



INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND

SEP 20 1977

Gentlemen:

I am enclosing herewith the text of the stand-by arrangement for Argentina approved by the Executive Board on September 16, 1977.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Dhruba Gupta".

Dhruba Gupta
Assistant Chief, Operations Division

Enclosure

Banco Central de la Republica Argentina
Buenos Aires
Argentina

September 19, 1977 21

Stand-By Arrangement - Argentina

1. Annexed hereto is a letter dated August 22, 1977 from the Minister of Economy of Argentina and the President of the Central Bank of Argentina, together with a memorandum setting forth the objectives and policies which the Government of Argentina will pursue.

2. The International Monetary Fund grants this stand-by arrangement to support these objectives and policies.

3. Argentina will remain in close consultation with the Fund during the period of the stand-by arrangement and, in particular, will consult with the Fund in accordance with paragraph 6 of the annexed letter and paragraph 6 below. These consultations may include correspondence and visits of officials of the Fund to Argentina or of representatives of Argentina to Washington, D.C. For the purpose of these consultations, 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.

4. For a period of one year from September 16, 1977 Argentina will have the right, after making full use of any gold tranche that it may have, to purchase from the Fund the currencies of other members in exchange for its own currency in an amount equivalent to 159.5 million special drawing rights, provided that (i) purchases under the stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 80 million until January 1, 1978; the equivalent of SDR 105 million until April 1, 1978; and the equivalent of SDR 135 million until July 1, 1978, and (ii) the right of Argentina to make purchases under this stand-by arrangement shall be subject to paragraph 5 below to the extent that such purchases would increase the Fund's holdings of Argentina's currency beyond the first credit tranche. If at any time any limit in (i) above would prevent a purchase under the stand-by arrangement that would not increase the Fund's holdings of Argentina's currency beyond the first credit tranche, the limit will not apply to that purchase. The amounts available in accordance with this paragraph 4 shall be augmented by amounts equivalent to repurchases in respect of purchases under the stand-by arrangement unless, when any 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.

5. During any period of the stand-by arrangement in which (a) the data as of the end of the last preceding calendar quarter show that (i) the limits on the cumulative cash deficit of the Treasury referred to in paragraph 3 of the annexed memorandum have been exceeded; or (ii) the limits on the net domestic assets of the Central Bank referred to in paragraph 4 of the annexed memorandum have been exceeded; or (iii) the targets for the cumulative increase in the net foreign assets of the monetary authorities referred to in paragraph 7 of the annexed memorandum has not been met; or (b) the intentions stated in paragraph 5 of the annexed letter have not been carried out; or (c) with respect to any use of the Fund's resources after December 31, 1977 understandings on limits pursuant to paragraph 4 of the annexed letter have not been reached or the understandings thus reached have not been observed, Argentina will not

request any purchase under the stand-by arrangement which would raise the Fund's holdings of its currency beyond the first credit tranche, except after reaching understandings with the Fund regarding the circumstances in which such purchases may be made.

6. During the period of the stand-by arrangement, Argentina will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of Argentina or whenever the Managing Director requests consultation because any criteria in paragraph 5 above are not being observed, or because he considers that consultation on the program is desirable. In addition, after the period of the stand-by arrangement, and while any Fund holdings of Argentina's currency above the first credit tranche include currency resulting from purchases under this stand-by arrangement, Argentina will consult the Fund from time to time, at the initiative of Argentina or at the request of the Managing Director, concerning Argentina's balance of payments policies.

7. Argentina will pay a charge for this stand-by arrangement in accordance with the decisions of the Fund on charges on stand-by arrangements.

8. Subject to paragraph 4 above, Argentina will have the right to engage in the 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 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 8, purchases under this stand-by 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.

9. Not later than three years after each purchase by Argentina under this arrangement, Argentina will repurchase an outstanding amount of its currency that results from the purchase. Any reductions in Argentina's currency held by the Fund shall reduce the outstanding amounts subject to repurchase under this paragraph 9 in accordance with the principles applied by the Fund for this purpose at the time of the reduction. Repurchases shall be made with assets specified by the Fund at the time of the repurchase in accordance with the policies and procedures of the Fund at the time of the repurchase.

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

Annex to Stand-By Arrangement

Buenos Aires, Argentina

August 22, 1977

Mr. H. Johannes Witteveen
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Witteveen:

1. We are pleased to send you herewith a memorandum describing the main elements of the economic and financial program the Government of Argentina intends to implement during the remainder of 1977. This program is designed to achieve during 1977 a strengthening of the balance of payments and a reduction in the rate of inflation, so as to lay a sound basis for renewed economic growth. The Government of Argentina intends to continue these policies in 1978 and to this end a specific plan will be drawn up later this year.

2. The policies pursued in the past fifteen months have been successful in turning the economy away from a situation of hyper-inflation and in bringing about a dramatic improvement in the balance of payments; nevertheless the effort must be maintained. To support the program described in the attached memorandum, we request a one-year stand-by arrangement from the International Monetary Fund for SDR 159.5 million.

3. The Central Bank of the Argentine Republic will consult with the Managing Director of the Fund on the currencies to be purchased prior to any purchase under the stand-by arrangement.

4. The Government of Argentina will reach understandings with the Fund late this year or early next year on the limits on net domestic credit of the Central Bank and on the deficit of the Treasury for the period of the stand-by arrangement after the end of 1977, as well as for the foreign exchange reserve goals of the monetary authorities.

5. During the period of the stand-by arrangement the Government will not introduce any multiple currency practices, nor introduce new or intensify existing restrictions on the making of payments and transfers for current international transactions, nor introduce new or intensify existing restrictions on imports for balance of payments reasons, nor enter into any new bilateral payments agreements with Fund members.

6. The Government of Argentina believes the policies set forth in the attached memorandum are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for that purpose. Argentina will consult with the Fund, in accordance with the policies of the Fund on such consultations, on the adoption of any measures that may be appropriate.

7. We thank you for the valuable cooperation that you and the staff of the International Monetary Fund have given us.

Sincerely yours,

 /s/
Adolfo C. Diz
President
Central Bank of the
Argentine Republic

 /s/
Jose Alfredo Martinez de Hoz
Minister of Economy

Enclosure: Memorandum of the Government of Argentina on Certain Aspects
of its Economic Policy for 1977.

Memorandum of the Government of Argentina on
Certain Aspects of its Economic Policy for 1977

1. When the new Government took office late in March 1976, Argentina was suffering from acute inflation, a deep economic recession, and a serious deterioration in its balance of payments. The situation called for drastic steps, and a financial plan was promptly formulated and implemented in order to restore internal and external equilibrium and to lay the basis for economic growth. The plan has been implemented with a large measure of success over the past fifteen months. The rate of inflation has slowed down significantly from an annual rate of over 900 per cent to about 120 per cent. Through a rise in revenues and a tight control on expenditures, the central government deficit was cut from the equivalent of 13 per cent of GDP in 1975 to less than 8 per cent in 1976, and declined in the last quarter of 1976 to about 6 per cent of GDP. Improved revenue performance of provincial and municipal governments, and revisions of public utility tariffs, have allowed a reduction of the Treasury's transfers to the rest of the public sector. The rigid system of price controls existing up to March 1976, which had resulted in price distortions as well as scarcity of goods, was dismantled, but surveillance continued to be exercised over those enterprises which have a dominant market position. Simultaneously, the exchange system was gradually liberalized and the exchange markets were unified. The revision of the exchange system, adherence to a flexible exchange rate policy, and pursuit of a realistic agricultural price policy provided a stimulus to both traditional and nontraditional exports. As a result the balance of payments improved, and a near equilibrium in the second half of 1976 was followed by a substantial surplus in the first six months of 1977. Also, outstanding swap operations, which amounted to US\$1.3 billion in June 1976, declined to US\$0.1 billion at the end of June 1977; thus, they were well below our target for that month. Monetary policy was aimed at reaching an equilibrium between supply and demand of financial resources, consistent with the goal of reducing inflation. This task was facilitated by a recovery in the public willingness to hold domestic financial assets, due in considerable part to a policy of maintaining realistic interest rates, and by the cautious credit policies pursued. As a result, net domestic assets of the Central Bank remained well below the targeted level. This process culminated in mid-1977, when the authorities undertook a complete reorganization of the financial system, which will make it possible to meet the financial requirements of the country more efficiently in the future.

2. The following paragraphs describe in broad lines the program for 1977, which is fundamentally aimed at reducing inflation and gradually reactivating the economy. The key elements of such a program would be a substantial reduction of the fiscal deficit, well defined incomes policies, and an appropriate credit program.

3. Although the fiscal disequilibrium is not the only cause of Argentina's high inflation, it is undoubtedly one of the main contributing factors. There is thus a need to urgently (a) improve the efficiency of the public sector, (b) reduce public expenditures, and (c) achieve further

increase in tax revenues. Accordingly, the central government budget for 1977 has been drafted with the intention of reducing the fiscal deficit by about one half in real terms. This objective can only be achieved through a combination of higher revenues and further reductions in real expenditure. Regarding revenues, in addition to the several new tax measures taken in the second half of last year--some of which became effective at the beginning of this year--and the tax measures introduced early this year, the Government has recently decreed a tax amnesty, which would allow individuals to regularize their fiscal position. Parallel to these measures, significant efforts have been, and will continue to be, made to increase the yield of existing taxes--particularly of the value added tax--by drastically reducing fiscal evasion. All these measures should together yield additional revenues for the Central Government equivalent to about 1.5 per cent of GDP, after excluding the share of these revenues to be distributed to local governments and to special earmarked funds. Given the magnitude and complexity of public expenditure, a drastic reduction in it may be achieved only over several years. Nevertheless, the 1977 central government budget envisages a reduction in the ratio of expenditure to GDP equivalent to over 2.5 percentage points of GDP, to be attained through a tight control of direct outlays of the Central Administration and a reduction in transfers to the rest of the public sector. The latter will result from higher revenues of local governments and efforts made to improve the performance of state enterprises. During the remainder of the year, we shall monitor continuously the yield from the different taxes and in the event that it should fall short of our targets, we shall adopt promptly additional measures, with regard either to revenues or expenditures, so as to compensate for the shortfall. On the basis of the available figures for the first six months, the central government deficit was below the budget target, and the Government expects that the deficit of the Treasury for 1977 (excluding from revenue net internal and external borrowing) will not exceed \$a 736 billion on December 31, 1977.

4. The monetary and credit program for the second half of 1977 is designed to be compatible with the desired slowdown of inflation. The maintenance of interest rates at realistic levels, together with the expected decline in inflationary expectations, should bring about a further real increase in demand for private sector financial assets. Moreover, as a result of its recent reorganization, the financial system will be more efficient and in a better position to finance the credit requirements of the economy, while the ability of the Central Bank to control monetary aggregates will be strengthened. Limits have been established for bank credit to the Treasury and to the major public entities and to the private sector, and through the use of newly reintroduced legal reserve requirements the Central Bank will make sure that the overall credit expansion will be consistent with the public's expected demand for financial resources, and the desired inflation and balance of payments targets. Under this plan, net domestic assets of the Central Bank (defined as currency issue minus net foreign assets), which were \$a 670 billion on June 30, 1977, will not exceed \$a 1,219 billion on December 31, 1977.

5. The Government is committed to a policy of allowing prices to be freely determined, so as to assure a more efficient functioning of the Argentine economy. In this context, the recent control measures were temporary, and aimed at cooling off inflationary expectations. At present, surveillance is exercised over those enterprises which have a dominant market position. This system is being gradually liberalized as adequate market competition, whether internal or external, is established. In this connection, import tariffs are being gradually lowered in order to allow a role for foreign competition in price determination. During 1977 it is our goal to continue to reduce the rate of inflation. As for wage policy, periodic adjustments have been granted, but the Government believes that a permanent improvement of the purchasing power of salaries will have to depend upon a lower rate of inflation and on the increase of production and productivity.

6. It is our intention to eliminate the remaining exchange restrictions and multiple currency practice subject to Fund approval before the end of 1977. The Government intends to continue the policy of gradually adjusting the exchange rate to reflect, inter alia, the differential increases in foreign and domestic costs. The highest export rebates will not be increased over present levels, while the other rebates will not be increased significantly.

7. Balance of payments prospects for the year as a whole are favorable. During the first half of the year, net international reserves increased sharply as a result of a strong export performance, led by a record volume of wheat sales and generally high exports of other traditional items, as well as manufactured goods. For the remainder of the year, exports are expected to continue at a satisfactory rate, reflecting in part a continuation of the flexible exchange rate policy being pursued by the authorities. However, since the bulk of cereal exports have already taken place in the first half of the year, and the pace of imports should pick up as economic recovery occurs and public sector investment materializes, no substantial change in reserves is foreseen during the second half. This forecast includes foreign borrowing by the private sector, an item which is difficult to project and lies outside the control of public sector borrowing discussed in paragraph 8. Accordingly, the cumulative increase (from the end of 1976) in net foreign assets of the monetary authorities will be no less than US\$534 million on December 31, 1977. Beyond the end of the year, balance of payments prospects will depend upon the export performance and on imports which are likely to continue to grow because of the expected recovery in investment and output and the continued liberalization of imports.

8. The Government attaches great importance to the control of the external debt of the public sector. The legal basis of a system for exercising firm control over the authorization of new external indebtedness by the public sector was reaffirmed by a Presidential instruction issued at the end of February 1977, stating that all borrowing by the public sector will require prior approval of the Ministry of Economy and of the Central Bank. Such a mechanism has been established and it is in operation. The Ministry of Economy and the Central Bank have established annual foreign borrowing guidelines for the public sector to be consistent with the foreign borrowing

capacity of Argentina and of the public sector, as well as with the investment programs authorized by the Government. As a result of this control, together with the rapid increase in exports, total public sector debt, as well as its related debt service payments, has been falling substantially in relation to exports of goods and services during 1977. At the same time, because of policies designed to eliminate the use of swap arrangements with the Central Bank, as well as general financial and exchange policies, total private sector external indebtedness has fallen in absolute terms.

9. For 1978, the Government intends to continue its program for sustained economic growth, further reduction in inflation, and the maintenance of a sound balance of payments position.