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FOR
AGENDA

EBS/75/463

CONFIDENTIAL

December 12, 1975

To: Members of the Executive Board
From: The Secretary
Subject: Argentina - Use of Fund Resources

Attached is the staff's analysis and recommendation with respect to a request expected to be received from Argentina for a purchase under paragraph (5) of the Decision on Compensatory Financing of Export Fluctuations. The decision proposed by the staff appears on page 3.

This subject has been tentatively scheduled for discussion on Friday, December 19, 1975.

Att: (1)

INTERNATIONAL MONETARY FUND

Argentina - Use of Fund Resources

Prepared by the Research Department and the Western Hemisphere Department

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

Approved by J. J. Polak and J. Del Canto

December 11, 1975

I. Introduction and Decision

The Managing Director has been informed that the Argentine authorities will shortly request a purchase of the equivalent of SDR 110 million under paragraph (5) of the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 1477-(63/8), adopted February 27, 1963, as amended by Executive Board Decision No. 2192-(66/81), adopted September 20, 1966). The request is being made with respect to an export shortfall for the 12-month period ended October 31, 1975.

This paper is being circulated in advance of the formal request from Argentina in order to give the Executive Directors more time to consider the matter.

Argentina's present quota is SDR 440 million and its outstanding purchases total the equivalent of SDR 250.1 million. The latter amount includes a purchase equivalent to SDR 64.0 million in March 1972 under the compensatory financing facility, a gold tranche purchase of SDR 110 million made in June 1975, and a purchase of SDR 76.1 million in November 1975 under the 1975 Oil Facility. The Fund's present holdings of Argentine pesos are at 131.8 per cent of quota including purchases outstanding under the compensatory financing facility and the Oil Facility, and slightly below 100 per cent of quota excluding such purchases. The purchase expected to be requested by the Argentine authorities under the compensatory financing facility is equivalent to 25 per cent of the quota and it requires a waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement.

Argentina is a participant in the Special Drawing Account and has received allocations totaling SDR 152.5 million. Holdings at end-November were SDR 1.1 million, or 0.7 per cent of net cumulative allocation. Since end-November, Argentina has used SDR 0.7 million to pay charges but has acquired SDR 10 million for the purposes of reconstitution. There is currently a need to reconstitute in an amount of SDR 60.3 million and Argentina will be subject to designation in an amount of SDR 20.0 million under Rule P-4 for the quarter commencing January 1, 1976.

Argentina accepted the obligations of Article VIII, Sections 2, 3, and 4, in May 1968. Argentina maintains a dual market system with rates on December 3, 1975 of \$a 55.43 per U.S. dollar (midpoint) in the financial market (trade and trade related transactions) and \$a 78.805 per U.S. dollar (midpoint) in the special financial market (invisibles and other capital). The latter rate is also the representative exchange rate established with the Fund.

The purchase expected to be requested would raise the amount outstanding under the Compensatory Financing Decision to 39.5 per cent of Argentina's quota. As stated in the amended Decision, requests for purchases that would increase purchases outstanding under paragraph (5) beyond 25 per cent of the member's quota will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, when required, appropriate solutions to its balance of payments difficulties. The 1974 Article VIII consultation discussions with Argentina were held in Buenos Aires during the period July 10-12, 1974 and the Staff Report (SM/74/212, 8/27/74) was discussed by the Executive Board at EBM/74/127 (10/16/74). In October 1975, an Argentine delegation visited Washington to discuss with the staff recent economic developments and prospects. Subsequently, a program to strengthen the medium-term balance of payments was presented to the Fund in connection with the recent request for a purchase under the 1975 Oil Facility (EBS/75/376, 10/20/75) involving principally a policy of realistic exchange rates, tax increases, and an incomes policy. During the two months since this program was announced the authorities have continued the policy of frequent changes in the exchange rates adopted in mid-1975 (EBD/75/251, 11/7/1975; EBD/75/265, 11/28/75; EBD/75/267, 12/5/75). Furthermore, on November 21, 1975 the commercial market was eliminated and all transactions previously handled in that market were moved into the more depreciated financial market, where the rate continues to be adjusted from time to time. The fiscal revenue measures described in the program have been somewhat delayed and modified, but the authorities recently have reiterated their intention to go forward with the plan to achieve a substantial increase in taxes. On the other hand, wage increases have been greater than anticipated.

In the present case, the minimum amount of shortfall that could be estimated under the provisions of the existing compensatory financing facility is equivalent to SDR 114.5 million. This amount exceeds the equivalent of 25 per cent of the member's quota (SDR 110 million), which is the amount of the purchase expected to be requested.

The staff considers that the shortfall is largely attributable to circumstances beyond the control of the member. The requirement that the shortfall should be of a short-term character is met by calculation of the shortfall as a deviation from the medium-term trend.

The staff believes that the expected request from Argentina for the purchase of the equivalent of SDR 110 million under the Compensatory Financing Decision will meet all the requirements set forth in that Decision. Accordingly, the following decision is recommended for consideration of the Executive

Directors and adoption after a duly authenticated request for a purchase of the above-mentioned amount under paragraph (5) of the Compensatory Financing Decision has been received:

The Fund has received a request by the Government of Argentina for the purchase of the equivalent of SDR 110 million under paragraph (5) of the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 1477-(63/8), adopted February 27, 1963, as amended by Executive Board Decision No. 2192-(66/81), adopted September 20, 1966). The Fund agrees to the requested purchase and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement on the repurchase terms set forth in the cable to the Fund dated December ___, 1975.

II. The Export Shortfall and the Balance of Payments Situation

1. Estimation of the export shortfall

For the shortfall year ended October 1975, the value of domestic exports from Argentina, at SDR 2,609.5 million, was 17.5 per cent below the peak level earned in the preceding year and 10 per cent less than the annual average in the preceding two years.

Estimation of the export shortfall on the basis of explicit export projections for commodities is not deemed necessary in the present case. Use of the lower limit of the permitted range for export forecasts (as set out on page 8 of the Second Report on Compensatory Financing) would yield an export shortfall equivalent to SDR 114.5 million (Table 1). This amount exceeds 25 per cent of quota (SDR 110 million) which is the amount of the purchase expected to be requested.

Table 1. Argentina: Estimation of Trend and Shortfall in Exports

(In millions of SDRs)

	Years ending October 31			
	1973	1974	1975	1976-77 Average
Exports	2,629.0	3,162.5	2,609.5	2,609.5 ^{1/}
Trend (five-year average)			2,724.0	
Shortfall			114.5	

^{1/} Lower limit of the permitted range for export forecasts, i.e., the value of exports in the shortfall year.

No deductions for double compensation were made in respect of the gold tranche purchase of SDR 110 million made in June 1975 and the purchase of SDR 76.1 million in November 1975, under the 1975 Oil Facility. No deductions for these purchases are required to be made for the reasons given in EBS/75/421 (11/21/75) as regards the gold tranche purchase, and, as regards the purchase under the 1975 Oil Facility, the position has been that purchases under that facility do not give rise to double compensation (EBS/75/247, 7/14/75).

2. Circumstances responsible for the shortfall

Agricultural commodities account for approximately 80 per cent of Argentina's merchandise exports, making the economy vulnerable to short-term influences largely outside its control. Although Argentina exports a wide variety of agricultural commodities, one group, namely, meat and meat products, was mainly responsible for the decline in exports in the shortfall year ended October 31, 1975. The value of exports of meat and meat products fell by SDR 329 million (59 per cent from average earnings in the two preceding years) compared with a net decline of SDR 286 million in total exports (Table 2). Beef exports, which normally account for over two thirds of total meat exports, fell by 75 per cent in value to SDR 84 million, compared with average earnings of SDR 338 million in the pre-shortfall period. The volume of beef shipments fell by 68 per cent while export unit values declined by 26 per cent (Table 3).

Argentine exports of beef, like those of other major exporters (Australia, New Zealand, and Uruguay), were severely disrupted by the virtual closure of the important market in the European Economic Community, which normally accounts for three quarters of annual Argentine shipments, and restrictions on access to other major markets in Canada, Japan, and the United States, through import quotas or voluntary restraints. As a result of the sharp fall in world demand for beef, prices, after reaching peak levels in 1973, fell sharply in 1974 and 1975. Buoyant demand conditions of the early 1970's had encouraged livestock producers in all major producing areas to withhold cattle, particularly breeding stock, in anticipation of higher future prices. However, the rise in feed grain prices began to severely erode producers' incomes and as a result cattle raisers, particularly in North America and the EEC, increased their slaughterings and reduced placements of cattle into feedlots. Livestock and hides and skins also reflected this pattern, and Argentina's earnings from these commodities, as well as from wool, also contributed to the decline in exports in the shortfall year.

Table 2. Argentina: Exports of Major Commodities
(In millions of SDRs)

	Years ended October 31		
	1973	1974	1975
Livestock and related products	973.5	649.3	381.6
Meat and meat products	682.1	433.0	228.6
of which: beef	(471.0)	(204.5)	(84.0)
Livestock	8.6	4.1	1.2
Hides and skins	25.0	9.2	7.7
Leather and leather products	122.9	131.9	78.8
Wool	134.9	71.1	65.3
Grains and grain products	688.4	1,002.7	1,029.1
Wheat	251.7	178.1	268.0
Maize	261.9	480.3	504.4
Sorghum	113.1	247.3	189.0
Other cereals and products	61.7	97.0	67.7
Sugar	71.3	181.7	178.9
Oilseeds, fats and products	209.5	222.4	128.4
Apples and pears	30.2	67.2	83.4
Cotton	--	7.4	14.6
Tea	9.2	11.5	12.4
Metals, machinery, vehicles, and other manufactures	161.3	272.0	159.2
Other exports	485.6	748.3	621.9
Total exports	2,629.0	3,162.5	2,609.5

Source: Central Bank of Argentina.

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Table 3. Argentina: Export Indices for Major Commodities

(1973-74 = 100)

	Value Shares	Years ended October 31								
		Value		Volume		Unit Value				
		1973	1974	1975	1973	1974	1975	1973	1974	1975
Total exports ^{1/}	100.0	94	106	85	110	90	73	84	117	122
Livestock and related products	35.3	124	76	44	132	68	64	91	109	72
Meat and meat products	28.8	122	78	41	131	69	53	90	110	76
Beef	17.4	139	61	25	146	54	32	92	108	74
Canned and cooked beef	5.0	88	112	75	100	100	101	88	112	75
Other meats	6.4	102	98	59	115	85	72	88	112	80
Livestock	0.3	135	65	19	156	44	23	74	126	69
Hides and skins	0.9	146	54	45	137	63	82	111	89	57
Wool	5.3	131	69	63	135	65	123	96	104	51
All other commodities	64.7	78	122	106	98	102	78	79	121	150
Grains and grain products	43.1	81	119	121	98	102	95	82	118	126
Wheat	11.1	117	83	125	147	53	86	67	133	122
Maize	19.5	71	129	136	82	118	108	88	112	129
Sorghum	9.4	63	137	105	74	126	97	88	112	112
Other cereals	3.1	74	126	66	98	102	42	76	124	157
Sugar	6.5	56	144	141	88	112	57	66	134	258
Oilseeds, animal fats and products	8.9	82	118	66	102	98	58	80	120	123
Peanut oil	2.3	78	122	3	104	96	2	74	126	150
Tung oil	0.3	111	89	129	140	59	107	69	131	106
Linseed oil	1.8	60	140	108	111	89	73	52	148	140
Other vegetable oils	1.6	60	140	78	71	129	65	87	113	125
Sunflower meal and cake	1.6	114	86	64	112	88	77	101	99	83
Linseed meal and cake	1.3	100	100	90	105	95	90	95	105	100
Iron and steel products	6.2	72	128	27	104	96	11	68	132	240

Source: Central Bank of Argentina.

^{1/} Average of items listed.

For all other exports as a group, including grains, sugar, fats and oils, and iron and steel, prices on world markets were on the whole favorable during the shortfall year; average export unit values increased by 50 per cent in relation to the average of the two pre-shortfall years. Unfortunately, Argentina was unable to take full advantage of these favorable prices due to lower export availabilities. This applied particularly to wheat, sugar, and iron and steel.

Export earnings from cereals, by far the most important subgroup, increased by about SDR 184 million (21 per cent) from the average earnings of SDR 845 million in the pre-shortfall period. The rise in the value of these exports was primarily due to higher unit values for all cereals. Except for maize, shipments of most cereals were generally lower than the average of the two pre-shortfall years, reflecting the unfavorable growing conditions of 1974/75. Yields of major grains (wheat, maize, and sorghum) declined by 15 to 24 per cent from the excellent results of a year earlier. Wheat acreage in 1974/75 had actually increased by 20 per cent from that of the previous year.

Sugar exports in the year ended October 1975 rose by SDR 52 million (41 per cent) from the average in the preceding two years. The rise was entirely attributable to a sharp increase in export unit values as shipments declined by 43 per cent. Despite an increase of 18 per cent in the area under sugar cultivation, output in 1974/75 was 9 per cent below that of a year earlier. This decline, together with an increase in domestic consumption, reduced export availabilities of sugar in the shortfall year.

Export earnings from oilseeds, animal fats and products were about 34 per cent lower than in the pre-shortfall period. Except for tung oil, shipments of other oils, meal and cake were lower, partly on account of increased domestic use of linseed cake and other products for animal feed. Export unit values for sunflower meal and cake declined by 17 per cent from the average of the pre-shortfall period while most other unit values were higher on balance.

Argentine exports of metals, machinery, iron and steel products, and other manufactures, were lower, reflecting partly excess domestic demand and partly an unfavorable exchange rate which reduced the profitability of exporting these items. The exchange rate was held constant from the end of 1972 until March 1975 despite the continued rise in domestic prices.

In summary, the export shortfall in the year ended October 1975 was largely attributable to the sharp decline in exports of meat and related products, which in turn reflected restrictions imposed by major beef importers, particularly the EEC. Higher unit values for most other agricultural commodities were generally offset by lower shipments reflecting partly the relatively poor crops of 1974/75. In view of these developments, the staff believes that the shortfall was largely attributable to circumstances beyond the control of the member.

3. Balance of payments position

Recent balance of payments developments were summarized in the paper accompanying the request for a purchase under the Oil Facility (EBS/75/376, 10/20/75). After registering a substantial overall surplus during the 18 months from the beginning of 1973 to mid-1974, Argentina's balance of payments position has deteriorated dramatically in the past 15 months. Exports leveled off in the second half of 1974 and have declined during 1975, as explained in the previous section, while imports rose sharply reflecting buoyant domestic demand, an overvalued peso, and rapid increases in import prices. In the 12 months ended June 1975 the current account shifted to a deficit of almost SDR 900 million from a surplus of over SDR 550 million in the preceding 12 months; and the overall deficit was close to SDR 1 billion as against a surplus of almost SDR 900 million in the earlier period.

Despite the substantial depreciation of the peso during 1975 and government efforts to clamp down on imports and to secure large-scale foreign loans, gross foreign reserves have remained low and net reserves have continued to decline during the second half of 1975. At the end of October, gross reserves totaled SDR 356 million as compared with a peak of SDR 1,536 million in June 1974; net reserves in October 1975 were minus SDR 313 million, a decline of SDR 788 million since the beginning of the year.