, the pursuit of a cautious public sector wage policy, and the curtailment of interest payments on the domestic debt through the mandatory debt restructuring referred to above. Also, starting in October 1989 the Treasury will stop making transfers to the public enterprises to cover their operating deficits (except for meeting the payroll of the state railways) and to the provinces. As regards the latter, the tax reform described above will result in a change in the composition of revenue, raising the share that accrues to the provinces; to ensure that this does not result in a widening of the fiscal deficit, and consistent with the Government's objective of decentralization, the intention is to transfer to the provinces an equivalent amount of spending now carried out by the National Administration, in areas such as education, health and social welfare.

13. The Government recognizes that the successful implementation of the fiscal plan will depend to a large extent on the ability to strengthen the control over the finances of the public enterprises. For this reason a decree will be issued in the next few days establishing a special commission comprising the Ministers of Economy, of Public Works and Services, and of Labor and Social Security to control the operations of the fourteen largest public enterprises. This commission will inter

alia determine the pricing and wage policy of the enterprises, establish guidelines for their policies as regards purchases of goods and services, and control the execution of their current and capital budgets. The commission will be assisted by delegates appointed to each of the fourteen enterprises, who will have control over the operations of the enterprises, on which they will inform the commission at frequent intervals. To facilitate an improved cash management in the public enterprises and other public sector agencies in the future, the Economic Emergency Law provides for the compensation of outstanding overdue obligations among all segments of the public sector, including the provinces. For the future, the intention of the Government is to avoid a buildup of new arrears in intra-public sector payments, for which purpose a clearing system for such obligations would be established with automatic settlement on a monthly basis.

14. The Government attaches the highest priority to the program of privatizing state enterprises, an effort that will be conducted in the framework of the Law of Reform of the State referred to above. This legislation authorizes the Government to split up existing state enterprises and to proceed with their total or partial privatization through the sale or granting of concessions for all or part of their activities, subject to Congress not opposing such plans within 90 days. Decrees already have been issued establishing the basic rules for the privatization program of the state telephone company and part of the state railways; it is expected that bids for the telephone company will be sought before the end of January 1990. Steps are planned for the coming weeks that would lead to the privatization of the state airline, the merchant fleet, several television and radio stations, and the maintenance services of certain segments of the state highway system. Moreover, the measurement, billing and collection for the electricity, water, and natural gas companies will be contracted shortly to private firms, with a view to strengthening the collection performance of these companies. At the same time, the Government intends to reinvigorate the efforts to open up oil fields controlled by the state oil company (YPF) to drilling by private companies. In this respect, the intention is to sell some 250 minor fields to private interests by the end of 1990, and to associate major international and national oil firms, through joint ventures, in the exploration and exploitation of the principal areas which up to now have been reserved exclusively for YPF. These efforts are expected to be sufficient to reduce YPF's investment expenditure substantially in 1990 without jeopardizing the objective of expanding domestic petroleum production. The sales of assets involved in the programs described in this paragraph may be estimated to produce a net cashflow for the Treasury roughly equivalent to 1 1/2 percent of GDP in 1990.

15. The financial position of the social security system has been weakened in recent years by widespread noncompliance in the payment of contributions, which has led to cuts in the real value of pensions paid notwithstanding the earmarking of special taxes on gasoline, natural gas and telephones, amounting to about 1 percent of GDP. The social

security system will undertake a major effort to enforce compliance in the payment of contributions, and revenue also is expected to be boosted by the granting of an amnesty. Together with the decline in inflation, these measures are expected to result in a sizable increase in the receipts of the system in 1990. To the extent that such increase materializes, the system may raise pensions in relation to wages. In any event, there will be no special transfers from the Treasury to the social security system and the system will no longer use Central Bank credit as a means of financing. Moreover, the outstanding stock of overdrafts under the OPP system will be dealt with in the context of the clearance of arrears among public sector entities referred to in paragraph 13 above, with any remaining debt to be paid over a period of no more than 12 months.

16. The Government has the intention to review the financial situation of the social security system and related social programs with a view to putting them on a sound financial basis for the longer run. This review will examine the possibility of transferring to cooperatives or mutual societies the fund for the self-employed, whose benefit payments are now covered only to the extent of about 10 percent by contributions. Other aspects to be covered in the review would be the relationship between the length of active employment and the vesting of retirement benefits, the privileged pension regimes, and the implications for the labor market of the heavy payroll taxes levied for the social security system and other social programs.

17. Aside from the improvement that is expected in pensions in 1990, the Government is making efforts to protect the poorest groups of society from the short-term effects of adjustment. To this effect, a new program has been launched to supplement the program of food distribution (PAN) that has been in place for several years. The new program takes the form of distribution to targeted groups of a bond that can be used for the purchase of specified goods; it is expected to cover about one million recipients, has been planned for a period of no more than six months, and would be financed by a tax on 1988 sales by large companies that is projected to yield the equivalent of about 1/3 percent of annual GDP. Moreover, this year the provinces have expanded the school lunch and similar programs.

18. In the second quarter of 1989 the acceleration of inflation and the very high level of real interest rates had a large negative impact on the quasi-fiscal operations of the Central Bank. A substantial reduction of inflation and interest rates in the past few months has resulted in a temporary surplus in such operations. However, the Central Bank's operating position remains a cause for concern, and to deal with its losses on a lasting basis the Central Bank will pursue a policy of reducing the stock of rediscounts at subsidized interest rates and will intensify efforts to recover the assets of financial entities in liquidation. In all, the Central Bank's losses would decline from the equivalent of 4.7 percent of GDP in 1989 to 1.3 percent of GDP in 1990.

19. Consistent with the objectives established in paragraphs 6, 12 and 18, the Government has set limits in australes for the overall deficit of the combined public sector, the operating deficit of the nonfinancial public sector, and treasury outlays (excluding interest payments) for the fourth quarter of 1989 and the successive quarters of 1990 as presented in Table 1.

20. Achievement of a fiscal position that does not require net financing from the domestic banking system will facilitate the implementation of an overall credit policy consistent with the objectives of restoring price stability and strengthening the balance of payments. Because of the paramount importance of these objectives, the Central Bank's monetary program for the last quarter of 1989 and for 1990 is premised on a cautious estimate of the demand for money, including remonetization. On this basis, and consistent with the balance of payments targets, limits have been set on the net domestic assets of the Central Bank for the last quarter of 1989 and the successive quarters of 1990 (Table 2). In implementing monetary and credit policy, the Central Bank pays attention to movements in money demand and relies on a variety of indicators, including the spread between the official exchange rate and the rate implicit in the quotation of BONEX in the stock market, the underlying trend of costs and prices, and the level of interest rates in relation to inflation. In the past two months interest rates have declined substantially without giving rise to pressures in the exchange markets. Additional reductions in interest rates may be expected as inflation recedes further and fiscal discipline is consolidated.

21. Over the years, the persistence of large fiscal deficits, the process of demonetization associated with high inflation, and the policy of selective credit have given rise to a bank structure in which the Central Bank intermediates most of the financial resources channeled through the banking system. It is the intention of the Government to return to commercial banks the function of allocating credit in accordance with market criteria. In this respect, the long-term goal of the Government is to reduce the reserve and investment requirements of commercial banks, and a start in this process is envisaged in the period ahead as remonetization gains momentum. In support of this effort, the Central Bank will avoid opening new rediscount lines and will work to reduce outstanding rediscounts. Also, in the context of the modification of the charter of the Central Bank, careful consideration will be given to the balance sheet position of the Central Bank, with a view to reestablishing the soundness of the Bank's financial position.

22. The Government is considering substantive reforms in the official banks. In particular the National Mortgage Bank is not meeting a genuine need and its operations will be drastically curtailed, while other institutions such as the National Development Bank will be overhauled with a view to raising their operating efficiency, so as to ensure that official banks no longer drain the resources of the Central Bank. This will be an important component of the efforts geared to

improving resource allocation in Argentina. In the meantime, and in the context of a tight monetary policy, the Central Bank will enforce compliance by official banks, including the provincial banks, with existing reserve requirements, will restrict their access to additional financial assistance from the Central Bank, and will start a process of recovery of their rediscounts. Also, access of these banks to the short-term interbank market will be carefully monitored to ensure the observance of sound banking practices. As a result, their lending capacity will depend to a large extent on the improvement in their loan recovery performance.

23. The Government is of the view that incomes policies have a role to play in the period of transition toward price stability, to complement financial policies. As part of an agreement reached with leading industrial firms in July, increases in wages in excess of 160 percent were not allowed to be reflected in prices. In fact, wage settlements concluded in the third quarter on the basis of collective bargaining were generally in compliance with the formal wage guidelines set by the Government. It is the intention of the Government to prevent further rounds of cost-push inflation by establishing a forward-looking wage policy for the six-month period starting October 1989.

24. The Government is committed to the liberalization of Argentina's external trade and payments system as a major step toward improving efficiency in the use of resources. It thus has the firm intention to open the economy to foreign trade, maintain a competitive exchange rate, eliminate the antiexport bias of industrial promotion schemes, and implement measures to attract foreign investment and the repatriation of capital held abroad by residents. Largely as a result of the measures adopted by the Government in July, a marked improvement already has occurred in the country's external position in the past two months. These gains are expected to be consolidated as the efforts to stabilize the economy take hold and longer term measures to restore domestic balance and restructure the economy are implemented.

25. The external current account deficit is projected to widen to US$2.6 billion in 1989 as a result of a decline in export volumes in the aftermath of a severe drought early in the year and of an increase in international interest rates. Substantial capital outflows associated with the severe disruption of exchange markets led to an overall balance of payments deficit of US$3.1 billion during the first half of the year and to the virtual exhaustion of the Central Bank's liquid international reserves. Since early July, a reversal in private capital flows and a rise in the surrender of export receipts has taken place, and there has been a substantial reconstitution of the official international reserves. In the second half of 1989 the overall balance of payments deficit would be limited to US$500 million. For 1990, the external current account deficit, including contractual interest obligations, would decline to US$ 2 billion, equivalent to 2.7 percent of GDP. This projection implies a sizable recovery in the value of exports on the basis of an increase in crop production indicated by the expansion of

the area sown, as well as a substantial increase in imports associated with the expected recovery in economic activity and reduction in import protection. In 1990 the overall balance of payments deficit would be reduced to US$560 million. Quarterly targets for the net international reserves through end-1990 are specified in Table 3.

26. The Government recognizes the importance of a competitive exchange rate to stimulate exports and boost economic growth. To this end, the austral was depreciated in the July package of emergency measures by 65 percent to A 650 per U.S. dollar, compared with a rate of around A 560 per U.S. dollar in the parallel exchange market immediately before the devaluation. In real effective terms (on a trade weighted basis and including the effect of export taxes), the austral is now about 10 percent more depreciated than in mid-1988. The Government believes that the fiscal and monetary policies described above are consistent with the maintenance of the fixed exchange rate of A 650 per U.S. dollar, and is ready to take any additional actions in those areas that may be needed to assure the viability of the present exchange rate. In any event, the exchange rate would be kept under scrutiny with a view to preserving external competitiveness and achieving the balance of payments targets of the program while making progress in liberalizing the exchange and trade system.

27. To assure an adequate return to exports, the Government has announced a program for the gradual reduction starting in September of the general export taxes that were imposed earlier this year. By mid-1990 the tax on industrial exports would be eliminated and those on agricultural exports would be reduced. With a few exceptions, taxes on most agricultural exports would be within a range of 10-22 percent by that time. Consideration is being given to the unification, at a moderate level, of these export tax rates, whereas the specific taxes that remain on a number of these products would be removed. The Government recognizes that the present system of export licenses may act as deterrent to the development of a stronger export base and intends to examine this matter with a view to abolishing such requirement. More generally, the Government believes that a competitive exchange rate policy and the structural reforms described in this memorandum are the key to the growth and diversification of exports. It therefore does not intend to introduce new programs to promote exports nor to approve new projects under the existing ones.

28. During 1987-88 progress was made toward liberalizing Argentina's restrictive import regime. In July of this year the Government took further steps in the same direction with the reduction in the production coverage of quantitative import restrictions to below 15 percent through the removal of restrictions on imports of a range of goods, including some motor vehicles, beer and wine. The Government intends to restore before the end of 1989 the automaticity of the import licensing system for goods in the free import list in accordance with the provisions of the Trade Policy Loan from the World Bank, while the remaining import prohibitions and quantitative restrictions on imports would be

eliminated by the end of 1990; by raising competition, these measures would both help in the effort to curb inflation and improve resource allocation. The Government also is committed to a reform of the import tariff schedule system that would simplify its present structure, reduce rate dispersion and lower the overall tariff level. As a first step, the Government has just decreed a reduction of all tariff rates as follows: basic rates in excess of 40 percent have been brought down to 40 percent; rates between 14 and 40 percent have been reduced by 7 percent; and a tax of 5 percent has been imposed on goods that thus far had not been subject to tax. A further simplification of the tariff schedule is intended in 1990 as the Government moves towards the longer term objective, to be reached over the coming 3-4 years, of a tariff structure with a few rates in a range not wider than 5 to 25 percent.

29. Exchange restrictions were intensified considerably in response to the foreign exchange crisis experienced in the first half of 1989. External payments arrears rose to an estimated $5.3 billion at the end of June and included arrears on some import payments. Restrictions on payments for current transactions have now been largely lifted, and the Government intends to eliminate most of the remaining restrictions on acccess to foreign exchange at the official exchange rate for other current service payments by the private sector by end-December 1989, as a means of providing adequate incentives for new foreign direct investment in the country in accordance with the objectives set in the Economic Emergency Law. In an attempt to limit the volatility of short-term capital movements in the guise of trade financing, in August 1989 the Government suspended the existing broad system for export prefinancing, under which there had been large capital inflows in the period following the July measures. Also, the Central Bank is considering a reduction of the minimum financing requirement for imports to 90 days. Any remaining restrictions, apart from the exception made in the next sentence, are expected to be eliminated in 1990 in the context of a move towards the unification of the foreign exchange markets. Except for debt service arrears on medium- and long-term public debt to commercial banks and related debt, the Government intends to reduce external payments arrears on public sector debt service, through cash payment or rescheduling, to no more than US$200 million by end-1989 and to eliminate all such arrears by end-March 1990, and to remain current thereafter.

30. The Government believes it is important for Argentina to restore normal relations with its external creditors, and intends to begin shortly negotiations with creditors on the regularization of its outstanding payments arrears and on the provision of future financing for the balance of payments. Argentina's external debt at the end of 1988, including obligations to the Fund and payments arrears, amounted to an estimated US$59 billion, or equivalent to more than three-fourths of GDP. Interest on this debt in 1989 is estimated at about 8.5 percent of GDP, and the Government believes that it will be necessary to reduce the debt and debt service burden if satisfactory economic growth is to be achieved over the medium to longer term. In the period ahead, as the

program's immediate stabilization objectives are pursued, the Government will be working with creditors, including commercial banks, to advance appropriately towards a comprehensive agreement for the longer term. Its efforts in this regard, and the progress of negotiations with external creditors, will be a subject of the first review of the program. Argentina's total external debt is projected at US$62 billion by end 1990, and limits for the total and short-term external debt of the public sector consistent with these projections have been established through December 1990 as set out in Table 4. The Government also intends to negotiate with the Paris Club the rescheduling of arrears and current service due on pre-cutoff date medium- and long-term debt, and to move swiftly to conclude outstanding bilateral agreements on previous reschedulings.

31. The Government believes that the policies described in this memorandum will be adequate for the achievement of the objectives set in its economic program. It must be recognized, however, that Argentina is just emerging from a period of hyperinflation and that inevitably there are risks arising from the entrenchment of inflationary behavior. Moreover, the structural reforms envisaged by the Government are very ambitious and involve actions in areas for which there is limited experience. For these reasons, deviations with respect to some of the program projections cannot be ruled out, but the Government is ready to take any corrective actions that may be needed to achieve the basic objectives that have been set. This will require careful monitoring of developments to identify any departures before they become so large that they can no longer be corrected. In any event, the Government will review with the Fund before the end of February 1990 the progress made in the implementation of the program in order to reach understandings on additional measures that may be needed to attain the program's objectives. In the context of the review, special attention will be given to the progress in implementing the tax reform and strengthening the tax collection agencies, the implementation of mechanisms to strengthen the control over the public enterprises, the development of the program of privatizations, and the negotiations with Argentina's foreign creditors.

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

(In millions of australes)

Period	Overall Cash Deficit of the Nonfinancial Public Sector (-)	Combined Deficit of the Nonfinancial Public Sector and the Central Bank (-)	Treasury Outlays
Oct.-Dec. 1989	-830,300	-770,500	1,444,400
Oct. 1989-Mar. 1990	-776,300	-945,700	2,755,100
Oct.1989-June 1990	-990,300	-1,259,900	4,267,100
Jan.-Sept. 1990	-178,000	-736,200	4,429,400
Jan.-Dec. 1990	-626,000	-1,244,000	6,288,600

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

(In millions of australes)

October-December 1989	1,497,450
October 1989-March 1990	1,999,350
October 1989-June 1990	2,752,750
January-September 1990	1,659,700
January-December 1990	2,707,400

1/ The change in the net domestic assets of the Central Bank is defined as the change in M-2 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 equals 0.896 and represents the ratio in August 1989 of a broad definition of the monetary base (currency issue plus deposits of financial institutions in the Central Bank, investments of financial institutions with the Central Bank related to deposits, and Central Bank paper held by financial institutions) to M-2. M-2 is measured as the monthly average of the sum of currency in circulation, sight deposits (excluding the treasury accounts with the Banco de la Nacion and the Unified Fund on a net basis), and savings and time deposits excluding foreign currency deposit and indexed deposits. Net international reserves for each month are the average of the net international reserves at the end of the previous and current month, as defined in Table 4. Targets have been set on the basis of estimated M-2 for September 1989 and will be adjusted to allow for the difference between the preliminary and the definitive estimate of M-2. In addition, in the fourth quarter of 1989, the target will be adjusted to allow for a reduction in the Central Bank remunerated domestic debt equivalent to any excess in the growth of real M-2 balances with respect to that envisaged in the program times the factor k.

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

(In millions of U.S. dollars)

October-December 1989	-950
October 1989-March 1990	-1,140
October1989-June 1990	-1,185
January-September 1990	80
January-December 1990	-560

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

Table 4. Argentina: Limits to the External Debt of the Public Sector During the Program Period 1/2/

(In millions of U.S. dollars)

Limit to the total outstanding disbursed external debt of the public sector 3/	53,000
Limit to cumulative net disbursements of short-term debt of the public sector contracted after September 30, 1989 4/	1,000

1/ Limits after December 1989 are indicative only.

2/ 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-June 1988 exchange rates.

3/ 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.

4/ Includes cumulated disbursements, net of repayments, of debt with a maturity up to one year, contracted by public sector entities after September 30, 1989, other than obligations classified as reserve liabilities.