

EBS/67/88  
Supplement 1

CONFIDENTIAL

May 1, 1967

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 with Argentina agreed at Meeting 67/28, May 1, 1967.

Att: (1)

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Stand-By Arrangement - Argentina

1. Annexed hereto is a letter dated March 13, 1967 from the Minister of Economy and the President of the Central Bank of the Republic of Argentina, which sets forth the policies and intentions which the authorities of Argentina will pursue.
2. In consideration of the policies and intentions set forth in the annexed letter, the International Monetary Fund agrees to a stand-by arrangement in support of these policies and intentions.
3. Argentina and the Fund will remain in close consultation during the period the stand-by arrangement is in effect. This consultation may take the form of correspondence and visits of officials of the Fund to Argentina or of representatives of Argentina to Washington, D.C. In addition, Argentina will keep the Fund informed of developments in the exchange, trade, credit, and fiscal situation through reports at intervals or dates requested by the Fund during the period the stand-by arrangement is in effect.
4. For a period of one year from May 1, 1967 Argentina will have the right to purchase from the Fund the currencies of other members in exchange for its own currency in an amount equivalent to \$125 million, provided that purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of \$50 million in the first four months, the equivalent of \$75 million in the first eight months, and the equivalent of \$100 million in the first ten months. The amounts prescribed in this paragraph 4 shall be augmented by amounts equivalent to repurchases in respect of purchases under the stand-by arrangement, unless when any such repurchase is made, Argentina informs the Fund that it does not wish the stand-by arrangement to be augmented by the amount of that repurchase. The right of Argentina to make purchases under this stand-by arrangement shall, to the extent that such purchases would increase the Fund's holdings of Argentine pesos above the level of the quota of Argentina, be subject to paragraph 6 below.
5. Argentina will pay charges for this stand-by arrangement in accordance with the decisions of the Fund of December 23, 1953, April 27 1959, and May 23, 1962.
6. During any period of the stand-by arrangement in which (i) the data as of the end of the last applicable calendar quarter show that the minimum goal for fiscal performance set forth in paragraph 5 of the annexed letter is not met; or (ii) the data as of the end of 1967 show that the minimum goal for balance of payments performance set forth in paragraph 15 of the said letter is not met; or (iii) the ceilings on net Central Bank credit to the Treasury, or the ceilings on the net domestic credit of the Central Bank or the limits on the public sector's use of

foreign suppliers' credits as set forth in paragraphs 6, 10, 11, and 19 of the said letter are exceeded, or (iv) the provisions of paragraphs 11 and 12 of the said letter relating to the reserve requirements applied to the deposit liabilities of the commercial banks are not fully complied with, Argentina will not request any further drawings under the stand-by arrangement, except after consulting with the Fund and agreeing with it on the terms on which any further drawings may be made. Moreover, if at any time during the period of the stand-by arrangement new restrictions are imposed on the making of payments and transfers for current international transactions or a unified exchange rate is not maintained, or if, prior to December 31, 1967, agreement has not been reached on the ceilings, targets, and goals referred to in paragraph 20 of the said letter, Argentina will not request any further drawings under the stand-by arrangement, except after consulting with the Fund and agreeing with it on the terms on which further drawings may be made.

7. Subject to paragraph 4 above, Argentina will have the right to engage in transactions covered by this stand-by arrangement without further review by the Fund. This right 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 (under Article XVI, Section 1(a)(ii)) or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or 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 7, purchases under the stand-by arrangement will be resumed only after consultation has taken place between the Fund and Argentina and agreement has been reached on the terms for the resumption of such purchases.

8. Not later than three years after each purchase of exchange by Argentina under this stand-by arrangement, Argentina will repurchase an equivalent amount of Argentine pesos from the Fund; provided that if the Argentine pesos held by the Fund as a result of the transactions under the stand-by arrangement are reduced by repurchases under Article V, Section 7, or otherwise, such reduction shall be credited against the earliest amounts that become payable under this paragraph 8. Repurchases shall be made in gold or convertible currencies acceptable to the Fund in accordance with the Fund's decision of July 20, 1962.

9. The rate of exchange at which Argentina will purchase currencies from the Fund in exchange for Argentine pesos and at which the Fund will return Argentine pesos in repurchase operations and make all other computations involving Argentine pesos will be such rate as the Fund may from time to time determine under Article IV, Section 8, of the Fund Agreement.

Buenos Aires, March 13, 1967

Mr. Pierre-Paul Schweitzer  
Managing Director  
International Monetary Fund  
19th and H Streets, N.W.  
Washington, D.C. 20431

Dear Mr. Schweitzer:

1. The Government of Argentina has embarked upon an economic and financial program that aims at bringing a halt to inflation, thereby laying the bases for sound long-term economic growth. After a long period of substantial inflation there is a broad consensus about the undesirable effects of such a process, and the authorities are convinced that the attainment of financial stability is a necessary condition for achieving an adequate rate of growth and improving the over-all efficiency of the economy. The program aims at a better allocation of resources through the transfer of human and other economic resources from low-productivity to high-productivity sectors, the execution of a sound fiscal policy, and a reduction of excessive protection in the foreign sector. One of the crucial ingredients of the program is an increase in the rate of investment, both in the public and the private sectors, and the elimination of the existing distortions in their structure and allocation. In this connection, the authorities believe that both internal and external saving will be forthcoming to provide for a substantial increase in investment as soon as reasonable expectations about internal financial stability are obtained. While they believe that most of the effort must and should be internal, external assistance and support will enhance the prospects of achieving success in their endeavors. In this respect, we consider it important to be able to count on the technical and financial cooperation of the Fund in our efforts, and therefore we turn to you to request, on the basis of the program described below, a one-year stand-by arrangement for \$125 million. The Central Bank will discuss with you the currencies to be purchased prior to any drawing under the requested stand-by arrangement.

#### Public sector policies

2. For many years the weak performance of the public sector has hampered the efforts to stimulate Argentina's economic growth and it has been responsible in large measure for the high rate of inflation that has affected adversely both the volume and allocation of the country's saving. The authorities are taking steps to reduce substantially the size of the fiscal deficit, but our aim is to go far beyond the financial aspects of public sector policy, inasmuch as we are fully convinced that the costs borne by the Argentine community for the public

services rendered are too high. We believe that the achievement of a sounder financial position for the public sector must be accompanied by, and in large measure depends upon, an improvement in the efficiency of the public sector. To attain these twin objectives we have (1) increased the rates charged by public service and government enterprises to economic levels, (2) adopted a series of measures to raise fiscal revenues, (3) established machinery for improving control over public sector wages, (4) pared drastically less essential or postponable expenditures, and (5) implemented plans designed to improve the operating efficiency of the public sector enterprises. In some cases our view is that the problems of the public sector can be solved only by transferring some activities to the private sector. In the petroleum field, for example, a new law will be enacted opening the field to private capital, thereby ensuring more rapid development of our potential in this area. More generally, the problem we face in the public sector is one of excess personnel, usually rather poorly paid, and providing services at a relatively high cost. It is our intention to move as swiftly as possible to transfer the excess personnel to higher productivity activities in the private sector. To smooth this process, the Government is establishing a Fund for Training and Re-employment which will be financed from the resources released by the reduction in personnel in the public enterprises. Because of the costs arising from the policy of shifting labor in an orderly fashion, the improvement in the financial performance of the public sector will be comparatively smaller than the gain in efficiency in 1967, but it is anticipated that the benefits in future years will be substantial.

3. More specifically on the public enterprises, the authorities have given them a framework--consisting of realistic prices, a centralized wage policy, and a specified amount of assistance from the Treasury--in which to carry out adjustments designed to raise efficiency. Regarding transfers to the enterprises from the Treasury, the ceilings that have been placed will limit the total to M\$N 105 billion in 1967, compared with M\$N 106 billion last year--a reduction of more than 20 per cent in real terms. Most important in this respect is the performance of the railroads, which are to receive about two thirds of the total transfers to state enterprises budgeted for 1967. Railway tariffs were recently increased on average by 66 per cent, and a new set of work rules designed to improve productivity and efficiency, resulting in a significant reduction in the number of workers needed, is being implemented. While the wage settlement has not yet been agreed, it is expected that it will be consistent with the plan to reduce the railway's reliance on financial assistance from the Treasury. In addition, public utility rates and charges for government services--including those for electricity, gas, water, and postal services--were recently raised to economic levels. The authorities recognize that the state enterprises will have to make major efforts to raise efficiency in order to meet the financial targets of the over-all program, but they believe that the goals established are not unreasonable. In the event that certain enterprises encounter financial difficulties despite an adequate effort to effect improvements in their operating efficiency, additional price increases will be

considered on a case-by-case basis. However, the authorities have made it clear to the managers of the enterprises that price increases will not be awarded in those cases where the evidence indicates that the pace of administrative reforms of the entity under considerations has not come up to the standard expected.

4. Regarding the National Government's budgetary program for 1967, the plan is to limit the fiscal deficit to M\$N 75 billion, compared with M\$N 148 billion in 1966. Put in another way, the deficit is projected to decline from about one third of total expenditures in 1966, to a ratio of less than one seventh this year. On the basis of the implementation of a firm wage policy and a reduction in transfers to the state enterprises, as was indicated above, the National Government's expenditures are programed to rise by only 22 per cent in 1967, which would mean that they would remain virtually constant in real terms. Revenues, on the other hand, are projected to increase sharply, by nearly 60 per cent, reflecting the tax measures being implemented. Important among the tax increases are the export taxes on the traditional export products, a new property tax, and a tax on bank credits.

5. As was indicated above, the plan is to limit the fiscal deficit in 1967 to M\$N 75 billion, and in executing this program it is the intention of the authorities that the deficit not exceed M\$N 50 billion prior to June 30, 1967; M\$N 60 billion prior to September 30, 1967; and M\$N 75 billion prior to December 31, 1967. If by the end of the first semester of 1967 the trends indicate that the deficit will rise above the limits indicated, either because of a shortfall in revenues or an increase in expenditures to a level above the amount now programed, the authorities will act promptly to increase revenues. New revenue measures could be implemented quickly and could yield a substantial increase in receipts if these should be needed. In managing the fiscal program, the authorities will not allow lags to develop in the payment of wages, and they will try to avoid having to reduce investment spending below the amount planned.

6. While the fiscal program calls for a reduction in the deficit of about 50 per cent from 1966 to 1967, the existence of heavy foreign debt service payments falling due this year means that the decline in financing needed from the Central Bank will be much less steep. The fiscal plan envisages Central Bank financing for the Treasury in the amount of M\$N 80 billion in 1967, compared with M\$N 99 billion last year. Allowing for seasonal variations in revenues and expenditures and taking into account the timing of receipts from the new taxes, net Central Bank credit to the Treasury (which stood at M\$N 335 billion at the end of 1966) will not exceed M\$N 390 billion during the second quarter of 1967; M\$N 400 billion during the third quarter of 1967; and M\$N 415 billion during the fourth quarter of 1967.

7. The Argentine authorities believe that the measures now being implemented will result in a sharp improvement in the public finances by next year, particularly as regards the reliance of the state enterprises on assistance from the Treasury. Moreover, it is anticipated that the intensification of efforts to improve tax administration will lead to a substantial increase in revenues. The authorities also intend to initiate work on a major tax reform designed to raise revenues, stimulate growth, and promote equity. One phase of this reform, involving the conversion of the present sales and excise taxes into taxes on value added, may be completed before the end of this year. The authorities believe that implementation of the series of measures described above will enable them gradually to reduce the reliance on export taxes.

Wage and price policies

8. The program of halting inflation depends critically on bringing the rate of increase of wages under much stricter control. In accordance with this objective, the Government is presently implementing a policy of limiting the annual wage increase for employees in the public sector to 15 per cent, and the budget for 1967 has been prepared on this basis. While this policy is serving to moderate the size of wage settlements, the authorities believe, however, that additional action is required on the wage front in order to ensure the success of the stabilization program, and they are therefore considering a general readjustment of wages, consistent with the over-all financial program, that could be expected to endure for a period of more than one year, beginning approximately in the middle of 1967.

9. Regarding pricing policies, the authorities have, as was indicated above, taken action to raise the prices charged by the public sector enterprises to economic levels. For most other prices, the policy of the Government is to allow them to be determined freely in the market, relying on wage policy, the reductions in import duties described below, and control over aggregate demand through credit and fiscal measures to reduce the rate of price increases during the coming year.

Credit policy

10. The Central Bank's credit plan for 1967 is designed to be compatible with a slowing down of the rate of inflation and the achievement of a sound balance of payments performance. In accordance with these objectives, limits, which take account of seasonal variation, have been established on the net domestic credit operations of the Central Bank. Net domestic credit will not exceed M\$N 508 billion during the second quarter of 1967; M\$N 528 billion during the third quarter of 1967; and M\$N 553 billion during the fourth quarter of 1967.

11. The credit program of the Central Bank is based on the reserve requirements against commercial bank deposit liabilities not being reduced below their present levels. It is the intention of the authorities to enforce these requirements fully--applying the established sanctions in the event of departures--and, moreover, in the event that

net reserve deficiencies rise above the amount registered in the month of December 1966, the excess will be considered as part of credit subject to the ceilings of the Central Bank described in the previous paragraph.

12. The authorities believe that the present system of reserve requirements is unduly complex, thereby contributing to inefficiencies in the operation of the banking system, and they have therefore initiated studies to determine how the system should be simplified. Because a change in the system of reserve requirements could have an impact not foreseen in the credit program described above, the authorities will consult with the Managing Director of the Fund prior to making any changes in the system that involve lowering any of the existing cash reserve requirements.

13. The authorities are not satisfied that the present regime of ceilings on the interest rates that may be charged and paid by the commercial banks is appropriate for promoting an efficient allocation of resources and a healthy development of the economy. As a consequence of these interest rate ceilings, the competitive position of the commercial banks vis-à-vis other financial institutions has deteriorated, and the process of channeling saving into investment has become less efficient. A large part of this problem will, of course, disappear once the rate of inflation has been reduced substantially, but even then it would appear useful to introduce more flexibility into the interest rate structure of the commercial banking system. The authorities have therefore undertaken to examine this matter with a view to taking action in the near future.

#### Exchange, trade, and foreign debt policies

14. To provide a stimulus for growth and to ensure the achievement of a sound balance of payments performance, the authorities recently adjusted the exchange rate to M\$N 350 per U.S. dollar. This adjustment of the rate has been accompanied by the elimination of virtually all restrictions on payments. It is the intention of the authorities not to impose new restrictions on the making of payments and transfers for current international transactions and to maintain the present unified exchange rate structure, relying rather on broad-gauged financial policies to ensure the maintenance of a satisfactory external position.

15. As part of their over-all financial program the authorities have established a balance of payments target for 1967 calling for an improvement in the net foreign reserves of the monetary authorities (Central Bank and Treasury) of \$100 million. A net gain in foreign reserves of this magnitude will enable the authorities to meet from their own resources a substantial portion of the short-term foreign debt falling due this year.

16. The policy of the Argentine Government will be to maintain a multilateral payments system on a nondiscriminatory basis, and to this end it will not enter into new bilateral payments agreements.



17. While the Argentine authorities are desirous of maintaining a nondiscriminatory commercial policy, they wish to note that the application of restrictive trade practices by some industrial countries that hamper Argentina's traditional exports may force the country to review its position.

18. The recent establishment of a new import tariff regime is an integral part of the Government's plan to improve the allocation of resources in Argentina, and to promote conditions for the development of a sound industrial base. The new tariff schedule provides for a substantial reduction in duties, and in addition it provides for a simplification and rationalization of the tariff structure. The maximum tariff under the new system will be 140 per cent, compared with the general maximum of 325 per cent under the previous schedule; in a few cases tariffs in excess of 325 per cent were being applied prior to the recent change. The authorities plan to effect further reductions in tariffs at some later date--after the impact of the recent adjustment has been absorbed--with a view to bringing domestic costs and prices into line with those prevailing in the international economy. In conjunction with the adoption of a new tariff schedule, most import prohibitions have been removed. The Government has also eliminated all export subsidies.

19. In recent years Argentina has improved the structure of its foreign debt, and it is the intention of the authorities to continue this policy. A major part of the improvement in the debt structure has derived from the improved control over the use of credits from foreign suppliers. The policy that has been adopted by the Government in this field is one of limiting authorizations for new suppliers' credits of less than eight years, in all currencies, for the public sector to the amount of gross amortization of existing suppliers' credits. Within this over-all limit flexibility will be exercised on the terms of the suppliers' credits approved, with the terms being related to the kinds of operations involved. The Central Bank will also establish the regular and prompt reporting of all guarantees by commercial banks of foreign loans to the private sector. Moreover, if the data should indicate that the short-term foreign commitments being undertaken by that sector are excessive, the authorities will take action to regulate them.

20. For the period of the stand-by arrangement remaining after the end of 1967, the Government will consult with the Fund and agree on the fiscal target, the ceiling on Central Bank credit to the Treasury, the ceiling on the net domestic credit of the Central Bank, and the foreign reserve goal.

21. If, in the opinion of the Argentine Government or the Managing Director of the International Monetary Fund, the policies outlined in this letter turn out to be inadequate to achieve the objectives of the program described above, the Government of Argentina will consult with the International Monetary Fund regarding additional measures to be adopted in order to achieve the objectives of the program described above.

Sincerely yours,

/s/  
Adalbert Krieger Vasena  
Minister of Economy

/s/  
Pedro Real, President  
Central Bank of the  
Republic of Argentina