Acuerdo Stand-By 1996.

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND

April 16, 1996

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

Ladies and Gentlemen:

I am enclosing herewith the text of the stand-by arrangement for Argentina as agreed at Executive Board Meeting 96/36 (4/12/96).

Yours very truly,

Klaus Böse

Klaus Böse
Deputy Division Chief
Operations Division
for General Resources

Enclosure
EBS/96/45, Supplement 1

CONFIDENTIAL

April 15, 1996

Argentina - Stand-By Arrangement

Attached hereto*is a letter, with an annexed Policy Memorandum, dated March 14, 1996 from the Minister of Economy and Public Work and Services of the Republic of Argentina 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;

(b) the policies and measures that the authorities of Argentina intend to pursue during 1996; and

(c) 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 April 12, 1996 to January 11, 1998 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 720 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 78 million until September 1, 1996, the equivalent of SDR 185 million until December 1, 1996, the equivalent of SDR 292 million until March 1, 1997, the equivalent of SDR 399 million until June 1, 1997, the equivalent of SDR 506 million until September 1, 1997 and the equivalent of SDR 613 million until December 1, 1997.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Argentina's currency subject to repurchase beyond 25 percent of quota.

3. Argentina will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Argentina's currency subject to repurchase 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 cumulative deficit or surplus of the public sector, or
(ii) the limit on the cumulative ceiling on noninterest expenditures of the National Administration, or

* See EBS/96/45 (3/15/96).

(iii) the limit on the cumulative change in net domestic assets of the Central Bank, or
(iv) the target on the cumulative change in the free international reserve of the Central Bank, or
(v) the limit on the cumulative net disbursements of external and domestic debt of the public sector, or
(vi) the limit on the cumulative net increase in short-term public sector debt, respectively, specified in Table 1 of th memorandum annexed to the attached letter, is not observed; or

(b) if Argentina incurs in external payments arrears; or

(c) after August 31, 1996, February 28, 1997 and August 31, 1997 until the respective reviews contemplated in the second paragraph of the attached letter are completed; or

(d) if at any time during the period of the stand-by arrangement Argentina

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or
(ii) introduces or modifies multiple currency practices; or
(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or
(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Argentina is prevented from purchasing under this stand-by arrangement because of this paragraph 3, 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.

4. Argentina will not make purchases under this stand-by arrangement during any period in which Argentina has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9331-(89/167), as amended, or (c) pursuant to subparagraph 16(a) or 33(a) of Decision No. 8955-(88/126), as amended, on the Compensatory and Contingency Financing Facility.

5. Argentina's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Argentina. When notice

of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Argentina and understandings have been reached regarding the circumstances in which such purchases can be resumed.

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

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

8. (a) Argentina shall repurchase the 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.

9. 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 memorandum annexed to the attached letter.

10. In accordance with the second paragraph of the attached letter, Argentina will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director 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.

Buenos Aires, Argentina
March 14, 1996

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

Dear Mr. Camdessus:

The attached policy memorandum and annexed table describe the economic policies and objectives of the Government of Argentina for 1996 and 1997, in support of which the Government requests a 21-month stand-by arrangement in an amount equivalent to SDR 720 million. On the basis of this program and measures that have been implemented recently, the Government also requests waivers of nonobserved performance criteria for December 1995 pertaining to the program supported by the current extended arrangement from the Fund.

The Government of Argentina believes that its policies are appropriate to achieve the objectives of its economic program. During the period of the arrangement, the authorities of Argentina will maintain close relations with the Fund and will consult on the adoption of any measures that may be needed, in accordance with the Fund's practices on such consultations. Reviews of the program will be carried out with the Fund before end-September 1996, end-February 1997, and end-August 1997.

Sincerely,

/s/
Domingo F. Cavallo
Minister of Economy and
Public Work and Services

Policy Memorandum

1. Since March 1991, when the Argentine peso was pegged to the U.S. dollar under the Convertibility Law, Argentina has undergone a profound economic and social transformation. Inflation declined to industrial country levels, and real GDP expanded by some 7 1/2 percent a year on average in the period 1991-94 on the strength of a sharp recovery in domestic demand and a steady increase in investment, boosted by large capital inflows. These achievements reflected in part the major progress made in strengthening the public finances and the far reaching social and economic reforms the Government implemented since 1989. These reforms opened up the economy, restructured the tax system and tax administration, deregulated economic activity, introduced a privately-run fully funded social security system, and achieved the privatization of virtually all public enterprises.

2. The encouraging performance of the Argentine economy was severely disrupted by the confidence crisis that ensued in the wake of the devaluation of the Mexican peso in late 1994. The onset of the crisis resulted in a sharp decline in bank deposits--which dropped by almost one-fifth in the period through April 1995--a sharp contraction in the availability of credit and the consequent adverse effects on economic activity and employment. Real GDP in the first three quarters of 1995 is estimated to have declined by 3.1 percent with respect to the same period in 1994. In turn, unemployment rose to 18.4 percent last May before declining to 16.4 percent in October. In response to the crisis, the Government of Argentina reaffirmed its commitment to convertibility and took strong measures to bolster the public finances and support the banking system, as described in our letters of August 29, and December 5, 1995. These measures succeeded in restoring confidence as manifested in the reflow of deposits, the rise of stock and bond prices, and the reopening of access to international capital markets. Some recent indicators suggest that industrial production and sales started to recover in the last quarter of 1995 and we are confident that this trend will accelerate in 1996. Consumer price inflation declined to 1.6 percent in 1995, the lowest level in over 50 years. At the same time, the external current account deficit narrowed by more than 2 percentage points of GDP with respect to 1994, mainly because of an increase in exports in excess of 30 percent. The Government is pleased by this demonstration of the resilience of the convertibility system.

3. The result of a tax moratorium in late 1995 far exceeded expectations, yielding Arg$5.4 billion in pledges. This significantly strengthened the flow of receipts expected in 1996 on account of payment of these pledges and is also expected to aid in the improvement of tax administration by bringing new taxpayers into the tax net. Nonetheless, the greater than expected severity of the recession had weakened fiscal revenue performance in 1995 even more than what had been contemplated in the revised program for 1995 described in the letter of August 29. This resulted in the nonobservance of some performance criteria in the program. As was indicated in the letter of August 29, use of part of the tax moratorium receipts to bolster fiscal revenue in 1995 was envisaged. Counting as revenue the discount with the banking system of moratorium pledges equivalent to some Arg$1.3 billion--a practice valid under

the Budget Law--all the targets of the program for 1995 were essentially met with only minor deviations. These deviations--amounting to less than 0.05 percent of GDP--were with respect to the performance criteria on the overall public sector deficit, the noninterest discretionary expenditure of the National Administration and the total external and domestic public debt. If the discount operation is considered as borrowing, the deviations in the overall deficit and the total debt would amount to about 1/2 percent of GDP. All other targets in the program were met with ample margins.

4. Provincial government finances were adversely affected by the financial crisis in 1995. Facing a sharp decline in their own revenues, lower transfer of tax revenue from the National Treasury, and a cut off of internal or external financing, many provinces delayed payments to public employees, pensioners, and suppliers. In the latter part of the year, provinces were forced to cut expenditure, including through the reduction in civil service wages and dismissal of personnel. As a result, the accrued deficit in the provincial public finances is estimated to have been contained at some Arg$2 1/2 billion (0.9 percent of GDP), about the same level as in 1994. Most provinces have started a process of privatization of public banks and enterprises, with assistance from the IBRD and the IDB.

5. The reflow of deposits since mid-1995 has enabled the banking system to strengthen its liquidity position. By January 1996, deposits had more than regained pre-crisis levels. To help rebuild the banking system's liquidity and promote lower interest spreads, starting September 1995, the Central Bank replaced the nonremunerated legal reserve requirements with liquidity requirements. The new requirements apply uniformly across the structure of deposits and cover a wider range of liabilities than the previous system. With this, the ratio of liquid assets to bank deposits rose to 21 percent by February 1996 from 16 percent in March 1995. A process of restructuring of the banking system is underway and so far 9 banks have been closed and some 45 financial entities have been merged or taken over by other institutions. The Government believes that, in overall terms, the financial system has fully regained its strength; remaining problems are being addressed with the help of trust funds set up for this purpose in early 1995.

The Economic Program for 1996-97

6. The Government of Argentina seeks to restore economic growth in conditions of low inflation and external viability, to increase savings and investment, and to deepen the process of structural reform and improving efficiency in the economy. Although much has already been achieved, the Government is determined to press forward with the profound institutional transformations of the country that it is seeking. With the economic program for 1996-97, the Government intends to carry forward reforms in the central government, the provincial governments, the health sector, labor markets, and the financial system. The Government believes that the ongoing recovery of economic activity will result in a rate of growth in real GDP of some 5 percent in 1996, with inflation kept around 2 percent. Export performance should continue to improve, though at a slower pace than last year, while imports would recover with the pick up in economic activity. The external current account deficit would remain at a

similar level in relation to GDP as in 1995. The deficit would be more than financed by private capital inflows, resulting in an increase in net international reserves that would offset the loss of last year. The implementation of structural reforms and a reduction in labor costs would boost prospects for increased investment and support our continuing efforts to reduce unemployment.

7. As in recent years, the basic principle of the Government's economic policy will be the maintenance of fiscal and financial discipline in the context of the Convertibility Law. The Government is committed to achieve structural equilibrium in the national public finances in the medium term. For 1996, the Government's objective is to attain a balanced position after including the proceeds of some capital operations. These operations, about half of which correspond to privatization, are projected to amount to Arg$2.5 billion, or 0.8 percent of GDP. In 1997, a balanced position will be attained without recourse to such operations. To meet these targets, and to advance the reform process, Congress has just approved legislation that temporarily empowers the Executive Branch to implement additional measures in the tax area and sets the basis for an administrative reform of the National Government. These measures should be sufficient to achieve the fiscal objectives even on conservative assumptions as to economic growth.

8. On the revenue side, the new legislation authorizes the Executive to: (1) eliminate certain exemptions from income taxes; (2) maintain the base VAT rate at 21 percent, with the option to apply a reduced rate to some specific staples; (3) eliminate exemptions to the VAT in commercial rents and the transportation and health sectors; and (4) double the wealth tax on certain assets to 1.0 percent. The overall yield of these and other revenue enhancing measures is estimated to amount to Arg$3.5 billion (of which about Arg$1.5 billion would be transferred to the provinces under the revenue-sharing agreement). As the revenue performance strengthens, the Government expects to be in a position to begin reducing the VAT rate which, at its present high level is deemed to be distortionary and to encourage tax evasion. The National Tax Office plans to step up its tax administration efforts including through, inter alia, the cross-checking of taxpayer information, enhanced audit procedures, the registry of financial assets by name, and the use of nonerasable cash registers.

9. Containment of expenditures has been achieved during the past two years and remains one of the main goals of the Government. The 1996 budget keeps primary expenditure unchanged in nominal terms (net of transfer to the provinces) implying a cut in real terms compared with 1995. The newly approved powers to reform the administration of the National Government will greatly help in observing the budgetary targets for expenditures. The new legislation enables the Administration to merge or eliminate public entities, close programs and agencies, and consolidate manpower. Consistent with the expenditure targets, the program includes quarterly limits on noninterest total expenditures.

10. The Federal Government is working with the provinces on the formulation of a medium-term plan to put their finances on a sound footing and provide a basis for the continued development of private sector activity. The aim is to reduce

the deficit sharply in 1996 and permit a workout of the provinces' debt problems, including the clearing of arrears. Current expenditures will decline reflecting the full year effect of the expenditure cuts introduced in the latter part of 1995, while work will continue on streamlining the structure of provincial taxes and strengthening tax administration at the provincial level. The privatization of provincial public enterprises and banks is being accelerated, with the provinces using proceeds from privatization to reduce their debt. The IBRD and IDB are assisting in preparing the provincial social security programs for their incorporation into the national social security system starting in 1997. The Federal Government also will review with the provinces the revenue sharing arrangement ("coparticipation scheme") during 1996 as required by the new constitution.

11. Monetary policy will continue to be governed by the Convertibility Law, which requires full backing of the Central Bank's monetary liabilities (currency issue plus the banking system liquidity requirements held in the Central Bank) with international reserves. In 1996, monetary policy will focus on further strengthening the liquidity of the banking system and the free reserves of the Central Bank. Based on the already introduced schedule for the repayment of outstanding rediscounts (at least Arg$370 million in 1996) and on the drawings under the prospective Fund arrangement, the economic program envisages a build-up of Arg$1.2 billion in free international reserves over the course of 1996. The program also includes a target for the net domestic assets of the Central Bank. Beginning in February 1996, liquidity requirements have been extended to a wider range of bank's liabilities. Given the strong growth of deposits that is being observed, the additional increase in the liquidity ratio still would leave ample funds for bank lending to the private sector to support the expected pick up in activity.

12. The Government expects significant financial deepening in the period ahead as confidence in the country's economic prospects improves. This process of remonetization will be helped by lower interest spreads as a result of the recent shift from nonremunerated legal reserve requirements to remunerated liquidity requirements. In addition, competition in the banking sector has been enhanced by the entry of new foreign banks, changes in management, the privatization of provincial banks and the closing and mergers of weaker financial institutions. As a result, it is expected that banking services will become more cost-effective and that financial volatility and country risk premia will be reduced. At the same time, the Government intends in the coming months to strengthen the prudential regulatory framework further by supplementing credit risk guidelines with market risk considerations.

13. The normalization of conditions in financial markets will permit the Government to proceed with its plans to build a secondary market for short-term government securities. This will require the issuance in 1996 of about Arg$2 billion of public debt with short maturities. This placement will be facilitated by the virtual absence of outstanding short-term public debt and the relatively low level of overall public sector indebtedness. Indeed, the total public sector debt, both foreign and domestic, amounts at present only to some 31 percent of GDP and is projected to decline in coming years in the light of the overall strengthening of the public finances. Nevertheless, as debt

service obligations are projected to rise starting 1997 as grace periods expire, the Government will make efforts to lengthen the maturity of its longer term borrowing in line with improved conditions in international capital markets. The limits on net public sector borrowing under the program are intended to facilitate achievement of these objectives.

14. The strong and broad based export performance in 1995 reflects an improved level of competitiveness. The elimination in recent years of restrictions on trade and payments and of a large number of distortive taxes, the progressive reduction of rigidities in the labor market, and other structural reforms contributed to improving the real effective exchange rate. The structural reforms planned for the period ahead, particularly in the labor market, should help ensure further gains in competitiveness. The more robust underlying competitive position and the enhanced prospects for trade creation both in the MERCOSUR region and in international markets has kept investor interest strong. The large number of projects currently in progress or under consideration, particularly in the mining, forestry, foodstuffs, automotive, energy and petrochemical sectors will serve to strengthen Argentina's external position and its prospects for strong export-led growth.

15. As indicated, the Government of Argentina attaches great importance to the implementation of structural changes in various areas. Further reforms in labor markets are required to improve efficiency, reduce costs, and encourage employment growth. The last stage of a 30 percent reduction in employer social security contributions became effective in January 1996. The law on work-related accidents was approved in the second half of 1995 and now is being implemented. This law provides for a compulsory insurance scheme but also imposes limits on disability litigation and is expected to lower industrial wage costs by up to 9 percent. The Government intends to present to Congress during 1996 proposals to reform collective bargaining further and to make collective agreements more flexible as these come up for renegotiation. In the area of privatization, the normalization of conditions in the financial markets will allow implementation of the last stage of its privatization program, which would entail the sale of the remaining electricity enterprises and the disposal of the residual government shares in already privatized entities, with total proceeds projected at Arg$1.5 billion in 1996. Finally, the Government is committed to improving the efficiency and equity of Argentina's health care system and reduce its costs. To this end, the Government intends to implement beginning in the second half of 1996 a program to reform PAMI (health care for pensioners) and Obras Sociales (the union-managed health care system), which together cover about 60 percent of the population. The IBRD is actively supporting this reform.

16. For 1997 we foresee a further acceleration in the growth rate of GDP, with inflation remaining at a low level. Domestic demand, especially investment is expected to rise rapidly. As GDP grows, imports should increase but exports would continue their expansion, and the external current account could widen moderately. The broad based structural reforms that are underway or will be started in 1996 will continue to be pursued vigorously in 1997. These reforms, in particular, those that are being implemented in the provinces and in the National Government are expected to yield substantial savings over the medium

term for the public sector as a whole. In the process, however, the deficit of the National Government may need to rise as the Government assumes the burdens arising from the transfer of provincial pension systems to the federal level and from the trust funds created to facilitate the restructuring of the provincial and federal administrations. This additional deficit will be reduced rapidly over the coming years. Without counting the deficit just mentioned, e.g., on a basis comparable to 1996, we expect to achieve budgetary balance in 1997, mainly as a result of the increased economic activity, the savings to be obtained from the administrative reform, and improvements in tax administration.

17. The main parameters of the 1996 program are shown in the attached table, which also details the performance criteria. Reviews with the Fund to examine performance under the program and assess progress in respect to structural reforms will be carried out before end-September 1996, and end-February and end-August 1997. The policies for 1997 will be discussed in more detail, and the corresponding performance criteria of the program will be set, during the second of the program reviews that are being proposed.

Table 1. Argentina: Quantitative Performance Criteria for 1996

	Indicative Dec. 1995- March 1996	Dec. 1995- June 1996	Dec. 1995- Sept. 1996	Dec. 1995- Dec. 1996
	(In millions of pesos or U.S. dollars)			
1. Cumulative deficit (-) or surplus of the Public Sector 1/	-1,200	-1,475	-2,120	-2,500
2. Cumulative ceiling on noninterest expenditures of the National Administration 2/	11,750	23,300	36,200	48,900
3. Cumulative change in net domestic assets of the Central Bank 3/	190	-180	-490	-810
4. Cumulative change in the free international reserves of the Central Bank 4/	105	445	815	1,180
5. Cumulative net disbursements of external and domestic debt of the public sector 5/	2,300	2,600	3,700	3,500
6. Cumulative net increase in short-term public sector debt 6/	500	250	1,250	1,800

1/ The public sector balance as defined in the program, includes the nonfinancial public sector result (measured from below the line) and the quasifiscal balance of the Central Bank (BCRA). It excludes the outcome of the provincial nonfinancial public sector. Also, it excludes receipts from privatization. The quasifiscal balance of the BCRA is defined as interest earnings on international reserves minus interest on net swap operations and Letras de Liquidez Bancarias (Lelibans), and transfer payments to the Government.

2/ The ceiling will be adjusted up (or down) for any excess (or shortfall) from the program level in automatic revenue transfers to the provinces under the tax revenue-sharing arrangement.

3/ The net domestic assets (NDA) of the BCRA are defined as the difference between the monetary liabilities and the net international reserves (NIR) of the BCRA, both measured on the basis of end-of-period data. If needed, the ceiling corresponding to December 1996 could be adjusted upwards to accommodate seasonal liquidity needs of the banking system by up to Arg$300 million. The monetary liabilities include currency issue, legal bank reserves and liquidity requirements at the BCRA (reverse swap operations and Lelibans). The NIR are defined as gross international reserves of the BCRA (defined below) less liabilities to the IMF, and will be valued at exchange rates of December 31, 1995.

4/ The free international reserves of the BCRA are defined as the difference between gross international reserves and monetary liabilities of the BCRA. If needed, the target for December 1996 could be adjusted downwards to accommodate seasonal liquidity needs by up to Arg$300 million. Gross international reserves include BCRA holdings of gold, SDR's, foreign currency in the form of cash and deposits abroad, and Argentina's net balance within the Latin American Trade Clearing System (ALADI), and exclude central bank holdings of government debt instruments.

5/ Total outstanding debt of the public sector includes all foreign currency denominated and Argentine peso denominated obligations and guarantees of the national public sector and public enterprises (including those obtained for constituting trust funds), obligations with multilateral organizations of provincial governments and the national financial public sector, including the BCRA and other official banks. The limit excludes all new debt issued for the consolidation of domestic arrears incurred before 1991 (BOCONs) arising from Judicial Court decisions. It excludes new borrowing by the foreign trade bank BICE and any adjustment during the period to the stock of BOCONs (including those related to oil and gas royalties) resulting from the capitalization of interest. It also excludes disbursements by the IBRD and the IDB of loans related to Obras Sociales, PAMI, and the Provincial Pension Funds. The ceiling will be adjusted for any revision to the initial stock of debt resulting from the registration of old external debt. The limit will be adjusted for borrowing to compensate for any shortfall in privatization receipts relative to the program. Data used to monitor external and domestic debt developments will be taken from the debt reporting system and the balance of payments accounts. The stock of debt will be valued at December 31, 1995 exchange rates and measured at end of period.

6/ The ceiling includes the net change in all domestic and foreign public and publicly guaranteed debt with a maturity of one year or less. It includes short term debt of the Central Bank, but excludes normal external trade related short term debt.