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Supplement 2

CONFIDENTIAL

June 6, 1962

To: Members of the Executive Board  
From: The Acting Secretary  
Subject: Argentina - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement with Argentina as agreed at Executive Board Meeting 62/25, June 6, 1962.

Att:(1)

## Stand-By Arrangement with Argentina

1. Annexed hereto is a letter dated May 14, 1962 from the Minister of Economy and the President of the Central Bank of Argentina which sets forth the policies and intentions which the authorities of Argentina will pursue.

2. In consideration of the policies and intentions set forth in the annexed letter, the International Monetary Fund agrees to a stand-by arrangement to support these policies and intentions.

3. Argentina will avoid excessive variations of the rate in the exchange market arising from temporary factors, but will not counter the fundamental trend of the market.

4. For a period of one year from June 7, 1962, Argentina will have the right, subject to paragraph 15 of the annexed letter, to purchase from the Fund the currencies of other members in exchange for its own currency in an amount equivalent to \$100 million, provided that purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of \$50 million in the first six months and \$75 million in the first nine months. The amounts prescribed in this paragraph 4 shall be augmented by amounts equivalent to repurchases in respect of purchases under this stand-by arrangement, unless when any such repurchase is made Argentina informs the Fund that it does not wish the stand-by arrangement to be augmented by the amount of that repurchase.

5. Argentina will pay charges for this stand-by arrangement in accordance with the decisions of the Fund of December 23, 1953 and April 27, 1959.

6. Argentina and the Fund will remain in close consultation during the period the stand-by arrangement is in effect. This consultation may take the form of correspondence and visits of officials of the Fund to Argentina or of representatives of Argentina to Washington, D.C. In addition, Argentina will keep the Fund informed of developments in the exchange, trade, credit, and fiscal situation through reports at intervals or dates requested by the Fund during the period the stand-by arrangement is in effect.

7. Subject to paragraph 4 above, Argentina will have the right to engage in the transactions covered by the stand-by arrangement without further review by the Fund. This right can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally (under Article XVI, Section 1(a)(ii)) or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Argentina. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 7, purchases under this stand-by

arrangement will be resumed only after consultation has taken place between the Fund and Argentina and agreement has been reached on the terms for the resumption of such purchases.

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

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

Annex to Stand-By Arrangement

Poder Ejecutivo Nacional

MINISTERIO DE ECONOMIA

Buenos Aires, May 14, 1962

Mr. Per Jacobsson  
Managing Director  
International Monetary Fund  
Washington 25, D. C.

Dear Mr. Jacobsson:

1. Since November 2, 1961 when the Argentine Government requested a stand-by arrangement with the International Monetary Fund, there have been serious unforeseen economic and political changes. Substantial parts of the program described at that time could not be implemented. Consequently, the authorities decided not to request any drawings under the stand-by arrangement agreed to by the International Monetary Fund to support that program. Moreover, as it is now impossible to return to the planned objectives, the authorities request the cancellation of the existing stand-by arrangement.

2. The Argentine Government is currently faced with very serious economic problems. The country's gross reserves of gold and convertible foreign exchange have declined from \$478 million at the end of September 1961 to \$233 million as of April 7, 1962. During the same period a serious fiscal imbalance appeared which required financing from the Central Bank amounting to M\$N 16.4 billion, while unpaid commitments are estimated to have more than doubled. The financial imbalance was further increased by a deterioration of the position of the government-owned Banco de la Nación, which developed a deficiency with respect to required reserves which amounted to M\$N 6.3 billion during the first fortnight of March, besides an overdraft in its current account with the Central Bank of M\$N 5.0 billion on April 7.

3. To rectify the situation, the authorities have undertaken a new program involving substantial new measures. To support this program, which is described in this letter, the Argentine Government wishes to enter into a new one-year stand-by arrangement with the Fund for \$100 million. Argentina will discuss with the Managing Director the particular currencies to be purchased from the Fund prior to any purchase under the proposed stand-by arrangement.

4. Currencies drawn from the Fund will be used to maintain an orderly exchange market free of restrictions. Excessive variations in the exchange market arising from temporary factors will be avoided, but the fundamental trend of the market will not be countered.

5. The most intractable immediate problem has arisen with the very serious fiscal deficit. After three years of progress in reducing the deficit, the fiscal deficit financed from the Central Bank in the first five months of fiscal 1961-62 has almost equalled the total financing received in the previous three years. Drastic measures are essential to control this problem. To have an immediate impact, the authorities have already taken the following measures:

(a) Imposed a new 20 per cent surcharge on most imports, a measure expected to yield annually about M\$N 15 billion, equal to some 14 per cent of estimated total central government receipts for 1961-62.

(b) Increased the sales tax from 10 to 13 per cent, the maximum permissible by law..

(c) Increased the price of gasoline by an average of about 30 per cent, the increased receipts to be primarily devoted to the road fund, although part will be devoted to improving the financial position of the government-owned petroleum corporation.

In addition to these measures, the Government has initiated action to reduce expenditures as rapidly as possible. In particular, a strict economy program has been undertaken to eliminate M\$N 10 billion of programmed administrative expenses from the current budget. Moreover, quick action is being taken to reduce the operating deficits of state enterprises both by raising charges and increasing the efficiency of operation.

6. With the aid of these measures, the authorities expect to reduce the deficit for the remaining seven months of the fiscal year to relatively small proportions. However, inasmuch as it will take time for even emergency measures to take effect, the authorities believe that they may be forced to have some limited further recourse to the Central Bank. This recourse will only be made if it is absolutely unavoidable and will at no time during the period of the stand-by arrangement raise the total Central Bank loans to the Government by more than M\$N 5 billion over the level outstanding on May 2, 1962. The Government is fully determined that there will be no further financing of the public sector through the Central Bank in the next fiscal year.

7. To improve the longer-term position of the government's finances, the authorities are determined to implement an effective program to end the very large deficit of the government-owned railroads, which accounts for most of the budget deficit. To reduce and eventually to eliminate this deficit, the authorities plan to work closely with the experts of the IBRD Transportation Study Group, under whose auspices a major survey

of the problems has already been made. The Government has already started the implementation of the recommendations of this group. For example, the authorities have promulgated new work rules substantially in accordance with the recommendations of that survey, have reduced personnel employed by some 25 per cent, have ceased operations on 4,000 kilometers of uneconomic lines, and have closed or transferred to private enterprise several auxiliary services. The authorities are determined to continue implementation of this program, in order not only to reduce the deficit but also to improve the service to the public, which has now reached deplorable levels.

8. The Government intends to reduce current government expenditure as rapidly as possible in order to increase resources devoted to critical fields of public investment. It is hoped especially that more resources can be made available in this way which, supplemented by the expected increased foreign assistance, will permit substantial provision for low cost housing, the completion of the new road network, and the development of adequate electricity supplies.

9. The authorities are determined to maintain a bank credit policy which will create stable and orderly monetary conditions. Thus, the growth of the value of bank credit will be limited to that compatible with price and exchange rate stability and will thereby ensure that the basis is laid for the maximum sustained growth of the economy. To this end it is planned to maintain the present reserve requirements on the commercial banks. However, the Central Bank may, if it is necessary to limit the spread of severe financial crisis occasioned by withdrawal of foreign financing for internal working capital, grant up to a total of M\$N 3 billion in selected short-term rediscounts. It is expected that confidence in the peso will shortly recover and that the present monetary stringency will thus end. In the period of recovering confidence, the Central Bank will review the bank credit increase closely and will, if it deems the growth to be unduly rapid, increase reserve requirements to limit the growth of bank credit to a rate which is compatible with monetary stability in the long run.

10. The credit policies of the Banco de la Nación have in the recent past been the cause of a substantial part of the monetary imbalance. The credit program of this bank is currently being reviewed in detail and it is the firm policy of the Government that the present borrowing of this bank from the Central Bank will be steadily reduced and, in particular, that at no time during the term of the stand-by arrangement will there be any net addition to the total financing of this bank from the Central Bank in any form over the level existing on May 2, 1962.

11. In summary, the policy of the Central Bank with respect to the over-all credit increase will be designed to ensure that there will be no recurrence of the recent instability of the peso. To this end the total expansion of central bank credit will be kept under continual review to ensure that as little expansion as possible takes place until the rise in

prices is clearly checked. In no event will the net increase in the total resources of the Central Bank made available to the economy, i.e., any increase in gross domestic assets of the Central Bank plus any reduction of legal reserve requirements, exceed M\$N 8 billion in the period between May 2 and November 15, 1962. The Government will consult with the Fund and agree on the appropriate central bank credit program for the remaining period of the stand-by arrangement after November 15.

12. The policy introduced at the beginning of 1959 of prohibiting central bank financing of medium-term and long-term credit operations will continue unchanged. Accordingly, the new operations of the National Mortgage Bank and the Industrial Bank of the Argentine Republic will be financed without recourse to the Central Bank.

13. It is considered unfortunate that at this time additional taxes have had to be imposed on international trade. The Government considers these taxes to be damaging to the interest of Argentina over the longer run. However, there was no suitable alternative available which could raise the substantial amount of revenue immediately required to meet the very serious budget deficit. Also, there is a large imbalance of trade which clearly has to be reduced as quickly as possible. It is the firm intention of the Government to lower the taxes on trade as soon as possible. In particular, the Government plans an early review of the high surcharges on imports, as it is believed that these are seriously affecting the development of the country by promoting high cost inefficient industry.

14. In view of the very serious external payments position of the country, all purchases abroad on credit by government agencies and enterprises will be subject to prior approval by the Ministry of Economy and the Central Bank. It will be the policy in this review not to approve any further use of medium-term financial and suppliers' credits beyond the amount of repayments currently made. Moreover, the Central Bank has decided to restrict severely the capacity of commercial banks to guarantee obligations payable in foreign exchange. With respect to the official banks, there will be no increase in the total outstanding level of guarantees provided for foreign financing nor any increase in the outstanding level of short-term and medium-term foreign indebtedness.

15. If at any time during the period of the stand-by arrangement the limits specified in or pursuant to paragraphs 6, 10 and 11 of this letter are exceeded, Argentina will consult with the International Monetary Fund and agree on new terms prior to making any further drawings under the stand-by arrangement.

/s/  
E. A. Mendez Delfino  
President, Central Bank of Argentina

/s/  
Alvaro C. Alsogaray  
Minister of Economy

FOR  
AGENDA

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EBS/63/37

CONFIDENTIAL

March 18, 1963

To: Members of the Executive Board  
From: The Secretary  
Subject: Argentina - Request for Extension of Stand-By Arrangement

The attached request from Argentina for extension of the present stand-by arrangement, together with the staff's analysis and recommendation, is circulated for consideration by the Executive Directors at a meeting tentatively scheduled for Wednesday, March 27, 1963.

Att:(1)



CONFIDENTIAL

## INTERNATIONAL MONETARY FUND

Argentina--Request for Extension of Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange Restrictions  
Department, the Legal Department, and  
the Office of the Treasurer)

Approved by Jorge Del Canto

March 18, 1963

I. Introduction

The Government of Argentina entered into a stand-by arrangement with the Fund on June 7, 1962 for a period of 12 months for an amount equal to \$100 million. Under this stand-by arrangement Argentina has purchased the equivalent of \$50 million and has pursued policies which have allowed it to maintain a free exchange market and to meet its foreign debt obligations to date. Notwithstanding these efforts, the economic situation has remained difficult. In order to provide a basis to face future problems, the Argentine Government has taken additional corrective measures and has requested that the Fund continue its support under the present stand-by arrangement beyond June 6, 1963 by extending the arrangement for a period of four months. A letter dated March 13, 1963 from the Minister of Economy and the President of the Central Bank (see Appendix I) indicates the reasons for the request and sets out Argentina's financial program and policies in support of which the extension of the stand-by arrangement is requested.

Argentina became a member of the Fund on September 20, 1956. Its initial quota of \$150 million was increased in December 1959 to \$280 million under the Fourth Resolution of the Board of Governors on the Enlargement of Fund Resources Through Increases in Quotas.

Argentina has made extensive use of the Fund's resources, with gross drawings totaling \$327.5 million. Repurchases have totaled \$99.5 million, and Argentina's net outstanding drawings on the Fund, after taking into consideration purchases of its currency by other members, amount to \$212 million. The Fund's present holdings of Argentine pesos, therefore, are 150.7 per cent of quota.

The four-month extension of the stand-by arrangement requested by the Argentine authorities would also involve a change in the phasing of the amounts which are still available under paragraph 4 of the arrangement. Under the extended stand-by arrangement, Argentina would have the right to draw the undrawn balance of \$50 million as follows: up to \$25 million prior to May 31, 1963, and thereafter a cumulative total equivalent to that \$25 million plus \$5 million per month. These amounts would

be augmented at Argentina's option by amounts equivalent to repurchases in respect of purchases under the stand-by arrangement. Argentina undertakes to discuss with the Managing Director, prior to making purchases under the proposed arrangement, the particular currencies to be purchased from the Fund. In view of Argentina's repurchase commitments amounting to \$3 million per month and the phasing of drawings under the proposed extension of the stand-by arrangement, Fund holdings of Argentine currency will at no time during the period of the stand-by arrangement exceed 161.5 per cent of quota.

## II. Recent Economic Developments

Since the stand-by arrangement with the Fund was approved at the beginning of June 1962, the immediate difficulties facing the country have changed, even though the fundamental problem has continued unaltered. At that time the immediate problem was to check the decline in foreign exchange reserves of the Central Bank. Now reserves have been stabilized at a very low level and it is the immediate problem to obtain a revival of industrial activity under as orderly financial conditions as possible. But throughout, the basic problem has been the massive deficits incurred by the inefficient government sector, and particularly those of the state agencies.

Between October 1961 and April 1962 the size of the fiscal deficit increased which led to substantial recourse by the Government to the Central Bank. The immediate cause of the increase was a sharp rise in programmed expenditures, principally due to higher wages but also to higher foreign debt service payments at a time when revenues were stagnating. Despite the attempts of the Government to correct this situation, the deficit continued at a high rate through the end of 1962. The new taxes on imports and sales introduced in April 1962 were not fully enforced and plans to improve the operation of the state agencies were not effectively implemented. The operating deficit of the railroads in particular continued to rise until recently it has been estimated at M\$N 30 billion or \$230 million annually. Even this figure does not fully indicate the cost imposed on the National Government budget by the railroads for it does not include the full amount of railroad pension payments, which are now equal to more than 30 per cent of the wage bill. The government petroleum agency, despite its right to much of the income from the rich natural petroleum resources of Argentina, has continued to have a cash deficit financed by the nonpayment of suppliers and by the diversion to its own use of taxes collected for other purposes.

Throughout the past year the Government has been very reluctant to use direct Central Bank credit to finance the public sector deficit, realizing that this would accelerate the inflation and cause severe problems in the exchange market. Thus, in 1962 the authorities chose to delay payments until cash resources were available, and gradually even wage and salary payments fell as much as two months into arrears. So as to limit the accumulation of arrears, payments were partly made in debt certificates, usable for the payment of taxes, and in bonds carrying a gold clause. Despite these endeavors, the Government has been forced to borrow substantially from the Central Bank, particularly in recent months.

The over-all expansion of Central Bank credit was limited through November 15, 1962 to approximately the rate indicated to the Fund at the time of the request for the stand-by arrangement. However, the margin of expansion was almost all used by the public sector, despite the original plan to direct a major part to the private sector. After November 15, during a period of seasonal expansion for which no limits had been announced, Central Bank credit increased more rapidly. Again, the abnormal growth was directed exclusively to the public sector.

Credit to the private sector was quite sharply restricted during 1962. Such growth as did occur during the second half of the year was largely involuntary, arising from the meeting of foreign exchange commitments by the banks which they had guaranteed for the private sector. In particular, the government-owned Banco de la Nación, which in 1961 had expanded credit very rapidly and had incurred serious deficiencies against its legal reserve requirements, recently has conducted its operations with more restraint, and after the middle of 1962 it reduced its reliance on the Central Bank until it was called on, toward the end of the year, to provide additional financing for the Government. Some of the private commercial banks also developed reserve deficiencies during 1962, but for these banks as a group there is still a small net excess of reserves.

The tightness of bank credit during 1962 was directly related to the serious loss of confidence in the currency and to an associated outflow of capital. In 1962 the real value of the money supply in Argentina declined by about 25 per cent, which reflected increased misgivings as to the stability of the value of the peso, due both to the continuing depreciation in the exchange market and to prolonged political uncertainties. Recently, however, there have been some signs of a limited recovery of confidence and an increasing willingness on the part of the public to hold money.

The clearest indication of this improvement in confidence has been given by the exchange market. After the unpegging of the peso in April 1962 the rate followed a depreciating trend until early December, despite the indirect support provided by the Central Bank which provided foreign exchange to meet the debts of state agencies from its own resources. In December 1962 the situation changed, the exchange rate strengthened, the state agencies began again to cover their needs in the exchange market, and the Central Bank was able to buy moderate amounts to add to its working balances, so checking the appreciation of the peso. However, this improvement has been in part due to seasonal factors, as well as to an improvement in short-run expectations.

The easier situation in the exchange market also reflects a substantial improvement in the foreign trade balance of Argentina during 1962. The depreciation of the exchange rate and more restrictive credit policies have stimulated exports and have led to a marked decline in imports. For the year as a whole the trade deficit was reduced by more than \$250 million.

While the external position has improved recently, the internal economic situation has deteriorated gravely. Under the impact of the adjustments forced by the depreciation of the exchange rate and by the accumulation

of internal payments arrears by the Government, industrial activity has declined substantially, particularly during the second half of 1962. During the third quarter of 1962 industrial production was almost 13 per cent below the equivalent period of 1961, and while later estimates of production and unemployment are not available there have been no indications of any recent improvement in the level of activity.

### III. The Financial Program

The Argentine authorities fully intend to continue to pursue the objectives of the stabilization programs which they have endeavored to follow during the past four years. In particular, they intend to maintain an exchange market free of direct restrictions, to continue with strict monetary policies, and to improve the budgetary situation as rapidly as possible. The policies that they intend to follow are described below. In the short time available before the change of administration, however, at best only limited progress can be made toward the solution of the budget problem and in improving the efficiency of the state enterprises. For these reasons and because of the gravely depressed state of the domestic economy, it is felt that external assistance for Argentina, mainly in the form of debt refinancing, will be essential in the next few months to permit a holding operation to prevent any further deterioration and if possible to ease the strain on the economy during this period of political decision.

#### 1. Fiscal policies

In February 1963 the budget estimates for fiscal 1962-63 were reviewed in the light of experience gained during the first three months of the fiscal year. On this basis it appeared that Treasury cash expenditures would reach M\$N 174 billion for the year, while revenues, at existing rates of taxation, would not exceed M\$N 118 billion, leaving an over-all deficit for the year of M\$N 56 billion. Allowing for certain long-term operations, the prospective deficit, to be financed through the banking system, was of the order of M\$N 50 billion. In fiscal 1961-62 the comparable deficit, financed through the banking system, was about M\$N 30 billion.

In the light of these estimates, the authorities have undertaken a series of measures intended to reduce the uncovered deficit to an annual rate of about M\$N 24 billion, which would limit borrowing through the banking system to about M\$N 2 billion a month for the rest of the fiscal year. From November 1962 through January 1963, by contrast, bank financing averaged M\$N 3.4 billion a month.

An initial effort to increase revenues had already been made in November 1962, when a 5 per cent tax was imposed on the value of most agricultural and livestock production, and the price of ordinary gasoline was raised from M\$N 7 per liter to M\$N 10 per liter, with comparable increases for other petroleum products. In February and March 1963 the Government introduced further revenue measures estimated to yield M\$N 14.3 billion in a full year. These included new taxes on cigarettes, gasoline, lubricants,

tires, and lottery prizes, an increase in import surcharges and the elimination of some exemptions from existing import surcharges. The Government has decided to terminate certain arrangements whereby customs duties and other taxes may be paid in installments, and has decided to grant no further tax reliefs or reductions. Steps have also been taken to increase the number of tax inspectors and to improve the tax collection machinery.

As regards expenditures, the scope for economies in the Central Administration is limited, as at present most payments are for salaries and pensions or for debt servicing. A full review of these outlays has been undertaken, however, and it is hoped to effect some new economies. In addition, it has been decided that there will be no wage or salary increases for government employees during the term of the present administration, and that there will be no increases in the scale of social security pensions. A further step looking toward an ultimate overhaul of the pension system has been the decision to end the arrangements under which a contributor to the social security scheme can elect voluntary retirement after 20 years of active employment.

In addition to these measures, some immediate steps have been taken to reduce the deficits of the state enterprises and other agencies, which are responsible for the greater part of the Treasury deficit. In particular, the deficit of the State Railways, which was estimated at almost M\$N 35 billion (including pension payments for the year), is to be reduced by M\$N 7 billion. Of this reduction, M\$N 5 billion will be secured through the renegotiation of debts to foreign and domestic suppliers, and a further M\$N 2 billion from increases in fares and rates and from operating economies. Arrangements have also been made for the State Petroleum Company (YPF) to make regular payments to the Road Fund as required by law. Since the Road Fund will not let any more contracts during the term of the present administration, except for roads financed by IBRD or AID loans, some part of these receipts will be temporarily available for investment in government securities.

It is recognized that the immediate steps described above to reduce the deficits of the state enterprises are only interim measures of limited significance. The eventual reorganization and revitalization of these agencies so as to put them on a sound financial footing would require far-reaching decisions and reforms which would only mature slowly. Some first steps, however, have been taken in this direction. In particular, some of the recommendations of the Transport Planning Group, which are based on a study undertaken jointly with the IBRD, have been put into effect. The management structure of the railroads has been reorganized, giving greater independence to the managers of the individual lines, and a general manager for the system and other key personnel have been appointed. It is the intention of the new managers to make a start with closing unprofitable lines this year, and to release some redundant labor provided the employment situation permits. A new appointment has been made to the presidency of YPF, which has recently been vacant, and the management of this institution too has been reorganized so as to give more authority and independence to the responsible authorities.

## 2. Credit policy

The steps already taken to reduce the fiscal deficit, together with the relief which it is hoped will be obtained from the refinancing of foreign debt and from other sources of external assistance, have made it possible to develop a credit program for the next seven months covering the remainder of the term of the present administration which will be consistent with encouraging the revival of economic activity while limiting inflation and permitting the maintenance of orderly and stable conditions in the free exchange market. Under this program, the net expansion of Central Bank credit from March through September 1963 will be limited to M\$N 2.5 billion a month, which would give a cumulative total of M\$N 17.5 billion in the seven months. This expansion is equivalent to almost 11 per cent of the existing total of the monetary liabilities of the Central Bank or to an annual rate of increase of about 20 per cent and is thus substantially higher than has been programed under previous stabilization plans in Argentina. As indicated above, it will not be possible, despite the efforts of the authorities, to reduce the credit needs of the public sector below M\$N 2 billion a month. Deficit financing on this scale means that the government sector will absorb the greater part of the permissible credit expansion. This in turn will require the continuation of very tight credit policies vis-a-vis the private sector, a development that the authorities regard as unfortunate but inevitable in view of the very low level of international reserves in the Central Bank. The private sector will benefit directly from the improved rate of payments by the Government and additional relief should come from "secondary expansion" of commercial bank lending based on the increased deposits resulting from the Central Bank financing of the Government. Within the available margin of expansion, the authorities intend to meet the seasonal credit needs of agricultural producers, and to pay special attention to the requirements of the sectors suffering from drought. Every effort will be made to counter the effects of the industrial recession. In particular, it is hoped to develop a special scheme for the partial financing of selected nontraditional exports. As in the past, however, the Central Bank will not extend any credits to the Mortgage and Industrial Banks for the purpose of financing their medium-term or long-term operations.

The problem of reserve deficiencies on the part of certain commercial banks has also caused the authorities concern. Recently the position of the Banco de la Nación has improved, but a number of private banks are still in difficulties on account of the nonpayment of loans extended to otherwise sound firms which have themselves been unable to collect debts owing to them. In order to relieve these banks of the extremely heavy burden of penalties for their deficiencies, the Central Bank is planning to permit some deficiencies of this sort to be funded over a period of years, providing that the relief is passed on to the debtor firms. So as to avoid a repetition of the experience of 1962 when a number of banks found themselves overextended by reason of their foreign exchange guarantees, the Central Bank has taken steps to insure the reporting of all such contingent liabilities in the future and has prohibited new bank guarantees of short-term foreign credits not related to imports. The Banco de la

Nación and the Banco Industrial, moreover, have undertaken not to allow their outstanding guarantees of foreign loans on behalf of the private sector to rise above the present level, and to submit guarantees in excess of \$50,000 for prior approval by the Central Bank. The Central Bank itself will continue with its present policy of avoiding exchange rate guarantees or of assuming exchange risks of this kind, including those arising from swap transactions.

### 3. External indebtedness

The heavy volume of short-term and medium-term debt payments falling due in 1963 and the rising burden of interest payments on the balance of payments have shown the need to control future borrowing of this type by the various government enterprises and agencies. Under existing regulations all such borrowing must be registered with the Central Bank. It has now been decided that for the remainder of the term of the present administration new suppliers' credits to the public sector, that is, credits with a term of more than 180 days and less than eight years, will be limited to a total of \$25 million.

### 4. Exchange policy and the restrictive system

It is the firm intention of the authorities to maintain an exchange system free of direct restrictions. Since April 1962 the exchange rate has been free to move in response to changing market conditions, and the authorities do not intend to depart from this policy. Central Bank intervention will be confined to preventing excessive day-to-day fluctuations in the exchange rate. The Central Bank may buy exchange from time to time when market conditions permit, in order to meet its obligations and to maintain an adequate reserve. In no circumstances, however, will the authorities intervene to counter the fundamental trend of the market.

The authorities regret the recent increase in certain import surcharges, which was dictated only by the weakness of the balance of payments situation and by the urgent need to obtain an immediate increase in tax revenues. The increases have been made on a selective basis, with a view to obtaining revenue and not to increasing the already excessive margin of protection accorded to some industries. One important step is being taken toward liberalization, however, with the removal of import surcharges on fertilizers and pesticides. Owing to a serious shortfall in the harvest, exports of wheat were temporarily prohibited in November 1962. The Government has now indicated its intention to remove this prohibition as soon as possible. The authorities have also indicated that certain administrative measures which resulted incidentally in an increased degree of flag discrimination in the Argentine import trade will be terminated as soon as possible.

5. Payments prospects and external assistance

The authorities remain concerned about the payments outlook for the current calendar year in view of the heavy schedule of debt payments and the smaller private capital inflow. It is recognized that the decline in foreign exchange reserves has been checked during the past three months, but it is believed that this improvement is partly due to the seasonal rise in exports. More importantly, they believe it has been due to monetary and fiscal policies which have imposed an impossibly heavy burden on the domestic economy. For example, while foreign debts have been paid on schedule, domestic suppliers in some cases have waited for as much as three years to be paid. If there is to be any relaxation of this severe restraint, it is regarded as inevitable that pressure on the foreign exchange reserves will recur and the Central Bank will need further support. Finally, due to adverse crop conditions it is considered unlikely that the high level of agricultural exports reached in 1962 will be sustained.

As debt payments on account of the official sector, including the Central Bank, will amount to over \$400 million in 1963, a major part of the support was requested in the form of debt refinancing. During 1962 the Export-Import Bank agreed to 100 per cent refinancing of principal payments due from Argentina to an aggregate amount of \$72 million, sufficient to cover all maturities for about 22 months beginning November 15, 1962. The Federal Republic of Germany, Italy, the United Kingdom, Japan, France, Switzerland, and the Netherlands have also agreed in principle to refinance 50 per cent of the maturing principal payments for 1963 and 1964 on most suppliers' credits, assistance equivalent to about \$135 million. Readjustment of quotas of payment in the old Paris Club debts also provided a reduction of \$15 million in payments in 1963.

In view of the deteriorating economic situation, the Argentine authorities have requested financial assistance from the U.S. Government in addition to the refinancing already provided by the Export-Import Bank and the remaining \$25 million of the U.S. Treasury stand-by arrangement. It is hoped that up to \$40 million additional assistance may be made available by the U.S. Government. There has also been a request that the European countries and Japan consider increasing the refinancing provided for suppliers' credit maturities in 1963 above the 50 per cent previously agreed in principle. Finally, it is also planned to approach the European and U.S. banks to extend the maturities of repayments due in 1963 on loans contracted in 1960. With this support for their policies, the Argentine authorities believe that it will be possible, as described above, to promote some measure of economic recovery and to maintain orderly conditions in the free exchange market until the new administration takes office in October 1963.



#### IV. Staff Appraisal

The serious economic difficulties currently faced by Argentina are a clear indication that the efforts of the authorities over the past four years to overcome the country's economic problems have not yet been successful. There have been considerable achievements in some areas. The exchange system is now free from direct restrictions and most domestic controls have been dismantled. In another direction, there has been extensive industrial re-equipment. Nevertheless, it is evident that there are very serious continuing weaknesses. Much has clearly yet to be done if Argentina is once again to achieve the rate of economic growth of which it is inherently capable.

An examination of the program outlined by the authorities discloses that it is designed primarily to meet the immediate task of checking the deterioration of the situation and that relatively little progress is expected toward overcoming the more basic problems in the next seven months. Although efforts are being made to strengthen the railway management, the crippling deficit of the railways, by itself equivalent to 20 per cent of the total exports of the country, will undoubtedly continue close to the same level as last year, apart from some relief coming from debt refinancing. The petroleum industry, which in every other country with resources similar to those of Argentina contributes heavily to financing the public sector, will at best cease to absorb tax revenues. The civil service, due to an undue distortion of pay scales, will continue to be very seriously understaffed at policy-making and executive levels while maintaining excessive numbers in the lower grades. Pensions will continue at scales far beyond the capacity of even wealthier economies. High cost and inefficient industries will continue to be encouraged by protection, thus inhibiting the development of agriculture and competitive export manufactures.

The policies outlined by the authorities must thus be judged as a first attempt to cope with the problems that present themselves. It is admitted that much remains to be done in the over-all attack on the problem of financial instability. But the efforts made must be viewed in the light of present political conditions. At this moment of serious political difficulties and with general elections scheduled for June 23, 1963, it does not seem feasible for the major economic problems to be solved by the present administration. Thus, the authorities are confining their efforts primarily to providing as stable an economic basis as possible while a political solution is being reached.

By this test, the efforts are substantial and the program can be judged favorably. It provides for increased taxation on luxury goods and on imports to provide the revenues needed to avoid the accumulation of further arrears of internal payments. It is strongly felt by the authorities that this disorderly practice has sharply reduced the authority of the Government and cannot be allowed to persist indefinitely. From this decision logically follows the policy of denying further wage and pension increases during the term of this administration, as it would be foolish to grant increases when present remunerations are not being paid.

Although the Argentine Government is making a substantial effort through economies and new tax measures, a more substantial contribution to the easing of the immediate difficulties is expected to come from foreign assistance, especially foreign assistance in the form of debt refinancing. It is unfortunate that a country of Argentina's resources should be in a position where such help is necessary, but in present circumstances full servicing of the external debt would almost certainly lead to serious economic difficulties, with especially severe impact on the exchange market. It will only be by courageous policies that any substantial amount of debt service can be maintained. The willingness of the creditors to show forbearance in this period will be invaluable. It is in the interests of both Argentina and the creditors for the problems to be faced realistically at the negotiating table and not by disorderly defaults in payments. But, it is also important at this time that the origins of the problem are understood and that steps are taken to prevent their recurrence. It is necessary both for creditor countries to be less forthcoming with credits designed primarily to sell exports, and for Argentina to institute much more effective controls over the contraction of foreign debts. The ceiling imposed on suppliers' credits by the authorities is a useful first step, but if it is to succeed in the longer run it must be followed up by effective and detailed planning of the borrowing programs of the state enterprises.

The credit program of the authorities provides for an unusually large amount of credit for the public sector. This is most unsatisfactory since it diverts capital to unproductive uses. However, in circumstances where the Government is not able to reduce its commitments, a refusal to use this source of financing would inevitably lead to further arrears of payments to suppliers and this is more damaging to the private sector than any lack of new bank credit.

The over-all expansion of Central Bank credit is much larger than is consistent with the rebuilding of the foreign assets of the Central Bank that is eventually necessary for the proper management of the exchange market. Inevitably with this expansion there will be a continuation of price increases, perhaps at a rate slightly below the past year. It is, however, the consequence of the unsolved budgetary problems described above. Moreover, it is to be noted that, with the increased support that is expected and with the consequent easing of the immediate payments problem, an internal expansion of this magnitude should be possible without it bearing heavily on the exchange market. Furthermore, due to the depressed state of industry, there is a definite need for a certain amount of expansion. There has been an undue contraction in peso holdings and it should be possible, if political conditions improve, for these balances to be at least partially rebuilt.

As indicated above, Argentina is not in this period making much headway toward a solution of its budgetary problems. This raises a question concerning the justification of further use of Fund resources. However, it appears to the staff that there are special circumstances in this case which do justify drawings under the stand-by arrangement. Argentina has

maintained close contacts with the Fund and has in fact made substantial progress under the program on which this stand-by arrangement was originally granted in reducing its balance of payments deficit. At considerable cost to the internal economy, Argentina has responsibly maintained external debt service while reducing imports and expanding exports under the stimulus of a depreciating exchange rate and relatively tight Central Bank credit policies. Moreover, Argentina has maintained intact the freedom of the exchange market from direct restrictions, thus avoiding the serious distortions which would otherwise have arisen in this difficult period. At this time, due to the imminence of a political decision, it is not feasible for more substantial progress to be made toward solving the budgetary problem.

It is therefore recommended that the stand-by arrangement be extended to October 6, 1963, in consideration of the letter of March 13, 1963 from the Minister of Economy and the President of the Central Bank. Under the extended stand-by arrangement Fund holdings would not increase at any time above 162 per cent of quota.

The following decision is submitted for the consideration of the Executive Board:

1. Argentina has requested that its present stand-by arrangement which expires on June 6, 1963 (EBS/62/59, Sup. 2, 6/6/62) be extended through October 6, 1963. The Fund agrees to the request and grants the necessary waiver under Article V, Section 4, of the Fund Agreement.

2. In addition, Argentina has consulted the Fund on the terms and conditions for further drawings under the stand-by arrangement. The letter of March 13, 1963 from the Minister of Economy and the President of the Central Bank of Argentina (EBS/63/37, 3/18/63) shall be annexed to the stand-by arrangement with Argentina and the references in the stand-by arrangement to the policies and intentions of Argentina set forth in the letter of May 14, 1962 shall be understood to mean those policies and intentions as modified by the letter of March 13, 1963.

3. The first sentence of paragraph 4 of the stand-by arrangement with Argentina is amended to read as follows:

"For the period ending on October 6, 1963 Argentina will have the right, subject to paragraph 12 of the annexed letter of March 13, 1963, to purchase from the Fund the currencies of other members in exchange for its own currency in an amount equivalent to \$100 million, provided that the total amount of all purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of \$75 million before May 31, 1963, and thereafter a cumulative total equivalent to this \$75 million plus \$5 million for each month after May 31, 1963."

4. The following shall be added at the end of paragraph 8 of the stand-by arrangement with Argentina: "In accordance with the Fund's decision of July 20, 1962."

Annex to Stand-By Arrangement

Poder Ejecutivo Nacional

MINISTERIO DE ECONOMIA

Buenos Aires, March 13, 1963

Dear Mr. Jacobsson:

1. Last June the International Monetary Fund entered into a stand-by arrangement with Argentina for \$100 million which enabled it to face a very difficult balance of payments situation. Argentina has purchased \$50 million from the Fund under this arrangement and has followed policies which have permitted considerable progress to be made in overcoming the problem. The very large trade deficit is being rapidly eliminated, and the decline in the foreign exchange reserves of the Central Bank has been checked. At the same time, the Argentine authorities have facilitated the servicing of all bank-guaranteed foreign debt obligations virtually without delay. However, the burden to the economy resulting from this adjustment of the balance of payments to the repayment of foreign debt has been substantial, while at the same time Argentina has been passing through a period of political uncertainty. Business activity has declined, and in particular there has been a substantial reduction in manufacturing output. For these reasons, it has not been possible to carry through the fiscal program as it was originally planned. Tax receipts have fallen below expectations, and it has not yet been possible to improve the efficiency of the state enterprises.

2. At this time, the Argentine Government is making renewed efforts to meet these problems, and requests the continued support of the Fund on the terms described in this letter under the present stand-by arrangement, extended for a further four months until October 1963. This period coincides with the remaining term in office of the present administration. Additional support for these efforts is also expected from the U.S. Government in the form of debt relief and new credits, and from European Governments (Paris Club) and Japan through debt relief. Moreover, the authorities intend to approach other foreign suppliers with a view to renegotiating additional debts owed by the public sector.

3. The most important immediate cause of the economic problem of Argentina has been the seriously unbalanced budget of the National Government. To improve this situation the Government has taken a series of measures during the past few months. In November 1962 the price of gasoline was raised from M\$N 7 to M\$N 10 per liter, and a new 5 per cent tax was imposed on meat and cereal products, notwithstanding the unsuitability of this measure from the standpoint of stimulating agricultural production. More recently, in February 1963, the Government has introduced additional taxes which are expected to yield M\$N 14.3 billion a year, equivalent to about 11 per cent of estimated level of receipts in the current fiscal year.

These include (a) a new tax of M\$N 1 per liter on gasoline, to yield M\$N 3.8 billion; (b) an increase in the price of cigarettes, to yield M\$N 3 billion; (c) increased surcharges on imports and the elimination of certain exemptions from existing surcharges, to yield M\$N 5 billion; (d) an increased tax on lubricants, to yield M\$N 1.5 billion; and (e) miscellaneous minor taxes, to yield M\$N 1 billion. The railroads have increased suburban passenger fares by 10 to 15 per cent, long distance passenger fares by 10 per cent, and freight rates by up to 10 per cent. The state gas corporation has also increased its charges, and increases have been authorized in road transport fares and electricity charges in Buenos Aires. In addition, the Government is making a complete review of its expenditures so as to introduce all possible economies. Moreover, plans for new investment expenditures financed from domestic sources have been postponed until the new administration takes office. Thus, the road agency has virtually ceased to undertake new projects except for those financed by foreign funds. The Government has also decided that no new tax reliefs or reductions will be made during the period of the stand-by arrangement, and has implemented a program to improve tax collections.

4. During the past year the difficult financial position of the Government has led to considerable delays in the payment of salaries, pensions, and debts owing to suppliers, a situation which the authorities regard as most undesirable and unjust. In view of the need to concentrate available resources on achieving more regular payments in the future, it has been decreed that during the term of this administration no wage or salary increases will be considered for employees in the public sector, and there will be no increases in the existing scale of social security pensions. As a longer term measure, directed toward the reform of the social security arrangements, the Government has also annulled the right of contributors to the social security pension funds to elect voluntary retirement on part pension after 20 years of active employment.

5. In addition to the immediate steps to reduce the cash budget deficit, the authorities have taken measures designed to achieve over the longer run an improvement in the operations of the state-owned enterprises. In particular, many of the recommendations of the Transport Planning Group, based on a study undertaken jointly with the IBRD, for a complete reorganization of the administration of the railroads have been implemented, and a completely new structure of management has been introduced, giving greater authority to the managers of the individual lines. In addition, the management of the State Petroleum Company (YPF) has been strengthened and reorganized. Moreover, the authorities have given close attention to the problem of the disorderly acceptance of foreign credits by state enterprises, and for this and other reasons have decided to strengthen greatly the National Development Council. Henceforward, all foreign borrowing by the public sector will require prior authorization of the Ministry of Economy on the advice of the National Development Council and the Central Bank. To perfect the technique of these controls, the Government plans to obtain technical assistance from the IBRD.

6. Despite the substantial efforts of the authorities and the relief provided by debt refinancing from abroad, it will not be possible for the Government to avoid some financing for the public sector from the Central Bank in the next few months. The total amount of such financing will at no time exceed the cumulative total of M\$N 2 billion monthly for the seven calendar months March through September 1963.

7. The Central Bank financing of the public sector on the scale foreseen will lead to some monetary expansion through the commercial banks. This in turn should ease the tight monetary situation of the private sector, which has been due in large part to the unsatisfactory state of the public finances. In addition, the Central Bank will provide a small amount of credit to the private sector through normal seasonal rediscounts and export credits, and whatever assistance is possible to the sectors affected by the economic recession and the drought. The amount of this expansion, however, will be strictly limited in view of the low level of the resources of the Central Bank. Thus, the total domestic assets of the Central Bank, including export credits and the amounts released by any reduction of reserve requirements against the liabilities of the commercial banks, will not at any time exceed the level of February 28, 1963, increased on a cumulative basis by M\$N 2.5 billion a month in each of the seven months March through September 1963. Moreover, the Central Bank will adhere strictly to the policy of not entering into any new operations with the Industrial and Mortgage Banks to finance medium- and long-term transactions by those banks.

8. Currencies drawn from the Fund will be used to maintain an orderly exchange market free of restrictions with a single exchange rate free to fluctuate in response to fundamental market trends. Further, the Central Bank will continue with its policy of refusing to grant exchange rate guarantees or to assume exchange risks arising from any type of contract.

9. The Government regrets that little progress has been made in reducing the high level of taxes on imports, and that recently some additional increases have been imposed. It is recognized that the degree of protection afforded by these taxes is excessive and will lead to the undue growth of high-cost inefficient industries, thus retarding the growth of the economy. In view of the difficult payments situation, it is necessary at this time to limit imports and also to obtain as much revenue for the budget as possible. An exception, however, has been made in the case of fertilizers and pesticides, the surcharges on which were removed in March 1963. Upon the return of more normal circumstances, the Government plans to review the entire system of import surcharges and to reduce these taxes as much as possible.

10. Because of the effect of the drought on the volume of wheat production it was necessary to suspend exports after they had reached 1,300,000 tons, in order to insure the necessary minimum for domestic consumption. This was an emergency measure which the government intends to re-examine as soon as the means are obtained to enable the domestic industry, with proper financing, to make its purchases in free competition with exporters. In addition, recent measures increasing shipping discrimination which were introduced primarily for administrative reasons will be terminated as soon as possible.

11. As recent events have shown the need for tight control over foreign borrowing by the public sector, the authorities have introduced strict limits on new operations of this type. In particular, the Government has decided that from February 28, 1963 until the new administration takes office the total amount of new suppliers' credits for more than 180 days for the public sector, all of which are registered at the Central Bank, will not exceed \$25 million. In addition, to insure that foreign commitments on behalf of the private sector do not again become unduly large, the Central Bank has taken action to insure regular and prompt reporting of all guarantees of foreign loans made by the commercial banks. Regulations have been issued prohibiting any new bank guarantees on short-term financing from abroad not specifically related to imports and providing for the gradual elimination of existing guarantees of this type. Finally, the Industrial Bank and the Bank of the Nation have undertaken to keep all guarantees of foreign loans to the private sector at their present level, and to submit for prior Central Bank approval all such guarantees in excess of \$50,000.

12. During any period in which (a) the limits specified in paragraphs 6, 7, and 11 of this letter are exceeded, or (b) any restrictions on exchange transactions are maintained, Argentina will not request any further drawing under the stand-by arrangement except after consulting the Fund and agreeing with it on the terms on which further drawings may be made.

Sincerely yours,

/s/  
Luis Otero Monsegur  
President  
Central Bank of Argentina

/s/  
Eustaquio Méndez Delfino  
Minister of Economy

Mr. Per Jacobsson  
Managing Director  
International Monetary Fund  
Washington 25, D.C.