

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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Supplement 1

CONFIDENTIAL

January 25, 1983

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 83/18, January 24, 1983.

Att: (1)

Stand-By Arrangement - Argentina

Attached hereto is a letter with annexed memoranda dated January 7, 1983 from the Minister of Economy and the President of the Central Bank of the Argentine Republic 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.

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 January 24, 1983 to April 23, 1984 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 1,500 million, subject to paragraphs 2, 3, 4, and 5 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 300.74 million until May 20, 1983, the equivalent of SDR 600.51 million until August 20, 1983, the equivalent of SDR 900.27 million until November 20, 1983, and the equivalent of SDR 1,200.04 million until February 20, 1984.

(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's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 2 to 1 until purchases under the arrangement reach the equivalent of SDR 300,937,500 and then from ordinary and borrowed resources in the ratio of 1 to 1.2, 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 stand-by arrangement, other than the initial purchase equivalent to SDR 300.74 million that it may request not later than within 15 days of the effective date of this arrangement, that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

(a) during any period in which the ceiling on the net domestic assets of the Central Bank described in paragraph 4 of the Memorandum of Understanding annexed to the attached letter has been exceeded; or

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

- (i) the cumulative overall balance of payments targets described in paragraph 2 of the Memorandum of Understanding annexed to the attached letter have not been met, or
 - (ii) the limit on the cumulative borrowing needs of the nonfinancial public sector described in paragraph 3 of the Memorandum of Understanding annexed to the attached letter has been exceeded, or
 - (iii) the cumulative limit on the outstanding disbursed external debt of the public sector described in paragraph 5 of the Memorandum of Understanding annexed to the attached letter has been exceeded, or
 - (iv) the limits on total maturities falling due within 36 months of the end of each calendar quarter described in paragraph 5 of the Memorandum of Understanding annexed to the attached letter have been exceeded, or,
- (c) during any period after February 28, 1983 in which the system of special rebates for exports to new markets has not been terminated, or
- (d) during any period after March 31, 1983 in which the schedule for the phased elimination of the minimum foreign financing requirements for imports, as set out in paragraph 6 of the Memorandum of Understanding annexed to the attached letter, has not been adhered to, or
- (e) during any period after June 30, 1983 in which external payments arrears persist or reappear, or
- (f) during any period after July 31, 1983 in which understandings between Argentina and the Fund on a schedule for the elimination of existing multiple currency practices and restrictions on payments and transfers for current international transactions have not been reached, or
- (g) during the entire period of this stand-by arrangement, if Argentina
- (i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

- (ii) introduces or modifies multiple currency practices except as referred to in paragraph 7 of the Memorandum of Understanding annexed to the attached letter, or
- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or
- (iv) imposes or intensifies 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'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 notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, 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.

6. 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, on the request of Argentina, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Argentina will consult the Fund on the timing of purchases involving borrowed resources.

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

9. (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 repurchase will be completed not later than seven years from the date of purchase.

10. 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 memoranda.

11. In accordance with paragraph 5 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, Argentina
January 7, 1983

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosiere,

1. Annexed are (1) a Memorandum of the Government of the Republic of Argentina on Certain Aspects of its Economic Policy for the period through March 1984; and (2) a Memorandum of Understanding setting out certain operational guidelines for the conduct of this economic policy from January 1983 through April 1984. The memoranda describe the measures that Argentina already has taken and still has to take in order to correct economic imbalances and to ensure economic growth on solid and stable foundations.

2. In support of this 15-month program, we request herewith a stand-by arrangement with the International Monetary Fund in an amount of SDR 1,500 million, including access to the Fund's borrowed resources. We believe that our request for Argentina's maximum access to Fund resources permissible under existing policies is fully justified given the exceptional circumstances of our country and the pronounced deterioration in international capital market conditions which not only affect Argentina but the entire world. Moreover, believing as we do that the process of full economic recovery and restoration of financial stability will not be completed by the time the present Government leaves office, we would like to ensure that the authorities who will succeed it will have the opportunity to establish, if they desire, new financial relations between Argentina and the Fund. To this end the Government is prepared to arrange preliminary contacts prior to March 1984 between representatives of the Fund and the authorities in charge of the next government.

3. The Government of the Republic of Argentina intends to enter into discussions with the international financial community to secure a restructuring of its public and private external debt and attaches great importance to any assistance the Fund could lend in this exercise, as well as in efforts to obtain new external financing.

4. The annexed Memorandum of Understanding covers the principal economic targets and policy undertakings for the period of the requested arrangement. The Government of the Republic of Argentina understands that if, for any reason, any of these targets or policy undertakings are not observed in the period to the end of the arrangement, Argentina will not request any purchase under the arrangement that would raise the Fund's holdings of Argentina pesos beyond the first credit tranche

and 12.5 per cent of quota, until after reaching understandings with the Fund regarding the circumstances in which such purchases might be resumed.

5. The Government of the Republic of Argentina believes that the policies set out in the annexed Memorandum on Certain Aspects of its Economic Policy and further elaborated in the annexed Memorandum of Understanding are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund in accordance with the Fund's policies on such consultations, about the progress made in the implementation of its program and any policy adaptations that may be appropriate for the attainment of its objectives. The first such consultation with the management of the Fund in May 1983 will include a review of trade and exchange policies.

Yours sincerely,

Julio Gonzalez del Solar
President of the Central Bank
of the Republic of Argentina

Jorge Wehbe
Minister of Economy

Annexed (2): Memorandum of the Government of the Republic of Argentina
on Certain Aspects of its Economic Policy
Memorandum of Understanding

MEMORANDUM OF THE GOVERNMENT OF THE REPUBLIC OF ARGENTINA
ON CERTAIN ASPECTS OF ITS ECONOMIC POLICY

I. Objectives and Strategies for Economic Recovery

1. The Argentine economy is in a severely depressed state and plagued with acute imbalances. The rate of inflation remains high and real wages have declined sharply. Real GDP growth, uneven during 1976-79, came to a halt in 1980 and was negative in 1981-82. Output now barely is at its level of six years ago, and real per capita income is at its lowest level in a decade. Unemployment approached 6 per cent in mid-1982 and underemployment has risen sharply.

2. The exchange rate policy pursued until March 31, 1981 led to an overvaluation of the peso and caused heavy external current payments imbalances which were financed by foreign borrowing on an increasing scale and on ever shorter terms. From that time on, attempts were made to correct these imbalances by an adjustment of the real exchange rate, which did reduce the deficit to some extent, but the lack of supporting domestic policies and waning confidence caused the overall balance of payments deficit to grow in the remainder of 1981. After a brief improvement in early 1982, the overall imbalances intensified during the second quarter of the year, when Argentina's access to international financial markets was interrupted, shipping routes were altered, and payments arrears began to accumulate. Argentina's external debt now exceeds US\$36 billion, about one half of which falls due in 1983. The overall balance of payments deficit incurred in 1981 and 1982 combined is estimated at US\$9 billion, which has reduced the disposable international reserves of the Central Bank to an extremely low level. Internally, wholesale prices rose by 180 per cent during 1981 and by about 310 per cent during 1982, reaching an annual rate of increase of 495 per cent in the second half of last year.

3. Notwithstanding heavy foreign borrowing, private and public investment stagnated during 1978-80 and dropped sharply in 1981-82 with the intensification of the economic recession. Gross fixed capital formation is estimated to have been only 17 per cent of GDP in 1982, compared with 25 per cent of GDP in the mid-1970s. Moreover, certain public investments in the last six years were in sectors yielding low, and in certain cases, negative rates of return.

4. The revival of the economy and the reduction of unemployment, therefore, have been the Government's priority economic objectives. The strategy has been divided into two stages: with the help of an emergency public works program, efforts were initially directed to reactivating activities that are heavily labor-intensive and make little use of imported inputs. Because of budget constraints, however, this program has been limited to the resumption of work on certain projects, the speeding up of others, and maintenance work. The second stage will involve increased capacity utilization (now at some 60 per cent on the average in

manufacturing), particularly in sectors that can generate quick and substantial increases in foreign exchange earnings. In pursuit of this objective, public investment will be directed primarily to the development of the energy sector, where prospects for achieving such increases are promising.

5. It will take more than a year to bring the economy back on a path of satisfactory and self-sustaining growth. With the plant and equipment now in place, an excellent fine grain crop this year and good prospects for the coarse grain harvest, it would be reasonable to expect an output growth of the order of 5 per cent in 1983. The attainment of higher growth rates beyond 1983 is certain to call for more capital formation in the public and private sectors which, in turn, will require concerted efforts to mobilize domestic savings. To this end, corrective measures are being taken to raise prices in the public sector to levels that cover costs and finance a reasonable part of investment. Also, adjustments have been made in the exchange and interest rates in order to encourage savings, improve resource allocation, and stimulate productive activity.

6. Present world economic conditions would not seem to favor a rapid recovery of the external sector. Nevertheless, the adoption of policies designed to stimulate both traditional and nontraditional exports is being given priority. The limited size of Argentina's domestic market prevents industries from taking full advantage of economies of scale; it is, therefore, necessary to move ahead with a steady and aggressive policy of export growth, the success of which will depend in good part on an improvement in international economic conditions and a reduction in protectionism, especially in the industrial countries. The Government intends to adopt policies that will encourage the development of an efficient, export-oriented industrial sector that will offer improved employment opportunities. Recent experience also demonstrates that Argentina's payments difficulties cannot be resolved by reliance on external borrowing alone--a course which in good measure has been the cause of these difficulties--but must be dealt with by increasing earnings from international trade in goods and services. This is the policy presently being followed by utilizing fully the existing productive capacity of exporters with traditional markets and by offering incentives to the development of new export lines and markets. The importance of maintaining steady trading relationships is being given due weight in the formulation of exchange rate and other policies affecting the export sector.

II. Economic Management

7. It is believed that energy development and conservation can contribute to output and employment growth and provide relief to the balance of payments. Argentina so far has been a small importer of oil and gas. Efforts now are being made to turn the country gradually into a net hydrocarbon exporter notwithstanding a likely rebound in domestic consumption as economic activity picks up. Until 1982, low domestic

retail prices were a major obstacle to higher production. Measures have been taken to remedy this situation and encourage conservation, primarily the adoption since November 1982 of a schedule of monthly adjustments in domestic fuel prices (including a special 20 per cent real increase between November 1982 and February 1983) which should result on average in a 7.9 per cent real price increase per month during the period through February 1983 and in one of 3.2 per cent per month in the period through March 1984. Should it prove necessary for fiscal or other reasons, consideration would be given to increasing fuel prices by another 10 per cent in real terms in the course of 1983. Moreover, negotiations have been resumed with firms under risk contracts to guarantee them remunerative ex-well prices and thus encourage new drillings and increased production. Prospects for an increase in natural gas production and exports are even more encouraging. Major discoveries since 1978 have raised estimates of commercially recoverable gas reserves to M³ 600 million. This level should be sufficient to allow for an important substitution of gas-fired for liquid fuel-fired thermal power generation, for the development of a local fertilizer industry--which in turn would help save foreign exchange and increase yields in agriculture--and possibly for exports to neighboring countries.

8. The determination of prices should in normal circumstances be left to market forces in order to prevent distortions in resource allocation. Circumstances in the second quarter of 1982 caused a delay in exchange rate adjustments, which unavoidably led to the imposition of trade and payments restrictions. In July, the exchange rate was adjusted and public tariffs were raised. This caused the authorities to adopt a system of price agreements, and eventually price controls, for the 725 leading industrial firms in order to avoid excesses in pricing on the part of those firms which enjoy dominant market positions. Adjustments are permitted only once a month, but the controls are administered with utmost flexibility, taking due account of cost movements and permitting efficient enterprises to achieve reasonable rates of return on their investment. It is the Government's intention to relax these price controls progressively as the stabilization program takes hold and inflation subsides. An increased availability of imports as external payments arrears are eliminated and trade restrictions are lifted will play an important rôle in this respect.

9. Argentina's situation from the second quarter of 1982 on called for a rapid and sizable reduction in the level of imports and, to effect this adjustment, quantitative restrictions on imports were imposed. Nonessential imports were banned in May, and in August import quotas restricting imports by firm and by type of merchandise to 70 per cent of the annualized U.S. dollar value of each category of imports during the period July 1981-April 1982 were established. Recognizing that this system produced distortions, acted as a break on economic recovery to the extent that it reduced the supply of imported inputs, raised domestic prices, and was no substitute for an enduring balance of payments adjustment, the Government in November dismantled this import quota system. The Government intends to liberalize the remaining

import restrictions when the availability of foreign exchange permits. The temporary suspension in September 1982, because of suspected over-invoicing, of imports from Paraguay and Uruguay included in the LAIA negotiated list was lifted in October-November 1982 after import applications were resubmitted, reviewed, and declared import values adjusted in cases of demonstrable excesses.

10. The authorities are of the conviction that a sharp deceleration of inflation is a precondition for an improvement in real labor remunerations. The economic program has been designed to slow domestic price increases to an annual rate of about 85 per cent in the first quarter of 1984. Attainment of this objective will require a drastic reduction of the growth of nominal demand in the economy. To ensure that the restraint in money demand growth will mainly affect the rate of price increase while allowing for a recovery of domestic output and employment, the Government will act with prudence in determining the frequency and size of wage adjustments.

11. Real wages fell precipitously in the first half of 1982 and in June reached one of their lowest levels in a decade. To prevent an excessive contraction in real per capita consumption, large pay hikes, either in the form of flat peso increases or of increases proportional to pay levels were granted from July 1982 on. These large nominal wage adjustments resulted in some recovery of real labor remuneration levels, particularly in the construction sector where real wages had contracted sharply owing to the severity of the recession in that sector, but was limited in other industries. It is recognized, however, that large nominal wage hikes can have but a very short-lived impact on real labor remunerations while they may trigger an uncontrollable wage-price spiral. More generally, the Government believes that it should abstain from intervening in the process of wage determination in the private sector, and that wage levels are best left to the decision of each enterprise in the light of its own economic conditions and of the labor market situation. In this regard, the Government would expect the anticipated revival of economic activity in 1983 to bring about an improvement in real labor remuneration of around 5 per cent on the average and would hope that this improvement will be reflected primarily in employment gains. Until free collective bargaining is reinstated with the next administration, the Government will continue (as required by law) to set minimum and basic conventional wages, even though these have been of little practical relevance in recent years, accounting as they did for only a minor portion of wages and salaries actually paid. Basic conventional wages had remained unchanged since October 1981 and, in November 1982, a long overdue adjustment was made. In proceeding with the adjustment of these implicit wage floors in the future, the authorities will be mindful of not raising them to the point where they would cause actual remunerations to move at a rate inconsistent with the intended deceleration of inflation and recovery of output and employment.

12. This said, it is recognized that the pattern for wage adjustments in the private sector will be set in large measure by the policy of remuneration pursued in the public sector. The wage bill of the general government dropped from more than 10 per cent of GDP in 1979 and in 1980 to below 7.5 per cent of GDP in 1982, reflecting in part the freeze imposed on public sector remunerations during the first half of the year and the adoption of flat peso increases in the third quarter. To the extent permitted by the need to compress sharply the borrowing requirements of the public sector, current budget plans for 1983 imply a real increase in the remunerations of public employees of 5 per cent. In addition, in order to retain qualified medium- and high-level civil servants their salary scale will be partially restructured so as to correct the distortions in salary levels introduced by the flat peso increases of July-September 1982. Such selective increases will be quarterly commencing on April 1, will be kept during 1983 to one half of the full contemplated restructuring and will be subject to the availability of budgetary resources consistent with the fiscal program. The restructuring process will be completed in 1984. Altogether, the government wage bill would be held to no more than 7.5 per cent of GDP, a level significantly below that recorded in 1980 and 1981. Although wage developments in the public enterprises in principle follow the pattern of those in the private sector, the Government will monitor carefully the behavior of remunerations in the state enterprises and bring appropriate pressure to bear on these enterprises to ensure that the remunerations they pay remain in line with those for government employees.

13. There has been a marked deterioration in the public finances since 1977, particularly in the last two years. Public sector expenditure rose to about 40 per cent of GDP, to a large extent because of mounting interest payments on the internal and external debt and notwithstanding a drop in capital spending. Meanwhile, government revenues declined, affected as they were by rapidly changing economic conditions, modifications in the tax system and widespread tax evasion. Savings of the public sector fell sharply, from a high of 10-1/2 per cent of GDP in 1977 to around minus 3-1/2 per cent of GDP in 1981 and to minus 5 per cent of GDP in 1982. The overall borrowing requirements of the public sector, which in 1977 had been compressed to 4-1/2 per cent of GDP, widened steadily thereafter to a high of 14-1/3 per cent of GDP in both 1981 and 1982. Consequently, the public sector not only preempted a growing share of domestic financial savings, but also borrowed heavily abroad.

14. The Government is committed to prudent financial management and thereby to strengthening the confidence of the private sector, where expectations are markedly influenced not only by the size of the public sector deficit but also by the magnitude and composition of public spending. There also is a need for relieving pressures on the domestic financial market in order to free savings for the revival of output in the private sector.

15. Accordingly, the net borrowing requirements of the public sector will be kept to 8 per cent of GDP in 1983 and to 5 per cent of GDP in the first quarter of 1984. In order to raise public investment somewhat from its depressed level in 1982, the bulk of the improvement in public finances will have to come from a turnaround in public sector savings from sharply negative levels in 1981 and 1982 to over 1 per cent of GDP in 1983. To achieve this objective, government revenue will be raised by 2 percentage points to over 23-1/2 per cent of GDP, largely on account of the increase in fuel taxes. At the same time, current government spending will be held to 21-1/3 per cent of GDP, or 2 percentage points less than in 1982. The operating costs of public enterprises will be kept under close watch, and tariffs will be increased substantially. With effect from October 20, 1982, a schedule of monthly adjustments in public sector tariffs was established, a schedule that aims at a weighted average increase of 2.8 per cent a month (excluding the special 20 per cent real fuel tax increase of November 1982-February 1983) over and above the increase in the wholesale price index. Altogether, the objective is to seek an improvement in the savings rate of public enterprises of the order of 1-1/3 per cent of GDP in 1983.

16. The Government intends to strengthen the tax base. Following the exchange rate adjustments in July 1982, taxes on nonpromoted exports were raised as an emergency measure from a range of 0-10 per cent to one of 10-25 per cent. The potential effects of this decision on the farm sector were considered carefully and the conclusion was reached that its drawbacks would be more than outweighed by its fiscal benefits and its moderating influence on the domestic prices of tradeable goods. Moreover, the 1981/82 coarse grain crop had been harvested and the 1982/83 fine grain crop already had been planted. Altogether, it is estimated that this tax represented about 1.2 per cent of GDP in 1982 and that it would rise to 1.9 per cent of GDP in 1983. The Government recognizes, however, that this system of export taxes, combined with a system of automatic tax rebates for promoted exports, produces major distortions in resource allocation, and hence hampers the development of an efficient and dynamic export sector. It is intended, therefore, to simplify over time this system of export taxes and rebates. As a first step in that direction, the system of special rebates for exports to new markets is to be eliminated in February 1983, although rebates already approved under this system will be allowed to continue until their pre-established expiration dates.

17. Other tax revenues performed well in the second half of 1982. Value-added tax (VAT) collections increased strongly as nominal GDP growth accelerated and sales in the third quarter of the year surged. VAT rates for foodstuffs and medicines were lowered from 12 per cent to 8 per cent in September, compared with a 20 per cent standard rate for all other goods, to help mitigate the impact of inflation on low income groups. But the expectation is that the revenue thus foregone

will be partly, if not wholly, offset by the gradual recovery of production, imports, and sales and by a systematic effort at reducing tax evasion, now estimated at around 50 per cent in the case of the VAT alone. A growth of other government revenue is expected from the adoption of a tax moratorium and the impact of the ongoing adjustments in the domestic prices of petroleum derivatives and electricity.

18. The Government will observe austerity in its consumption spending through tight control over the growth of its wage bill and by keeping the increase in its outlays on goods and services below that in domestic prices. Although no dismissal from government employment can be envisaged in current economic circumstances, no more than one half of the positions vacated by attrition will be filled. With such prudent management of current spending and the anticipated increase in revenue, government savings should rise from minus 1.8 per cent of GDP in 1982 to 2-1/2 per cent of GDP in 1983.

19. Given the transitory nature of this Government, it would seem inappropriate to introduce major modifications in the size and overall priorities of the public investment program. Nonetheless, concern for economic reactivation dictates that in 1983 real public investment spending be raised by around 1 per cent of GDP from its level of 8.5 per cent of GDP in 1982, and care has been taken in the 1983 budget to concentrate such spending on labor-intensive projects with a large income multiplier effect. Projects with low economic returns and those of no immediate priority have been cancelled or postponed, except when breach of contracts involved higher costs than continuing with the project.

20. The financial system was substantially modified in July 1982 with the objective of alleviating the heavy domestic and foreign debt burden of enterprises resulting from large-scale borrowing during 1978-80. With these modifications, the real value of the private sector's debt to the financial system was reduced by 40 per cent from July through October. But the cost of this operation was high as the low level of real interest rates caused real domestic financial savings to fall sharply. Monetary policy therefore is being directed toward the reconstitution of real financial savings and the efficient allocation of financial resources.

21. A number of measures in this direction were taken in the latter part of 1982 as the interest rate structure established in July 1982 was gradually made more flexible. The maximum monthly interest rates payable on regulated deposits of 30 days were increased in steps from an initial level of 5 per cent per month in July to 7 per cent in September and to 8-1/2 per cent in November, and the rates on regulated deposits at longer terms were raised correspondingly. The rate of interest on the subsidized basic and additional loans was raised from the original 6 per cent a month in July to 8 per cent a month in September. That lending rate was raised further to 9 per cent a month in November, and new access to these loans was suspended from November 1, 1982. Also, regulations were issued in November 1982 to prevent maturing exchange guarantees granted during June-December 1981 from causing an undue Central Bank credit expansion and a loss of foreign exchange reserves.

22. With effect from January 1, 1983, the monetary authorities have adopted a policy whereby the key regulated deposit rates and the lending rate for loans financed from regulated deposits will be set at the beginning of each month on the basis of a three-month moving average of the wholesale price index--the observed increase in that index during the two preceding months and the projected increase for the current month. The lending rate will be set at least equal to that three-month moving average; the 30-day deposit rate will be set within 1 percentage point below that average and the rates on deposits of more than 30 days will be set in line with the 30-day rate. Recognizing that this formula is based on partially estimated data for the preceding month and projected data for the current month, the authorities are prepared during the course of each month to adjust minimum reserve requirements or to conduct their open market operations in such a way as to produce an interest rate on Central Bank absorption bills which will compensate for any significant underestimation of the current inflation rate resulting from the formula.

23. More generally, the authorities view the ultimate test of the appropriateness of interest rate policy to be the degree of success in achieving the balance of payments objectives and the targeted real increase in the financial assets of the private sector; they are prepared to adapt the formula for setting regulated deposit and lending rates to the extent that is necessary to meet these goals. In the short run, the results of the regular bill auctions and the movements in the rates on unregulated deposits will be used as indicators of the appropriateness of that formula, and regulated rates will be set above the levels indicated by the price formula if this appears necessary.

24. A major obstacle to economic recovery since the second quarter of 1982 has been the foreign exchange shortage. Two major reasons for this shortage were adverse movements in the leads and lags of import payments and surrender of export receipts and the drying up of external sources of finance at a time of heavy external debt service payments. From July 1982, another reason has been the emergence of a large differential between the commercial exchange rate applicable to merchandise transactions, the financial rate applicable to all other authorized transactions, and the rate in the parallel market which emerged as exchange restrictions were tightened. As a consequence, under- and over-invoicing became widespread, unrecorded border transactions increased, exporters withheld shipments, and a large portion of service receipts evaded official channels.

25. To avoid the continuation of these distortions in trade and payments flows the Government is determined to restore order in the foreign exchange market. While continuing with the daily depreciation of the commercial rate initiated in July 1982, the unification between the financial and commercial exchange rates was accelerated in September and October by introducing, and subsequently increasing, the mix of the two rates for trade transactions. The exchange markets subsequently were unified on November 1, 1982, for a 13-1/2 per cent peso depreciation for

trade related transactions, and since then the exchange rate has been adjusted about in line with the rate of domestic inflation. This policy will be applied with sufficient flexibility to meet the overall balance of payments objectives.

26. A parallel market will remain in existence so long as complete freedom of exchange transactions has not been restored. Moreover, the benefits in terms of resource allocation of a unified exchange rate are at least partly foregone by such payments restrictions as presently exist. Despite the drawbacks of exchange restrictions, the freeing of the capital account of the balance of payments has to be ruled out in Argentina's present circumstances, but it is the intention of the Government to phase out gradually restrictions on payments and transfers on current account. To this effect a program of gradual liberalization has been drawn up, which calls for a return to complete freedom for current payments by December 31, 1983, except possibly for limits on certain invisible payments to prevent disguised capital outflows. The 180-day minimum import financing requirement also will be reduced in steps and eventually eliminated.

27. Beginning in the second quarter of 1982 Argentina incurred large external payments arrears, of which US\$2.5 billion remained outstanding at the end of December. The authorities are giving the highest priority to the total elimination of these arrears, in their determination to restore the normal flow of imports and Argentina's international creditworthiness.

28. The authorities have asked foreign banks to restructure Argentina's debt maturities. As already indicated, principal payments equivalent to about one half of the external debt of US\$36 billion at the end of 1982 fall due in 1983. This debt amortization schedule obviously is unrealistic for a country with Argentina's level of income and export earnings. The Government trusts that the private international banking community will recognize this fact and respond positively to Argentina's request for debt relief. Should foreign banks be prepared to go further and resume lending to Argentina, the Government will observe prudent limits on its total external borrowing, especially in the shorter maturity ranges.

Government of the Republic of Argentina
January 7, 1983

Buenos Aires, Argentina
January 7, 1983

MEMORANDUM OF UNDERSTANDING

1. This Memorandum describes more concretely the key targets and policy undertakings of the accompanying Memorandum of the Government of the Republic of Argentina on Certain Aspects of its Economic Policy.

2. The overall balance of payments target for 1983 and for the 15-month period through the first quarter of 1984 is a deficit of no more than US\$500 million. The intermediate targets are a deficit of no more than US\$400 million for the three-month period through March 31, 1983; a deficit of no more than US\$220 million for the six-month period through June 30, 1983; and a surplus of at least US\$20 million for the nine-month period through September 30, 1983. For the purpose of these targets, the balance of payments performance will be measured by changes in the net international reserve position of the Central Bank of the Republic of Argentina. The Central Bank's net international reserve position will be defined as the difference between (a) the sum of its holdings of gold, SDRs, reserve position in the IMF, and all claims on nonresidents except discounted export letters of credit and credit lines granted to nonresidents; and (b) the sum of any outstanding external payments arrears and all other obligations to nonresidents, regardless of their currency denomination, any outstanding foreign currency swaps with residents, any loans obtained by public sector entities the foreign currency proceeds of which were surrendered to the Central Bank without the borrowing entity receiving the peso counterpart, any other balance of payments support loans, the cumulative net issue of external bonds (BONEX) against pesos for settlement by the private sector of outstanding external obligations (but excluding external bonds issued in settlement of foreign loans carrying an exchange rate guarantee by the Central Bank) and any debt to the IMF and the BIS. For the purpose of this definition, all foreign assets and liabilities will be expressed in U.S. dollars. All foreign assets and liabilities in other foreign currencies will be converted into U.S. dollars at the market rates of the respective currencies; gold will be valued at a fixed accounting rate of US\$42 per fine troy ounce; and the Central Bank's SDR holdings and Argentina's IMF position, be the latter positive or negative, will be valued in SDRs converted into U.S. dollars at the basket valuation of the Special Drawing Right. The Central Bank's net international reserve position as of September 30, 1982, so defined, is shown in attached Table 1. However, for purposes of measuring balance of payments performance, the change in the net international reserve position will be adjusted for changes in the U.S. dollar value of assets and liabilities denominated in other foreign currencies. An adjustment factor will be calculated weekly as the difference between (a) the U.S. dollar value of such assets and liabilities as of the day before the end of each statistical week valued at market rates on that day and (b) that same stock of assets and liabilities valued at the market

rates on the day before the end of the preceding statistical week. The cumulative value of these weekly adjustment factors will be subtracted from the change in net international reserves of the Central Bank as measured at current market rates.

3. The cumulative global borrowing needs of the nonfinancial public sector will not exceed \$a 105 trillion from January 1, 1983 until March 31, 1983; \$a 218 trillion until June 30, 1983; \$a 326 trillion until September 30, 1983; \$a 445 trillion until December 31, 1983; and \$a 559 trillion until March 31, 1984. These borrowing needs will be defined as the sum of the net increase above their respective stocks on December 31, 1982 in (a) the external debt of the nonfinancial public sector, including short-term debt, foreign currency denominated Treasury bills and bonds (BONEX) (excluding BONEX issued against pesos) converted into U.S. dollars if denominated in another foreign currency (and properly adjusted for exchange rate movements) and all U.S. dollar values converted into pesos at the average exchange rate of the U.S. dollar during the calendar quarter of the transaction; (b) external bonds in foreign currency issued against pesos in settlement of foreign obligations carrying an exchange rate guarantee by the Central Bank, valued in pesos at the amount actually received by the Treasury on the date of each such transaction; (c) the net debt (credit minus deposits) of the nonfinancial public sector to the Central Bank of the Republic of Argentina (including external bonds issued against pesos other than those referred to in (b) above) and the rest of the domestic financial system, excluding any valuation adjustments for alterations in the external value of the Argentine peso in the pertinent foreign currency denominated accounts; and (d) net placement of Treasury bills and bonds with the nonfinancial private sector. For the purpose of these cumulative limits, the nonfinancial public sector will be defined as the Treasury, the Special Accounts, the decentralized agencies, the Social Security System, the provinces, the Municipality of Buenos Aires, and the public enterprises listed in attached Table 2.

4. The net domestic assets of the Central Bank of the Republic of Argentina will at no time during the first quarter of 1983 increase by more than the increase (or decrease by less than the decrease) in its banknote issue above (below) its base stock on December 31, 1982, plus \$a 9.7 trillion, but in no event by more than 40 per cent of the base stock, plus \$a 9.7 trillion; at no time during the second quarter of 1983 increase by more than the increase (or decrease by less than the decrease) in its banknote issue above (below) its base stock, plus \$a 15.0 trillion, but in no event by more than 80 per cent of the base stock, plus \$a 15.0 trillion; at no time during the third quarter of 1983 increase by more than the increase (or decrease by less than the decrease) in its banknote issue above (below) its base stock, plus \$a 4.9 trillion, but in no event by more than 130 per cent of the base stock, plus \$a 4.9 trillion; at no time during the last quarter of 1983 increase by more than the increase (or decrease by less than the decrease) in its banknote issue above (below) its base stock, plus \$a 11.7 trillion; but in no event by more than 170 per cent of the

base stock, plus \$a 11.7 trillion; and at no time during the first quarter of 1984 increase by more than the increase (or decrease by less than the decrease) in its banknote issue above (below) its base stock, plus \$a 24.3 trillion, but in no event by more than 220 per cent of the base stock, plus \$a 24.3 trillion. For the purpose of this ceiling, the net domestic assets of the Central Bank will be defined as the difference between (a) its banknote issue and (b) its net international reserve position, defined as in paragraph 2 above, with the U.S. dollar value converted at all times into Argentine pesos at the Central Bank's accounting rate on December 31, 1982.

5. The outstanding disbursed external debt of the public sector will at no time during the period of the arrangement exceed by more than US\$2 billion the stock of such debt outstanding on December 31, 1982. Furthermore, the total maturities falling due within three years of the end of each calendar quarter, based on the stock of debt outstanding as of the end of that calendar quarter, will not exceed the total maturities falling due within three years of December 31, 1982, based on the stock of debt outstanding as of that date, by more than US\$600 million on March 31, 1983, by more than US\$1.2 billion on June 30, 1983, by more than US\$1.8 billion on September 30, 1983, by more than US\$2.4 billion on December 31, 1983, and by more than US\$3 billion on March 31, 1984. These limits on maturities falling due within three years of the end of each calendar quarter will be subject to a downward adjustment (even, if appropriate, to negative values) for (a) any net debt relief on maturities falling due within these periods obtained through multicreditor agreements involving a formal refinancing or rescheduling of the external debt of the public sector, and for (b) any increase in arrears on principal payments on public sector debt over and above the amount of such arrears outstanding on December 31, 1982. For purpose of these limits, the external debt of the public sector will be defined as all external obligations of the total public sector, including the official banks (the domestic offices of Banco de la Nacion, the National Development Bank, the Mortgage Bank, the National Postal Savings Bank, and the provincial and municipal banks), but excluding any increase in the stock of Argentine government bonds denominated in foreign currency but issued against pesos; any increase in the external obligations of the public sector treated as international reserve liabilities of the Central Bank as per paragraph 2 above; and any increase in the external debt of the public sector as the result of default by the private sector on a publicly guaranteed debt. External debt in currencies other than the U.S. dollar will be converted into U.S. dollars at the exchange rates prevailing on December 31, 1982.

6. During 1983 and through April 1984, the Government will not impose any new or intensify any existing restriction on payments and transfers for current international transactions; conclude any bilateral payments agreement inconsistent with Article VIII of the Articles of Agreement, or impose any new or intensify any existing import restriction for balance of payments reasons. During the second quarter of 1983 the Government will undertake, in consultation with the Fund, a

comprehensive review of the Argentine exchange and trade system and reach understandings with the Fund on a schedule for the elimination of existing multiple currency practices and restrictions on payments and transfers for current international transactions and of the consequent distortions. The Government will terminate the system of special rebates for exports to new markets by February 28, 1983, although rebates authorized before that date will continue in effect until their pre-established expiration dates. The Government will reduce the minimum foreign financing requirement for private imports, now at 180 days, to no more than 150 days by March 31, 1983, to no more than 120 days by June 30, 1983, and to no more than 90 days by September 30, 1983, and it will eliminate this requirement entirely by December 31, 1983.

7. During 1983 and through April 1984, the Government will not introduce or modify any multiple currency practice with the following exceptions: (a) any modification in a multiple currency practice which reduces the differential between the effective exchange rate applied for a given transaction and the official buying or selling rate for the peso in the unified exchange market; and (b) pending the completion of the review mentioned in paragraph 6 above, the continued operation of the existing system of export rebates within the existing range of rates, including the reclassification of exports within that range of rates.

8. All external payments arrears will be eliminated as quickly as possible and, in any event, by June 30, 1983. Once eliminated, foreign exchange will be provided freely at the official exchange rate for all bona fide current international payments. However, reasonable limits may be applied on the automatic allocation of foreign exchange for foreign travel and remittances in order to prevent disguised capital outflows.

9. The Government intends to initiate shortly discussions with its foreign creditors with a view to achieving a restructuring of Argentina's external public and private debt that would produce an amortization profile attuned to Argentina's repayment capacity.

Sincerely yours,

Julio Gonzalez del Solar
President of the Central Bank
of the Republic of Argentina

Jorge Wehbe
Minister of Economy

Table 1. Argentina: Net International Reserves as of September 30, 1982

(In millions of U.S. dollars)

<u>Assets</u>	<u>3,304</u>
Gold <u>1/</u>	185
Foreign exchange	421
ALADI	140
Investment realizable in foreign exchange	2,310
SDRs	--
IMF reserve position	248
<u>Liabilities</u>	<u>5,005</u>
ALADI	62
Liabilities to IMF	--
Arrears	1,709
Swaps	1,156
BONEX against pesos <u>2/</u>	1,464
Reserve loans from residents <u>3/</u>	141
Other external obligations of the Central Bank in foreign currencies	473
<u>Net international reserves</u>	<u>-1,701</u>

1/ Valued at US\$42 per fine troy ounce.

2/ Excludes external bonds issued against pesos in settlement of exchange guarantees issued by the Central Bank.

3/ External obligations of residents, the foreign currency proceeds of which were surrendered to the Central Bank without the borrowing entity receiving the counterpart in peso financing.

Table 2. Argentina: Selected List of Public Enterprises

Y.P.F.	Yacimientos Petroliferos Fiscales
Y.C.F.	Yacimientos Carboniferos Fiscales
Gas del Estado	
AyE.E.	Agua y Energia Electrica
SEGBA	Servicios Electricos de Gran Buenos Aires
HIDRONOR	
F.A.	Ferrocarriles Argentinos
A.A.	Aerolineas Argentinas
ENTel	Empresa Nacional de Telecomunicaciones
ENCOTel	Empresa Nacional de Correos y Telegrafos
A.T.C.	Argentina Television Color
ELMA	Empresa de Lineas Maritimas Argentinas
A.G.P.	Administracion General de Puertos
YACYRETA	
Salto Grande	
COMIP	Comision Mixta Argentina Paraguaya
AFNE	Astilleros y Fabricas Navales del Estado
P.B.B.	Petroquímica Bahía Blanca
O.S.N.	Obras Sanitarias de la Nacion
YMAD	Yacimientos Mineros Aguas de Dionisio