FOR
AGENDA

EBS/91/107

CONFIDENTIAL

June 28, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Request for Stand-By Arrangement - Letter of Intent

Attached for consideration by the Executive Directors is a letter from the Argentine authorities for a stand-by arrangement equivalent to SDR 780 million, together with a memorandum on economic policy. The staff paper describing and analyzing the economic program will be issued shortly.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Linde (ext. 8500) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Ministerio de Economía
y Obras y Servicios Públicos
Buenos Aires, Argentina
June 28, 1991

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

The attached Memorandum on Economic Policy contains a description of the economic policies the Government of Argentina intends to follow in the period through June 1992. The policies are aimed at securing low inflation and a viable external payments position with a view to creating the conditions for the sustained growth of output and employment.

The Government of Argentina would like to obtain the support of the International Monetary Fund for its economic program, and it hereby requests a stand-by arrangement for the period through June 1992 in the amount of SDR 780 million.

Discussions with Argentina's commercial bank creditors are continuing on ways to achieve market-based debt and debt service reduction which is considered essential for the restoration of medium-term viability of the balance of payments. The Government requests that 25 percent of each of the four purchases that would become available under the proposed arrangement be set aside for debt-reduction operations.

On the basis of the successful implementation of the current economic program, it is the intention of the Government to seek an extended arrangement with the Fund which would have as its objective the continuation and deepening of the structural reforms described in the attached memorandum.

An increase in minimum pension benefit levels, announced in June, is to be applied in July conditional upon approval of matching revenue measures by Congress. Draft legislation has been submitted to Congress to raise the VAT from 16 percent to 18 percent to cover two thirds of the cost of the additional social security benefits. Additional legislation will be submitted to Congress shortly to cover the remaining one third of these costs through a property tax in the federal district of Buenos Aires, through an increase in the statistical tax on foreign trade transactions, or through equivalent measures. These measures to cover the increase in social security benefits, if granted, will be in place before the proposed stand-by arrangement is to be discussed by the Executive Board.

The Government of Argentina believes that the policies described in the attached memorandum are adequate to achieve the objectives of its economic program but stands ready to take any additional measures that may be appropriate for this purpose. The Government will review with the Fund before the end of November 1991 the progress made in the implementation of the program.

Sincerely,

/S/
Roque B. Fernández
President of the
Central Bank of the Argentine Republic

/S/
Domingo F. Cavallo
Minister of Economy

Argentina: Memorandum on Economic Policy

1. The present Administration took office in the midst of a severe economic crisis in mid-1989. To overcome the difficulties faced by the Argentine economy, a broad program of economic adjustment and structural change was launched. Since that time considerable progress has been achieved on both fronts. The rate of price increase, which had reached hyperinflationary levels in mid-1989, slowed to an annual rate of about 100 percent in the last three months of 1990. A substantial accumulation of international reserves occurred as a result of remonetization. During most of 1990, central bank credit policy was tightened and considerable progress was made in improving the fiscal stance, as the primary balance of the nonfinancial public sector shifted from a deficit of 0.2 percent of GDP in 1989 to a surplus of 2.2 percent in 1990 (including 0.5 percent of GDP in sales of assets). Also, in 1990 there was a bottoming out of the two-year decline in economic activity. However, progress in dealing with imbalances was interrupted by episodes of instability in early 1990 and in early 1991, marked by the return of very high rates of inflation and unsettled foreign exchange markets. These episodes show the vulnerability of the economy to shifts in confidence and underscore the importance of maintaining consistency and steadiness in the application of economic policies in order to preserve the hard-won benefits of the Government's adjustment efforts.

2. The most recent of these episodes began toward the end of 1990 with a deterioration in the finances of the social security system and of provincial governments. This was compounded by a run on deposits of the provincial banks which had been lending heavily to provincial governments. In this situation the Central Bank expanded credit to finance year-end benefits of the social security system and to stabilize the provincial banks. As a consequence there was considerable downward pressure on the austral and a sizable loss of international reserves that began in late December. Inflation, which had been declining steadily since September, accelerated sharply in January and February 1991.

3. The Government acted to stabilize the economic situation by taking steps to strengthen the fiscal stance. Corrective price increases for public utilities and a boost in fuel excise taxes were introduced in February 1991. A package of tax measures was approved by Congress authorizing a small increase in the value-added tax, a doubling of the tax on assets, and an increase in the tax on bank drafts and on foreign exchange transactions. Adjustments to public sector wages and pensions and social security benefits were kept quite modest, consistent with the aim of promptly slowing inflation. In view of the high rate of price increase in February and a smaller but still substantial price increase in March, it was decided to grant a further adjustment to public sector wages and pensions but then to freeze them at this level for the remainder of 1991. Social security benefits also were adjusted further at this time.

4. While these corrective measures were taking hold, the Government set out to develop a broader framework for economic policy to consolidate the progress made in checking inflation and to lay the foundation for a longer term correction of the economy's problems. This strategy relies principally on a lasting improvement of fiscal policies, including the streamlining of the tax system and strengthening of tax administration. Accordingly, the Government designed a package of measures to break quickly and effectively the momentum of inflation and to build confidence in the Government's commitment to stabilization.

5. On March 27, 1991 the Congress approved a law as part of an economic program that established full convertibility of the austral at ₳ 10,000 per U.S. dollar, requiring the Central Bank to back fully the monetary base with foreign exchange reserves valued at market prices, and prohibiting all indexation of austral-denominated contracts. The backing of the monetary base with foreign exchange and the maintenance of strict control on central bank credit is to limit monetary expansion and, together with the further opening of the economy, should help reduce the inflation rate to international levels. To reactivate the economy, these policies would be reinforced by a broadening of the program of structural reform aimed at promoting greater efficiency in resource use and flexibility in the economy.

6. The initial results under the program were encouraging. Price increases as measured by the CPI declined from 27 percent in February to 7 percent in March, 5 1/2 percent in April, and 2 3/4 percent in May. Measured by the WPI, the rate of price increase declined from 37 percent in February to 0.4 percent in March, 1.4 percent in April, and 1.1 percent in May. Interest rates dropped in line with receding inflation. The primary balance of the nonfinancial public sector before asset sales shifted from a deficit of US$364 million in the first quarter of 1991 to an estimated surplus of US$238 million in the second quarter. Asset sales were US$299 million in the first quarter and US$333 million in the second quarter. After a very sharp fall, the index of industrial production rose by 5 percent in April and 7 percent in May, and confidence in the program has been signaled by a rise in the stock market index and in the secondary market value of dollar-denominated government bonds (BONEX). Central bank purchases of foreign exchange have totaled about US$900 million in the second quarter.

7. As the centerpiece of the adjustment program, fiscal policy is designed to produce a primary surplus of US$4.9 billion, including US$1.7 billion of capital revenue, during the 12 months ending June 1992. This would be sufficient to meet planned net debt servicing requirements and to permit a part of capital revenues associated with asset sales under the privatization program to be used for debt reduction. On this basis, the overall balance of the nonfinancial public sector would shift from a deficit of US$2.3 billion in 1990 (2.3 percent of GDP) to a surplus of US$0.7 billion (0.5 percent of GDP) in the program year. The combined balance of the nonfinancial public sector and the quasi-fiscal losses of the Central Bank would shift from

a deficit of US$3.2 billion (3.1 percent of GDP) to a surplus of US$0.2 billion (0.1 percent of GDP).

8. The Government's long-term strategy is to eliminate taxes with narrow bases and that give rise to distortions, such as the taxes on bank drafts and on foreign exchange transactions, and to concentrate collection efforts on the value-added tax, the income tax, the assets tax, social security taxes, and excise taxes. However, for the short run, a number of tax changes have been introduced with a view to raising revenues. The legislation approved in February 1991 an increase in the tax on bank drafts from 0.3 percent to 1.2 percent, allowing the increment to be deducted against either the VAT or income tax, and an increase in the VAT rate from 15.6 to 16 percent. In a move to improve compliance, the VAT rate for commercial use of utilities (electricity, gas, water, and telephone) was raised to 25 percent, which is expected to induce greater registration of VAT payers so that they may claim deductions for the higher VAT rate included in the price they must pay. The tax on assets was raised from 1 to 2 percent until the end of February 1992, with the increase earmarked to finance expenditure on education (mainly by the provinces). It is envisaged that income tax payments will be permitted to be credited against this tax--the reverse of earlier practice--in order to preserve credit for foreign income taxes paid by foreign firms operating in Argentina. A new tax of 1 1/2 percent was imposed on the transfer of real estate. The tax on most foreign exchange transactions was raised from 0.01 percent to 0.6 percent, with the majority of its revenue earmarked for provincial outlays on education. However, all export taxes were eliminated in March 1991, except those on sunflower seeds and soybeans, which were lowered from 13 percent to 6 percent.

9. The Government has proposed to Congress tax legislation that aims at increasing domestic investment and employment. The current income tax would be suspended for ten years to be replaced by a tax on distributed earnings. This would give firms an important incentive to reinvest profits. To improve social security tax compliance, nonwage remuneration of employees not currently subject to social security withholding would be treated as distributed earnings. This would provide an incentive to switch to greater wage remuneration. In addition, this legislation would give the Government the authority to eliminate or lower the rates on a number of taxes, including the tax on bank drafts, the tax on foreign exchange transactions, stamp taxes, and the tax on the transfer of financial instruments. These taxes would be reduced or eliminated only to the extent that this revenue could be replaced by collections from other sources.

10. In June the Government proposed to Congress additional measures to strengthen revenue and to reduce the seasonal concentration of expenditure. (1) The VAT would be raised from 16 percent to 18 percent. The additional revenue would be earmarked for the social security system to cover part of the cost of the boost in the minimum benefit levels that was announced in June to be applied in July, conditional

upon approval of matching revenue measures by Congress. (2) A property tax will be enacted in the Federal District of Buenos Aires similar to those that already exist in the provinces, or alternatively the rate of the statistical tax on foreign trade will be raised. (3) The semi-annual wage bonus (aguinaldo), which because of its size has caused instability in financial markets, would be spread out over the entire year, beginning in December 1991, thus smoothing the unevenness in the Government's financing needs as well as consumer spending patterns.

11. The changes noted in paragraph 8 are expected to increase net revenue by 1.7 percent of GDP on an annual basis. In addition, a substantial increase in revenue from existing taxes is expected from further improvements in tax administration and enforcement as well as from an increase in real GDP which is forecast to be some 5 percent in 1991, following a small decline in 1990. Quantitative limits for the overall fiscal balance (including quasi-fiscal losses of the Central Bank) are set out in Table 1. Also, indicative targets have been established for government revenue and the primary surplus, tax payments, and social security payments of the largest public enterprises and are set out in Table 2.

12. The Government has launched a major effort to improve tax administration with the advice of the Fund's Fiscal Affairs Department. The internal tax office (DGI) has been granted increased authority to close businesses for noncompliance with tax laws. Firms were being closed at a rate of 60 a month in the last quarter of 1990 and the expectation is that under the newly granted authority there will be a substantial increase in the number of closures of noncomplying firms in 1991. Fines for noncompliance with tax laws also have been increased, and the largest taxpayers' actual payments are now being published on a monthly basis. A new law provides that taxpayer audits that reveal unsatisfactory compliance will trigger presumption of similar noncompliance in previous years, unless audits are able to prove otherwise. A satisfactory audit would be taken as an indication of compliance in previous years. Also, a program has been launched to monitor closely the 1,000 largest taxpayers (accounting for 65 percent of domestic tax revenue) and is expected to be expanded to 30,000 taxpayers by the end of 1991 (accounting for 85 percent of domestic tax revenue). A calendar for the implementation of measures to strengthen tax administration is set out in an annex to this memorandum. A specific work program for the DGI has been prepared with the assistance of Fund staff, the implementation of which will be assessed in the context of reviews under the program. To increase compliance, the increase in the tax on bank drafts is made deductible against the VAT or income tax; this will not raise the tax burden of those in compliance with the latter taxes but will obtain revenue on a withholding basis from those who are evading those taxes. The proposed modification of income tax legislation noted above is intended to combat the evasion of social security contributions through the remuneration of employees with nonwage payments. Henceforth, business will pay income tax on fringe benefits which will be considered as distributed earnings. Such benefits will be taxed at a rate of 20 percent compared with the

employer's social security contribution rate of 16 percent. To achieve consistency in public employee remuneration, school teachers will no longer be exempt from the social security tax on part of their salaries. The 5 percent tax on wages destined for the social housing program (FONAVI) will now be earmarked for the social security system. Incorporating this revenue into the social security tax structure will make it possible to exercise greater control over collections. At the same time, the portion of the fuel tax that had been earmarked for the social security system (45 percent of the total fuel tax) will now be directed to FONAVI. Future outlays on social housing will be allocated within the framework of the budgetary appropriation process, while undisbursed funds would be transferred to the Unified Fund (FUCO) to be available to meet financing needs of the Treasury.

13. Efforts are under way to bring about a number of changes in central government operations. In January 1991, a universal "sunset" provision went into effect, withdrawing budgetary authority for all government entities and requiring the submission of new administrative structures. Economic policy-making functions since January have been consolidated in the Ministry of Economy. As of May 1991, the Government had approved new administrative structures, eliminating 97 out of 185 national directorates. Decisions on further changes in the administrative structure are expected to be taken shortly affecting the Ministries of Education, Defense, Justice, and the Secretariat of the Presidency.

14. Central government expenditure levels are to be reduced by the transfer of program functions to provinces in line with the higher level of resources available to them through revenue sharing. The transfer to the provinces of responsibility for secondary education, technical schools, and certain medical facilities and programs is now underway. Some social programs that had been funded through direct budgetary transfers from the Central Government will now be the responsibility of the provinces. These shifts are expected to save the Central Administration US$500 million during the program period. In addition, the portion of the fuel tax formerly allocated to the provinces (about 15 percent of the total fuel tax) will now revert to the Central Government in exchange for the right of provinces to levy their own fuel taxes. The reprogramming of the financing for the FONAVI housing program is expected to result in savings of US$200 million during the program period. Additional expenditure reduction of US$150 million, principally in the areas of atomic energy development and road construction also are envisaged in this period.

15. Certain structural reforms are being undertaken with the support of a loan from the World Bank, involving employment reduction, revision of the public sector salary structure, and introduction of effective budgeting and expenditure controls. Decree No. 2476 of November 1990 established a three-year program for reducing employment in the national administration by some 122,000 positions, or over 20 percent. In January 1991 21,000 contractual employees were released

and by June 1991 42,000 permanent employees had been released. Public sector salary scales, which had been badly compressed, are being reviewed. To provide better work incentives, standards for career streams and for promotion have been established. Also, standard work hours will be enforced. The Government will provide a lump-sum payment to public sector workers being laid off, and will pay the social insurance taxes of low wage workers for one year, thus giving private firms an incentive to hire them.

16. In April 1991 the Cabinet approved a draft law on financial management and expenditure control. The law would establish the Office of the Comptroller General of the Nation which would report to the President of the House of Representatives. The Government would be required to submit to Congress by September 15 each year a budget for the consolidated public sector for the following year consistent with the monetary program of the Central Bank. In addition, directives will be issued by the Ministry of the Economy requiring public enterprises to deposit in the Treasury the local currency counterpart of the foreign exchange needed to make scheduled service payments on the debt incurred by these entities with Paris Club creditors and commercial banks, which has been assumed by the Treasury. With regard to debt owed to multilateral creditors, the financial performance of public enterprises will be closely monitored to ensure that the generation of local currency revenues is sufficient to meet these obligations as well.

17. In addition to the reform of the Central Administration, the Government has adopted a program of reform of the public enterprises and has actively sought to reduce state involvement in the production of goods and services through its privatization program. The privatization of ENTEL (the former state telephone company) and Aerolineas Argentinas and the reorganization of the railroads (Ferrocarriles Argentinos) already have led to a reduction in public enterprise employment of more than 72,000. The privatization of three railway lines would lead to a further reduction of about 15,000 employees. The goal of the present reorganization plan is to reduce public enterprise employment by 82,000 from its level of 254,000 over the course of the next three years. The reductions will include the release of an additional 16,500 individuals by the state oil company (YPF). Total public enterprise employment reduction in 1991 is projected to be approximately 35,000, leading to a saving (net of severance payments) on the order of US$65 million in the year. When the program is concluded, the savings would be US$910 million on a continuing basis. The reorganization of the public enterprises is being undertaken with the technical and financial assistance of the World Bank.

18. In 1990 the Ministry of the Economy initiated measures to oversee the budgets and management practices of the public enterprises. These arrangements have assumed greater importance in 1991 with the dissolution of the Ministry of Public Works and the incorporation of its functions in the Ministry of Economy. In addition, an internal unit reporting to the Minister of Economy has been established to control and

evaluate the operations of the public enterprises and review options for improving accounting and budgetary control mechanisms. It is expected that these steps, in conjunction with the reduction in public enterprise employment and the pickup in economic activity, will result in improved financial performance of this sector in 1991-92.

19. Imbalances in Argentina's social security system have been exerting severe stress on the public finances. Far-reaching and difficult reforms are needed as part of the effort to achieve long-term macroeconomic equilibrium. The system has a very high dependency ratio (almost two beneficiaries for every three contributors) and is unable to meet the legally prescribed salary replacement ratio for retired workers (between 70 and 82 percent of the highest three-year average of adjusted earnings). The system is further burdened by a low retirement age, an aging population, and substantial evasion of social security taxation. The contribution rate needed to fund these benefits would be prohibitively high under present conditions; therefore benefit payments have been held below prescribed levels and in the past additional revenue was channeled to the system through earmarking of several excise taxes (mainly on energy products, public utilities, and tobacco) and by sizable outright transfers from the Central Bank or the Treasury.

20. Studies on the reforms needed in the Social Security System have been undertaken with the help of the World Bank. The most important objective of a reform would be to ensure the provision of an adequate but sustainable level of benefits to the eligible population. In the short run, the Government intends to strengthen the finances of the present system through improvements in the administration of contributions. In June a program was introduced to control the largest firms, which account for over 80 percent of social security contributions. Automatic auditing will take place if contributions fall below 90 percent of the previous month's level. Also cross-checking with the internal revenue service (DGI) will be initiated, beginning with the 690 largest contributors.

21. Provincial government finances have deteriorated over the past ten years. The main elements of this problem have been inefficiency in tax collection and sizable increases in public employment. With respect to the latter, employment in provincial governments and the municipality of Buenos Aires has grown by nearly 50 percent since 1983. The deficits incurred by the provincial governments have been financed largely by the provincial banks using funds borrowed from the Central Bank, by discretionary transfers and programmed transfers from the Central Government, and by increasing arrears on payments for current services from the publicly owned utilities. Extraordinary financing flows such as through central bank credit or discretionary transfers have been eliminated since March 1991, and steps have been instituted to recover the credit extended by the Central Bank. The elimination of these sources of financing has forced the provinces to undertake fiscal reforms and improve expenditure efficiency. The World Bank and IDB are providing technical support to bring about these reforms as well as

project financing to those provinces that achieve budgetary performance targets. At the same time, financial responsibility for various programs including secondary education is being transferred to provinces in line with the expected growth in the revenue base through the provinces' share of national tax revenues.

22. Monetary policy under the current program will be drastically circumscribed. The monetary base must be backed 100 percent by liquid international reserves. It is expected that the strengthening of fiscal policy will contribute to an easing of interest rates in real terms and reduce the crowding out of private spending. Liquid international reserves, which had reached US$6.0 billion in December 1990, declined somewhat in the first quarter of 1991, in part because of a bunching of debt service payments in the early months of the year. A process of remonetization began with the implementation of the present economic program, and with tight credit policies by the end of May the reserve position had been restored to US$6.0 billion, of which gold accounts for US$1.5 billion and cash, foreign exchange deposits abroad, and foreign securities account for US$3.0 billion.

23. It is assumed that money demand will grow in line with nominal income, and because the law of March 27 requires the backing of the monetary base with liquid international reserves, the increase in the monetary base will be essentially reflected in a growth in net international reserves. Limits on the expansion of the net domestic assets of the Central Bank for the program period are set out in Table 1. In order to achieve these limits, the Central Bank will maintain the discipline with provincial banks established at the beginning of the year. At that time four provincial banks which had repeatedly required central bank credit to satisfy clearing obligations were removed from the clearing arrangement until they demonstrated that they could meet their obligations. The Central Bank will enforce existing legal reserve requirements. These requirements remain high and together with considerable inefficiency that exists in the banking system contribute to excessive interest rate spreads, but reserve requirements will only be lowered on the basis of firm evidence of an increased demand for real money balances in order to avoid pressures on prices or the balance of payments.

24. The Central Bank has under way a program to recover the credits it has advanced to the provincial banks. Agreements also are being negotiated with individual provinces to withhold a portion of provincial revenue-sharing for the repayment of provincial liabilities to the Central Bank according to an agreed timetable.

25. In the 1970s the banking industry in Argentina grew considerably. After a retrenchment in the early 1980s, its further evolution was marked by an expansion of the official banks at the expense of private banks, and there was a sharp reduction in the number of nonbank financial intermediaries. High rates of inflation in recent years have masked the real costs of intermediation and inefficiency in

the banking system. This year's abrupt transition to a low rate of price increase has exposed the weaknesses of the system and therefore priority must be given to restructuring and strengthening the banking system.

26. The retail operations of two official banks, the National Development Bank (BANADE) and the National Mortgage Bank (BHN), have been suspended and will undergo a reorganization that will confine them to a narrower range of activities. Similarly, the Banco de la Nación Argentina, the country's largest commercial bank, will undergo a reorganization that will alter its structure and geographic coverage in order to concentrate its activities in agriculture and the small and medium business sectors.

27. Provincial banks, as was noted above, are being required to come into strict compliance with the norms for banking and prudential practices, including legal reserve requirements. Banks that do not conform are faced with exclusion from the clearing arrangement. Since March 1991 provincial banks have received no assistance from the Central Bank and are negotiating agreements to amortize the debts owed to the Central Bank through scheduled deductions from revenue-sharing until such debts are paid in full. The Central Bank is to undergo drastic reorganization. Draft legislation is being discussed with Congress on the revision of the Central Bank Charter that will redefine supervisory responsibilities and establish a separate, financially self-supporting entity to administer a deposit-guarantee program. Nontraditional functions of the Central Bank, including trade financing, are being phased out. Necessary changes in the accounting and internal control systems of the Central Bank are being prepared with technical assistance from the Statistics and Central Banking Departments of the IMF.

28. A crucial element of the Government's economic program is the adoption of full convertibility of the austral at a fixed exchange rate. On January 29, the upper bound was fixed at ₳ 10,000 per U.S. dollar while the lower bound was progressively depreciated to reach ₳ 9,900 on May 31, 1991. There are no restrictions on access to the foreign exchange market, and the rate of increase of costs and prices will need to converge rapidly to that of Argentina's main trading partners for the present policy to succeed.

29. The external current account balance, after improving substantially in 1990 to a surplus of 1 1/2 percent of GDP, is expected to shift to a deficit of 2 percent in 1991. This change would result from a drop in exports of US$1.8 billion as a consequence of a projected decline in Argentina's f.o.b. grain prices of 25 percent including the effects of increased competition from subsidized grain sales in world markets. Imports are expected to rise by US$2.4 billion from exceptionally low levels in 1989-90 as a result of tariff reductions, a pickup in economic activity, and the further opening of the economy. The capital account is expected to improve markedly in 1991 based on stronger inflows of private capital, including direct investment. In

addition, Argentina will request a rescheduling of obligations to Paris Club creditors. It is envisaged that under the program Argentina will continue to make partial payments of interest to commercial banks at the present rate of US$60 million a month, while making further reductions in the outstanding stock of debt through the debt-equity conversion program and other debt reduction operations. Nonrefinanciable arrears of the public sector, other than to commercial banks, are to be eliminated by the end of the program period, in tandem with the projected improvement in the fiscal situation, and quarterly performance criteria for the reduction of these arrears are set out in Table 1.

30. A key component of the Government's economic adjustment program is the further opening of the economy to foreign competition. In addition to fiscal restraint and the fixing of the exchange rate, the exposure of the economy to foreign competition is counted on to help brake inflation. A planned phasing out of export taxes was sharply accelerated in 1991. Export taxes which had averaged 11 percent were, with the exception of those on sunflower seeds and soybeans, eliminated on March 22. The duty rebate scheme was amended in May 1991, resulting in an average rate of 7 percent of f.o.b. value of exports and with the payment made entirely in cash, instead of partly in austral-denominated bonds. In April 1991, the Government eliminated the requirement for exporters to surrender their foreign exchange earnings. Also the Central Bank has discontinued the granting of new export financing and short term export prefinancing. Disbursements based on commitments for such financing will be funded out of collections of maturing claims. The balance outstanding of such credits declined from US$295 million in August 1989 to US$38 million in June 1991 for export prefinancing, and from US$696 to US$603 million for export financing.

31. In April 1991 the Government replaced the previous six-tier tariff structure with three tariff categories: 22 percent for finished products (except for automobiles and electronic goods, which are taxed at 35 percent down from 24 percent; 11 percent for intermediate products, and zero for raw materials and capital goods imports not produced locally. These changes lowered Argentina's average tariff rate from 18 percent to 9 percent, and all specific import duties were abolished. Imports of electronic goods may enter at any price while the established reference price will be used for customs duty payments only if a case of unfair import practices can be made by local producers.

32. Only the importation of automobiles is restricted by quotas. Whereas formerly the importation of automobiles was prohibited, for 1991 a quota of 8,000 automobiles (equivalent to 11 percent of domestic production) to be auctioned to the public has been established, with the proceeds accruing to the Treasury. Imports of food and pharmaceuticals are subject to approval by the Ministry of Social Welfare, but until now lengthy chemical testing has served to keep out many of these products. The Government has sent to Congress a new Food Code that will allow automatic imports of food and pharmaceuticals from countries with codes similar to Argentina. Most special import regimes have been

eliminated, including the temporary admission regime that had allowed imports used in the production of exports to enter duty-free. Imports used in the production of exports are now subject to tariffs, with rebates given to the producer at the time of export.

33. With respect to capital flows, a new Foreign Investment Code was introduced in September 1989 that seeks to provide equal treatment for domestic and foreign investors. Foreign investors may remit profits without restrictions. The profits tax on foreign investments was formerly 36 percent compared with 28 percent for domestic investors; both have been reduced to a uniform rate of 20 percent. To stimulate the repatriation of capital held abroad, the Government submitted a draft law to Congress in May 1991 which would allow a four-year period for domestic residents to repatriate capital with no questions asked upon payment of a tax; the rates of 1, 1 1/2, 2, and 3 percent would apply to capital repatriated in the first through fourth years, respectively. Thereafter, income derived from the repatriated capital would be subject to regular taxation. If capital of domestic residents is kept abroad, it is assessed a special profits tax of 2 percent for physical persons and 4 percent for corporations, which incorporates the corresponding assets tax.

34. External arrears that have arisen since 1988 have been largely confined to the medium- and long-term debt of the public sector. The Government attaches importance to restoring relations with external creditors by regularizing these obligations. For this purpose, Argentina, as already noted, will be seeking a rescheduling from Paris Club creditors. In June 1990 Argentina resumed making partial payments of interest to commercial banks on medium- and long-term debt that had been refinanced, and in January 1991 these payments were raised from US$40 million a month to US$60 million a month. To establish the conditions for the resumption of sustained economic growth, the Government believes it is necessary to pursue a phased reduction of its debt to commercial banks. To date this has been pursued through the sale of public sector assets and the privatization of parastatal enterprises in a number of sectors of the economy. The largest such sales have been the privatizations of the airline and telephone companies which made possible a reduction in external commercial debt in 1990-91 of more than US$7 billion, including US$1.3 billion of interest that was in arrears. Progress in the privatization program during 1991 is expected to generate cash revenues and debt exchanges that would permit a further reduction of bank debt.

35. As the debt is reduced to a level that could be dealt with through the use of enhancements and Argentina's own resources, the Government plans to enter into comprehensive negotiations with the commercial banks aimed at defining by 1992 a menu of options allowing for debt and debt-service reduction operations. The objective of such operations would be to restore Argentina's ability to service its debt in full once a comprehensive agreement is completed. Consistent with

the program, limits for total and short-term external debt of the public sector have been established through March 1992, as set out in Table 1.

36. The Government is committed to a program of broad structural reform of the Argentine economy. To date a key focus of this effort has been the reduction of the role of the public sector in the economy through an ambitious program of privatization and asset sales. This approach is seen as effective in attracting needed investment and in providing improved quality and delivery of goods and services. In addition to promoting gains in efficiency, these transactions provide a means for Argentina to achieve a substantial reduction in the size of its external debt. In 1990, as already has been noted, the state telephone company and the national airline sales were completed. In the second half of 1990, the decision was made to broaden the scope of the privatization program. As a result, Congress recently passed a series of laws that established the legal framework for privatizations in the energy and transportation sectors.

37. In the energy sector a combination of state ownership, complex taxation, and price controls had distorted relative prices and obstructed the efficient allocation of resources. In 1990 the Government began to prepare for large scale privatization by raising regulated energy prices to international levels. Concessionary rights in the development of 38 secondary oil fields were auctioned off that year with the provision that new owners under this and future sales would be able to market freely their share of the oil. In January 1991 the market for petroleum products was deregulated and all price controls were removed. Since then the Government has accepted bids for participation in the development of four major oil fields. The sale of an additional 28 secondary fields is expected in June or July. Participation rights in four other central producing areas have been tendered and contracts will be concluded with four major oil companies on a 50/50 ownership basis. Revenues from these sales are estimated at around US$600 million during the program period. The Government intends eventually to privatize the largest public enterprise (YPF). After a number of the company's holdings and activities are detached, there is to be a public offering of shares of a downsized YPF. Also, in the energy sector, electricity generation of the utility serving the city of Buenos Aires (SEGBA) and that of certain other utilities is to be privatized. The aim of the Government is to improve efficiency of electricity generation, transmission, and distribution services. With respect to natural gas, it is envisaged that deregulation of production and distribution services will lead to the privatization of the distribution services of the state gas company and the sale of a portion of the gas deposits held by YPF.

38. In the transportation sector, the concession to operate the Rosario-Bahia Blanca railroad line, one of the largest freight-carrying lines in Argentina, was awarded to a private consortium in April 1991 with full ownership to be transferred by September 1991. Bidding for concessions for the operation of two other rail lines is being made and

is to be closed within 90 days; bidding for the operation of two more rail lines will be opened in August. In addition, preparations are under way for the opening of bids for the privatization of the Buenos Aires metropolitan rail services. Plans are under way for reorganization of the nation's port system. Smaller ports will be taken over by provincial governments and services provided by the larger ports will be contracted out to the private sector. The Government plans to privatize fully the state shipping line (ELMA) and 16 ships already have been put up for sale. Progress is being made in privatizing the operation of the national highway system, with maintenance and toll collection for some 10,000 kilometers of highways now contracted with private firms.

39. The Defense Ministry is the holder of a number of firms, including several in heavy industry. In 1990 four of these enterprises were privatized. During the program period the Government intends to sell the Ministry's petrochemical complex as well as a major steel producing facility (SOMISA).

40. Institutional arrangements in labor markets have contributed to the persistence of inflation and have inhibited the efficient allocation of resources and thus have been factors behind low investment and growth. Collective bargaining in the private sector is on an industry-wide basis and global agreements put a floor under the agreed wage increase that applies to all firms in the industry, large or small. The Executive Branch is reviewing draft labor legislation with a view to eliminating existing rigidities in order to generate additional jobs. Under consideration are the possibility of allowing individual firms to negotiate labor contracts and of introducing temporary labor contracts and an unemployment insurance scheme. In addition, Congress is now considering a law that would modify existing rules on sickness and accident indemnization as well as employment termination awards, which are currently equal to one month's salary for each year worked; it is proposed that the latter be capped.

41. It is recognized that stability with growth is possible only with extensive structural reform of the institutions and regulations that constrain the flexibility and responsiveness of the private sector. Concurrent with the policies aimed at regaining economic stability, the Government intends to pursue systematically and vigorously the path of structural reforms that has been described in this letter. An important element of this long-term orientation is to seek a resolution of Argentina's external debt problem. The present program of privatization and sales of public assets provides a means for improving economic efficiency and for bringing about a substantial reduction of external debt. When appropriate, the remaining debt could be dealt with in a comprehensive fashion with the help of enhancements from multilateral sources. In this context, the Government looks forward to discussions in the near future on possible support from the Fund through an extended arrangement.

42. The Government believes that the policies presently in force will yield a major strengthening of the fiscal accounts and are consistent with the objective of halting inflation, thereby contributing to the resumption of economic growth. The Government stands ready to adopt additional measures as may be needed to ensure the success of the program. Development under the program will be monitored closely to facilitate the early correction of any deviations that may emerge.

Performance Criteria	July 1991– Sept. 1991	July 1991– Dec. 1991	July 1991– March 1992	July 1991– June 1992 1/
In billions of australes				
Overall cash deficit (–) or surplus of the nonfinancial public sector 2/	–120	2,650	7,440	6,820
Combined deficit (–) or surplus of the nonfinancial public sector and the Central Bank 2/ 3/	–2,800	60	2,230	1,780
Treasury outlays 4/	41,550	80,750	120,845	160,070
	Sept. 1991	Dec. 1991	March 1992	June 1992
Cumulative change in the net domestic assets of the Central Bank 5/	3,890	4,810	–560	520
In millions of U.S. dollars				
Cumulative change in net international reserves of the Central Bank 6/ 7/	–380	290	505	365
External arrears of the public sector 8/	695	310	150	—
External debt of the public sector 9/				
Total outstanding disbursed external debt 10/	55,500	55,500	55,500	55,500
Cumulative net disbursements of short-term debt 11/	1,000	1,000	1,000	1,000

1/ Indicative targets.

2/ The limits on the deficit will be reduced and the floors on the surplus will be raised by the amount of government asset sales in excess of the programmed levels. If the sale of assets is less than programmed there will be no adjustment for the period July-September 1991, and the floors on the surplus will be lowered by a maximum of US$136 million for the period July-December 1991 and a maximum of US$350 million for the period July 1991-March 1992.

3/ Includes interest payments due by the official banks and SOMISA.

4/ Excluding interest payments. These limits will be adjusted upward to the extent that treasury revenues exceed the indicative targets set out in Table 2.

5/ The change in the net domestic assets of the Central Bank is defined as the difference between the change in the monetary base and the change in the net international reserves of the Central Bank valued at the projected average exchange rate for each period. The monetary base is defined as the average monthly level of the sum of currency issue and deposits of financial institutions in the Central Bank. Net international reserves for each month are the average of the net international reserves at the end of the previous and current month.

6/ Negative sign signifies loss of net reserves. For measuring balance of payments performance, changes in international reserve assets and liabilities will not be affected by changes in gold prices nor, in the case of currencies other than the U.S. dollar, by changes in cross rates. The net international reserve target will be adjusted for any changes in the value of reserve assets and liabilities that result from factors other than balance of payments flows. This target will be adjusted downward by up to the equivalent of 25 percent of purchases subject to set-asides to the extent that Argentina's net international reserves are used to finance debt reduction operations.

7/ Target assumes a programmed level of asset sales of US$1,692 million. The target would be adjusted downward by the amount of revenue from the portion of these asset sales used in debt reduction operations. The target will be adjusted upward for government asset sales in excess of the programmed level, net of any use of revenue from these sales for debt reduction operations. In the event these asset sales are below programmed levels, the target will be adjusted as follows: no adjustment in September 1991; downward by a maximum of US$136 million, adjusted for any use of revenue from these sales for debt reduction operations, for December 1991; and downward by a maximum of US$350 million, adjusted for any use of revenue from the sales for debt reduction operation, for March 1992.

8/ Excludes debt service arrears on medium- and long-term public sector debt to commercial banks and related debt.

9/ Data on external debt that will be used for the monitoring of external debt developments will be taken from a Comprehensive Debt Reporting System and from the balance of payments accounts. The stock of debt should be valued at end-December 1990 exchange rates.

10/ The definition of total outstanding disbursed external debt of the public sector includes all external obligations of the public sector, including the Central Bank of the Republic of Argentina (BCRA) and the official banks. However, this definition excludes all external indebtedness related to bonds and notes issued in lieu of providing foreign exchange to meet principal payments falling due on private sector debt covered by exchange rate guarantees, and those categories of obligations not subject to the Central Bank's debt registration system as of September 15, 1984. It includes loans covered by swap arrangements undertaken by the Central Bank.

11/ Includes accumulated disbursements, net of repayments, of debt with a maturity up to one year, contracted by public sector entities after June 30, 1991, other than obligations classified as reserve liabilities.

Table 2. Argentina: Indicative Fiscal Targets

(In billions of australes)

Cumulative Targets	July 1991-September 1991	July 1991-Dec. 1991	July 1991-March 1992	July 1991-June 1992
Treasury revenue 1/	37,175	76,930	116,990	158,680
Public enterprise tax payments to Treasury 2/	6,975	14,310	21,180	27,910
Public enterprise tax payments to the social security system 2/ 3/	980	1,800	2,750	3,580
Public enterprise primary surplus 2/ 4/	850	1,980	1,430	2,560

1/ Defined as the sum of domestic taxes subject to sharing arrangements with the provinces; other taxes not shared with the provinces; and 37 percent of total fuel taxes and 50 percent of the tax on electricity.

2/ Public enterprises included under this target are the Buenos Aires electric utility (SEGBA), the state oil company (YPF), the state water and energy company (Agua y Energía), and the state gas company (Gas del Estado).

3/ Includes social security taxes and other social service charges.

4/ Excludes revenue from asset sales.

Tax Administration Annex to the Memorandum on Economic Policy

The Government will act to implement the following measures by dates indicated.

1. Control of the largest taxpayers

a. By July 1991, put in place the new version of the system of the largest taxpayers, which will allow the DGI to enter data from tax returns prior to payment of the tax. By December 1991, this system will also be extended to process income and asset tax returns.

b. By August 1991, increase to 2,000 the number of taxpayers controlled by the National Large-Taxpayer Unit.

c. By September 1991, put in place the system for the control of the largest taxpayers in 30 regional offices.

d. By May 1992, increase to 30,000 the number of taxpayers controlled by the 30 regional offices under the system mentioned in Section a.

2. Control of medium and small taxpayers

a. By July 1991, improve the collection system for promptly detecting taxpayers who stop filing, giving higher priority to those having greater revenue potential. The system will permit the listing of those who stop filing by region, size and economic activity.

b. By August 1991, tighten regulations regarding issuance of invoices for transactions subject to VAT to facilitate control through a greater uniformity of invoices.

c. Intensify the control of issuance of invoices. It is estimated that from August 1991 and thereafter about 400 establishments could be temporarily closed per month.

d. By September 1991, introduce changes in the tax code to increase fines for failure to file timely tax returns and to expedite procedures for applying fines.

e. By october 1991, implement an effective system for controlling delinquent accounts.

f. By November 1991, implement a limited system to cross-check information on purchases and sales in support of the auditing activity.

g. By December 1991, reassess the advantages and disadvantages of the withholding system for the VAT.

h. By January 1992, implement a system to select taxpayers for auditing aimed at identifying those taxpayers with the greatest potential for audit-induced tax revenue.

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

AUG - 9 1991

Dear Sirs:

I am enclosing herewith the text of the Stand-by Arrangement for Argentina approved by the Executive Board on July 29, 1991.

Sincerely,

K. Boese

Klaus Boese
Senior Operations Officer
Operations Division for
General Resources

Attachment

Banco Central de la Republica Argentina
Reconquista 266
1003 Buenos Aires
Argentina

CONFIDENTIAL

August 7, 1991

Argentina - Stand-By Arrangement

Attached hereto is a letter* dated June 28, 1991 from the Minister of Economy and the President of the Central Bank of Argentina, with annexed Memorandum on Economic Policy, requesting a stand-by arrangement and setting forth: (a) the objectives and policies that the authorities of Argentina intend to pursue for the period of this stand-by arrangement, and (b) understandings of Argentina with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Argentina will pursue for the remaining 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 July 29, 1991 to June 30, 1992, Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 780 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 195.0 million until December 1, 1991; the equivalent of SDR 390.0 million until March 1, 1992; and the equivalent of SDR 585.0 million until June 1, 1992.

(b) Each of the amounts that would be available in accordance with paragraphs 1 and 2 (a) above shall be reduced by an amount equivalent to 25 percent. The amount equivalent to corresponding reductions in the purchases made by Argentina under this stand-by arrangement, shall be made available subject to the following conditions:

(i) Argentina represents that it has a need to make a purchase because of use of its reserves or impending payments of the discharge of liabilities under debt reduction transactions;

(ii) the Fund, after examination of the request, has determined that the requested purchase is needed for the replenishment of Argentina's reserves or for the making of payments in connection with debt reduction operation; and

(iii) the Fund, upon a review of the financing of Argentina's program supported under this stand-by arrangement, has determined that the debt reduction involved is consistent with the objectives of the program.

* EBS/91/107 (6/28/91).

(c) Pursuant to a review under (b)(iii) above and if requested by Argentina, the Fund may decide to make available to Argentina, notwithstanding the phasing specified under (a) above but subject to the conditions specified in (b)(i) and (ii) above, an amount equivalent to 25 percent of the total of purchases that may be made by Argentina during the remaining period of this stand-by arrangement. In that event, the right of Argentina to make purchases under this stand-by arrangement shall be subject to such phasing of purchases and designation of amounts for debt reduction, as shall be determined.

(d) If requested by Argentina, the Fund may decide to discontinue the designation of amounts for debt reduction under (b) and (c) above, provided that the Fund determines that the objectives of Argentina's program supported by this stand-by arrangement can be achieved.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

4. Argentina will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota:

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

(i) the limit on the combined deficit of the nonfinancial public sector and the Central Bank, or

(ii) the limit on the cash deficit of the nonfinancial public sector, or

(iii) the limit on treasury outlays, or

(iv) the targets for change in the net domestic assets of the Central Bank, or

(v) the targets for change in net international reserves, or

(vi) the limit on external arrears of the public sector, or

(vii) the limit on the external debt of the public sector and the limit on net disbursements of short-term debt of the public sector, respectively specified in paragraphs 11, 23, 29 and 35 and Table 1 of the Memorandum on Economic Policy annexed to the attached letter are not observed; or

(b) During any period after November 30, 1991, February 28, 1992, and May 30, 1992, respectively, until reviews have been completed concerning the adequacy of financing assurances for the program, and suitable understandings have been reached on any additional measures that may be needed to attain the objectives of Argentina's economic program;

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

(i) imposes any new or intensifies any existing restrictions on payments and transfers for current international transactions, other than the restrictions evidenced by external payments arrears as described in EBS/91/107, or

(ii) introduces any new multiple currency practice, or

(iii) concludes any new 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 will not make purchases under this stand-by arrangement during any period of the arrangement in which Argentina has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase, or pursuant to Decision No. 9331-(89-163).

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

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Argentina, the Fund agrees to provide them at the time of the purchase.

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 repurchase 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.

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.

11. In accordance with the last paragraph of the authorities' 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 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.