International Monetary Fund

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International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

IMF Approves Three-Year Extended Fund Facility for Argentina

The International Monetary Fund (IMF) today approved a three-year credit for Argentina equivalent to SDR 2.08 billion (about US$2.8 billion) under the Extended Fund Facility (EFF)[1] to support the government's medium-term economic reform program for 1998-2000. The government attaches importance to the Fund's approval of its policy framework. It intends to treat the EFF credit as precautionary, and will only draw under it if adverse external circumstances make it necessary.

Background

Argentina registered a strong macroeconomic performance in 1997. The economy grew very rapidly, the unemployment rate fell, and inflation was virtually zero. The fiscal position improved as programmed, and there were no major difficulties in financing a widening of the external current account deficit. The prudent borrowing strategy followed by the public sector, and especially the strengthening of the banking system achieved in recent years, allowed Argentina to weather the turbulence that affected international capital markets in the latter part of the year without major immediate consequences for the economy.

The authorities attach the highest priority to maintaining stable macroeconomic conditions in the context of the convertibility regime—which pegs the Argentine peso to the U.S. dollar and enjoys broad political and social support—and continuing structural reform and modernization of the economy.

Medium–Term Strategy and the 1998 Program

The program for 1998–2000 assumes that the expected slowdown in the growth of world trade caused by the crisis in emerging economies in Asia will result in a deceleration of Argentina real GDP growth in 1998, but that real GDP growth should recover to potential output by 2000. The rate of unemployment should continue to decline gradually, inflation should remain in the neighborhood of 1 percent in 1998, and the current account deficit, as a result of an expected upturn in exports, should decline to about 3.5 percent of GDP by 2000.

The program envisages the continuation of fiscal adjustment, with near balance being reached in the public sector accounts by 2000. A reduction of the overall federal government deficit from the equivalent of 1.4 percent of GDP in 1997 to 1 percent of GDP in 1998 and further to 0.3 percent of GDP by 2000 is envisaged, despite the transitional costs of the switchover to privately administered pension funds, equivalent to about 1 percent of GDP annually.

Revenues in 1998–2000 should rise somewhat faster than GDP, reflecting the introduction in 1998 of a tax simplification for small businesses and the full effect of reforms in tax and customs administration, which already had begun to show positive results in 1997. To help contain expenditures, the present system of monthly budget authorizations will continue to limit outlays of spending ministries, and further savings are expected from the final stage of the restructuring of the social security administration.

The rules-based monetary framework under the currency board arrangement aims to strengthen confidence by maintaining a sound financial system and providing for an adequate cushion of liquidity that could compensate for the limited role of the central bank as a lender of last resort in the event of a crisis.

Structural Reforms

The structural reform agenda for 1998–2000 includes reforms in the labor market, in the tax system, and in budgetary procedures, the conclusion of the privatization process, and reforms in the health and judicial systems.

The program envisages putting in place a reform of the labor market by mid 1998. A comprehensive tax reform will seek to improve efficiency and equity of the tax system and promote the competitiveness of the economy. Reforms in budgetary procedures aim at promoting transparency and efficiency in public spending and include widening the coverage of the budget, moving to a pluriannual process, preparing annual assessments of the cost of fiscal benefits and incentives, and introducing the use of expenditure efficiency indicators.

Having divested itself from most of its enterprises over recent years, the federal government recently leased airports to the private sector and intends to proceed with the leasing of telecommunication frequencies by mid 1998. Other privatizations envisaged by the government for the period 1998-2000 include several power plants and the National Mortgage Bank. The government has also announced its intention to privatize the Banco de La Nación--the largest bank in the country.

Initiatives in health care will include a revision of the regulatory framework for private health care providers and the final phases of the restructuring of health insurance system for retirees and of health organizations run by unions. As part of a broader initiative to reform the judiciary system, the program also includes undertakings to modify judicial procedures to speed up the resolution of tax cases and increase legal security in credit markets.

Addressing Social Needs

Building on the significant progress made in 1997 in the area of poverty alleviation, the government intends to continue its efforts to restructure social programs to better target budgetary resources toward vulnerable groups. In addition to programs providing health care, food, assistance, and schooling respectively to needy mothers and infants, homeless children, needy elderly, and teenagers, low-cost housing will also be provided for at least 50,000 families a year, and basic infrastructure will be made available for the 1,000 poorest municipalities.

The Challenge Ahead

The strong growth of productive investment over recent years should result in further substantial gains in productivity and competitiveness, helping to moderate the widening of the current account deficit that accompanied economic recovery in 1997. To consolidate this process, a continued strengthening of financial policies, and further progress in structural reforms, especially in the labor market, are crucial to ensure the simultaneous achievement of a steady improvement in competitiveness and a further sustained decline in unemployment.

Argentina joined the IMF on September 20, 1956. Its quota[2] is SDR 1,537.1 million (about US$2,078 million). Its outstanding use of IMF credit currently totals SDR 4,246 (about US$5,739) million.

Argentina: Selected Economic Indicators

	1996	1997*
	(Percent change)	
Real GDP growth	4.2	8.1
Consumer prices (end of period)	0.0	0.3
	(Percent of GDP)	
Overall federal government balance (deficit-)	-2.2	-1.4
External current account balance (deficit-)	-1.9	-3.8

Sources: Argentine authorities; and IMF staff estimates.

* Projection.

[1] The EFF is an IMF financing facility that supports medium-term programs that seek to overcome balance of payments difficulties stemming from macroeconomic imbalances and structural problems. The repayment terms are 10 years with a 4 ½-year grace period, and the interest rate, adjusted weekly, is about 4.2 percent per annum.

[2] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

FOR AGENDA

EYZAGUIRRE G., Nicolas
ROOM HQ 11-320 0451

EBS/99/4

CONFIDENTIAL

January 13, 1999

To: Members of the Executive Board

From: The Secretary

Subject: **Argentina—Second Review Under the Extended Arrangement—Letter of Intent**

Attached for consideration by the Executive Directors is a letter of intent from the President of the Central Bank of the Republic of Argentina and the Minister of Economy and Public Works and Services, together with the policy memorandum of the government of Argentina. This subject, together with the staff report for the 1998 Article IV consultation with Argentina and the second review under the Extended Arrangement for Argentina (to be issued shortly), will be brought to the agenda for discussion on a date to be announced.

Mrs. Ter-Minassian (ext. 38844) or Mr. Reichmann (ext. 38610) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

Buenos Aires, Argentina
January 11th, 1999

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

Dear Mr. Camdessus:

The attached policy memorandum describes the progress made to date in the implementation of the economic program of the Government of Argentina for the period 1998-2000, which is supported by an extended arrangement from the Fund. Consistent with the undertakings included in our letter of December 3, 1997, the attached policy memorandum also details the economic policies for 1999. The Government of Argentina believes that the policies described therein are appropriate to continue achieving the objectives of its economic program and, together with the progress made so far in its implementation, provide a firm basis for concluding the second review under the arrangement.

During the remaining period of the arrangement, the authorities of Argentina will maintain close contacts 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. A third review of the program will be carried out with the Fund before end-September 1999.

Sincerely

/s/
Pedro Pou
President
Central Bank of the
Republic of Argentina

/s/
Roque Fernandez
Minister of Economy and
Public Works and Services

Attachment:
Policy Memorandum

POLICY MEMORANDUM

I. RECENT DEVELOPMENTS

1. From 1996 to the first half of 1998 the Argentine economy experienced rapid GDP growth in a context of price stability. More recently, however, the economy has not escaped the contagion from the Russian debt crisis, and has come under pressure. Reduced international capital inflows, combined with an increase in local interest rates and a decline in asset prices, contributed to weaken domestic demand which, together with a drop in exports, led to a decline (seasonally adjusted) in real GDP in the second half of the year. Nonetheless, for the year as a whole, real GDP is still expected to have shown positive growth of about 4½ percent. The rate of unemployment fell further to 12.4 percent in October, 1998, and consumer price inflation has continued below 1 percent per year. Import growth has decelerated in recent months; however, reflecting mainly a marked deterioration in the terms of trade, the trade deficit is expected to increase to US$6 billion in 1998, resulting in a current account deficit of the balance of payments of around 4.5 percent of GDP. Notwithstanding the crisis, the growth of deposits and the buildup of international reserves continued in the second half of the year, albeit at a much reduced pace, and the stock of international reserves, including liquidity requirements held abroad, increased to US$31.7 billion at the end of 1998 from under US$30 billion at the end of 1997.

2. **Macroeconomic policies** have been kept broadly in line with the program for 1998, and all program targets through September were met. However, the increased pressures that have emerged in recent months, including the slowdown in economic activity, may have resulted in a small deviation in two of the end year targets. The federal government deficit, estimated at Arg$3,850 million in 1998 (1.1 percent of GDP), may have exceeded the program ceiling by about Arg$350 million or around 0.1 percent of GDP. Efforts were made to contain expenditure; in fact, discretionary primary expenditure is estimated to be around Arg$1.5 billion below the program ceiling for 1998, notwithstanding sizable additional costs associated with floods brought about by the El Niño phenomenon. These efforts, however, could not compensate fully for a revenue shortfall that reflected mainly arrears in the payment of VAT, an acceleration of tax refunds in the first half of the year, a larger than anticipated shift of contributors from the public to the private pension system, and delays in the leasing of telecommunications frequencies. The aggregate provincial deficit is estimated also to have exceeded the indicative ceiling envisaged in the program by some 0.2 percent of GDP, reflecting the combined effects of the tax revenue shortfall and higher than programmed expenditures by some provinces. Despite these deviations, the program ceilings on the growth of total and short term public debt for 1998 were met with some margin as, in the context of tighter conditions in international capital markets, a larger than anticipated share of the deficit was financed by a run down of public sector deposits and receipts from asset sales. The ceiling on the expansion of the net domestic assets of the central bank also was met.

3. As regards **structural policies** in the fiscal area, the tax reform was approved largely as proposed. This reform will permit a broadening of the taxable base of the VAT, the introduction of a minimum corporate income tax based on firms' assets, improved transfer-pricing rules for tax purposes, and new rules for the deductibility of interest costs from the income tax. The provinces and the federal government have agreed to limit the coparticipation of the yield of the reform of the various taxes, to provide room for the reduction of employers' social security contributions. At the same time, steps have been taken to strengthen tax administration through the introduction of pre-shipment inspection of imports, improvement in tax audit procedures, upgrading of the information system of the Federal Administration of Public Revenue (AFIP), the introduction of a single presumptive tax (monotributo), a tightening of controls on the printing of VAT invoices, and the speeding up of the resolution of court cases in the area of tax enforcement.

4. Measures were taken to improve further the public expenditure management information system, and to promote cost effectiveness in public expenditure programs. A Public Ethics Office was set up and a new code of ethics of public employees was drafted. With assistance from the World Bank and the IDB, measures were adopted to improve the efficiency, targeting, monitoring, and control of social programs, and the administrative reform of the National Administration of Social Security (ANSES) was implemented as planned. The government leased most of the national airports in 1998, and completed the preparations for the privatization of the National Mortgage Bank and the sale of its remaining stake in the former state oil company (YPF).

5. In the financial sector, a new bank surveillance system was introduced, reinforcing external auditing procedures. The payment system was overhauled, by introducing a real time gross settlement system and new automated clearing houses, thereby reducing operating costs and the credit risk implicit in the settlement of financial transactions. As a step in the reform of labor market legislation, a law was approved that reduced dismissal costs, while eliminating most forms of temporary labor contracts with reduced social security contributions. In the area of education, efforts are underway to raise the number of years of mandatory basic general education and improve the standards of secondary education. In the judicial area, a National Judiciary Council has been established to manage the appointment of judges and oversee their activities, and steps are being taken to strengthen the State Attorney and Public Defender Offices, the provincial judicial systems, and the operations of the judiciary in the areas of tax enforcement and execution of bank collaterals and guarantees. Regarding health care, the restructuring of the union-run health organizations (Obras Sociales) and the health insurance system for retirees (PAMI) continued, with assistance from the World Bank and the IDB.

II. THE ECONOMIC PROGRAM FOR 1999

6. As anticipated in the policy memorandum attached to our letter to you of December 3, 1997, the government intends to continue in 1999 to aim its economic policies at promoting sustainable growth of output and employment, addressing priority social needs, and maintaining low inflation and a viable external position. In view of the presidential elections scheduled for October 1999, and in the context of the greater uncertainty associated with the present adverse international environment, the government recognizes the critical importance of maintaining the disciplined and restrained macroeconomic policies of recent years, making further progress in improving the public finances, strengthening the financial system, enhancing competitiveness, and deepening structural reforms. Continued Fund support through the extended arrangement will be important to help attain these objectives. In keeping with the precautionary character of this arrangement, the government intends to maintain the drawing rights accumulated so far under it as last resort borrowing.

7. The **short term macroeconomic outlook** is affected by the recent developments in international financial markets and the slowdown in the economies of Argentina's main trading partners. The 1999 program is based on the assumption that the rate of real GDP growth bottomed out in the last quarter of 1998 and will recover significantly in the course of 1999, averaging 2½–3 percent for the year as a whole. The program aims at keeping the annual rate of inflation at less than 1 percent, which is below the average in major trading partners and, together with an expected increase in productivity and the favorable impact of the tax reform on labor costs, will strengthen Argentina's international competitiveness. The external current account deficit is likely to widen to 4.9 percent of GDP in 1999, reflecting the continued weakness of commodity prices, the slowdown in external demand, and the growing external debt service burden.

8. **Fiscal policy** will continue to play a key role in raising savings and strengthening confidence in the continued viability of the convertibility regime. The program for 1999 aims at raising the primary surplus of the federal government from 0.7 percent of GDP in 1998 to 1.2 percent of GDP in 1999. With this result, the federal government deficit is projected to decline from Arg$3,850 million (1.1 percent of GDP) in 1998 to Arg$2,950 million (0.8 percent of GDP) in 1999. At the same time, the deficit of provincial governments, including the expenditure of a provincial trust fund for infrastructure, is expected to decline to Arg$1,450 million (0.4 percent of GDP) in 1999. With these outcomes, and taking into account the use of privatization receipts and the effects of the recognition of certain past obligations, in 1999 the federal public sector debt will increase by the equivalent of 0.5 percent of GDP to around 33 percent, while that of the provinces will rise slightly to 4½ percent of GDP.

9. Despite the planned reduction in employers' contributions to social security, federal government **revenue** is projected to rise slightly faster than GDP in 1999 because of the tax reform and continued efforts to strengthen tax administration. The tax increases included in

the tax reform mentioned in paragraph 3 will come into effect on January 1, 1999, but as the reduction in employers' contributions envisaged in the reform will be implemented gradually throughout the year, the reform is expected to result in a net increase of tax revenue in 1999. The government will continue to work with the provinces on the formulation of a proposal to fundamentally reform the **tax sharing** arrangement, as mandated by the 1994 constitution.

10. With respect to **tax administration**, the federal tax service (AFIP) will continue to implement the program described in the 1997 policy memorandum. In particular, during 1999 the AFIP will: (a) complete the shift to the new electronic tax filing and collection system (OSIRIS); (b) strengthen auditing procedures; (c) propose to Congress a modification of the tax code aimed at tightening time limits for tax audits and resolution of tax disputes, streamlining tax judiciary procedures, and establishing a single tax branch in the Judiciary; (d) submit to Congress a bill to strengthen collection of tax arrears by authorizing AFIP to put a lien on delinquent taxpayers' assets; (e) amend the customs code, following its congressional approval, with a view to incorporating MERCOSUR norms and new WTO valuation rules; change the labor statute for customs' employees; and upgrade the customs information system; and (f) broaden the coverage of the pre-shipment inspection system to include transactions of US$800 or more. The creation of a unified data bank for taxpayers, pensioners, and welfare recipients (SINTYS) also will contribute to strengthening the tax administration.

11. The 1999 budget approved by Congress envisages a freeze in nominal terms in primary federal **spending** which, excluding mandated transfers to provinces, will be kept to at most Arg$38,050 million, implying a reduction from 11.2 percent of GDP in 1998 to 10.8 percent of GDP in 1999. This expenditure containment effort will be facilitated by further steps in the area of **budgetary reform,** to promote efficiency in the use of public resources, including by improving procurement regulations and completing the computerization of procurement procedures, making a more comprehensive use of indicators of efficiency of public expenditure programs, and continuing the expansion of the Treasury's expenditure management information system (SIDIF) to include the operations of decentralized agencies.

12. Within the overall expenditure containment effort, special attention will be given to improving the efficiency of social spending. In the **education** area, a law approved in November 1998 provided additional resources of around Arg$300 million to assist provinces in the implementation of the Federal Education Law of 1993 and the Federal Education Pact of 1994, which were designed to improve the coverage and quality of basic and secondary education. As part of these efforts, the federal government will assist the provinces in the reform of the teachers' labor statute, with a view to raising professional standards while generating savings through productivity gains. With respect to tertiary education, steps will be taken in 1999 to restructure the financing of state universities, with emphasis on cost recovery, and to modernize their budgetary practices. To improve the targeting of **social protection programs**, the government will merge all food programs of the Secretariat of

Social Development under a single management unit, will extend the system to register beneficiaries of social programs (SISFAM) to all social programs, and will review the distribution of, and propose new eligibility criteria for, noncontributory pensions. The pluri-annual budget recently approved by Congress contemplates an increase in social spending from 74 percent of primary spending in 1998 to nearly 75 percent in 2001.

13. Further steps are required to consolidate the **reform of the social security** implemented in recent years. In particular, the government will seek to replace the minimum universal benefit (PBU)—which at present entails a commitment to provide a common basic benefit to every pensioner—with a means-tested arrangement consistent with the financial viability of the social security system and that would facilitate the redistribution of resources to the lower-income beneficiaries. The government also intends to strengthen the controls and collection procedures aimed at bringing into the system the segments of the population in the informal economy that still lack social security coverage.

14. A more fundamental change in fiscal policies will occur as a result of a "**Fiscal Responsibility Law**" which is expected to be approved by Congress in the coming months. This law will set limits on the indebtedness of the government, will constrain the growth of current public expenditure to that of GDP, and establish a Fiscal Stabilization Fund—to be financed by a percentage of tax revenue—to smooth out the impact of cyclical fluctuations and/or external shocks on tax revenue. The proposal establishes penalties on civil servants that fail to implement the budget and calls for mid-year congressional hearings on its implementation. The law also will help fiscal transparency by prohibiting the creation of extra budgetary funds and by requiring a detailed published account of the implementation of the budget. This law will be an essential complement to the Convertibility Law and will contribute to strengthening the basis for sustainable economic growth.

15. In 1999, the government intends to make further progress in the **privatization** or leasing of enterprises that remain under government control, together with selling its residual stake in previously privatized public enterprises. In particular, the government expects an early resolution of judiciary challenges that so far have prevented the leasing of telecommunication frequencies, to allow this operation to go through in 1999. Several nuclear and hydroelectric power plants will also be leased in 1999. During the year, the government expects to complete the privatization of the National Mortgage Bank and to sell its remaining stake in YPF and the loan portfolios of liquidated federal banks, such as BANADE. In the case of the last remaining federal commercial bank, the Banco Nación, the government will seek to shift its legal status from a state enterprise to a state-owned corporation, to allow greater disclosure of information on its activities and increased managerial responsibility.

16. The **provinces** are expected to strengthen their financial position in 1999 and their deficit is projected to decline from an estimated Arg$1,870 million in 1998 to Arg$1,450 million in 1999. Consistent with this objective, the government will continue to make the

granting of federal approval of provinces' foreign currency borrowing conditional on the observance of indicators of financial solvency, while the central bank will continue to enforce existing prudential regulations on the provinces' borrowing from domestic banks. The government will set up a system to collect and publish more up to date information on the finances of the provinces.

17. The government has recently begun to regain access to international capital markets, and a continuation of this process will facilitate **public debt management** in 1999. The government intends to limit recourse to short term debt, which will be kept at no more than 1.5 percent of GDP throughout 1999. It will also endeavor, market conditions permitting, to maintain the average maturity of the public debt at around nine years; and will seek to rebuild and maintain during 1999 a liquidity cushion equivalent to the budgetary financing requirements for a representative three-month-period.

18. Consistent with the convertibility regime, **financial policies** will continue to aim at strengthening confidence in the domestic banking system. In this context, the central bank will seek a further reduction in its net domestic assets in 1999 in line with the scheduled repurchases from the IMF and a recovery of repos' with the banking system. The central bank is seeking to augment the contingent repo facility with foreign banks, so as to maintain a total coverage of bank deposits with liquid assets (foreign exchange reserves plus the repo facility) at around 33 percent. To strengthen bank supervision further, the central bank will enhance its monitoring of bank risks, by incorporating on- and off- balance sheet items in determining compliance with prudential norms. Also, it will introduce market-risk components into CAMEL ratings, as well as stress analysis of banks' balance sheets as recommended by the new banking supervision manual being prepared by the superintendency of banks.

19. While the domestic banking system has weathered well the recent turbulence in international capital markets, additional steps will be taken in the area of **financial reform** in 1999 to strengthen the health of the system even further. In particular, the government will seek congressional approval of the already submitted changes to the Charter of the Central Bank (BCRA) and the Law of Financial Entities,' with a view to bringing them into line with the changed circumstances in financial markets and enhancing the BCRA's capacity to deal with the new challenges it faces. These changes would, inter alia, (a) facilitate the maintenance of adequate capitalization of the BCRA; (b) enhance the regulatory capacity of the BCRA, including over the banks' off-balance sheet operations, their internal and external indebtedness, and the activities of trust funds, mutual funds, and other nonbank entities; (c) simplify the mechanisms of BCRA assistance to financial entities, especially as regards the limits on total assistance and the duration of this assistance, as well as the guarantees involved; (d) facilitate the process of resolution or liquidation of failed financial entities: (e) standardize and regulate the characteristics of financial contracts, including derivatives; and (f) strengthen the legal protection and immunities of BCRA management for actions taken in the performance of their duties. Also in the area of financial reform, the government

will revise the legal framework for the insurance sector and strengthen preventive supervision of insurance firms, and it will submit to Congress laws strengthening the legal foundation for leasing activities and for lending on the basis of equipment purchases, inventories, and other secured transactions. In addition, steps will be taken to improve the quality and competitiveness of the rating industry.

20. The government will promote the further integration of Argentina with Mercosur and other regional trading partners, while at the same time seeking to increase **trade** with countries outside the region. Sustained high levels of investment, a continuation of the impressive productivity gains, and a reduction of labor costs are expected to help promote the competitiveness of Argentina's exports. During 1999, Argentina will make limited recourse to antidumping measures and safeguards, only to defend against unfair trading practices, and in strict compliance with WTO regulations. As a case in point, the specific duty on textiles and the safeguard regime under which a specific duty is applied on footwear are being phased out, as described in paragraph 27 of the policy memorandum attached to the government's letter of December 3, 1997. The government intends to eliminate the 3 percent surcharge to the common external tariff that was imposed in 1997 by December 1999.

21. Further initiatives will be taken in the area of **labor markets reform,** to help improve Argentina's international competitiveness and promote a further decline of unemployment. In addition to the reduction in employers' contributions envisaged in the tax reform, the government will seek to replace special labor statutes with collective bargaining agreements, and introduce enabling regulations for the new law on medium size enterprises. Also, the government will continue to strengthen, in cooperation with the provinces, the enforcement of labor regulations for employers and workers.

22. The government has launched a comprehensive program to deal with the Y2K problem. Accordingly, the BCRA has put in place a plan to prepare the banking system for this contingency, and nationwide tests of compliance with this plan will be carried out during the first half of 1999. Similar initiatives are being carried out in the tax administration (AFIP), the social security (ANSES), and the Treasury's expenditure management system (SIDIF).

23. The government remains committed to promoting the opening of markets and to improving the efficiency of **economic regulation** in the country. In this context, during 1999, a new anti-trust law is expected to be approved by Congress. In addition, the government will take steps, with assistance from the World Bank and the IDB, to rationalize and harmonize the operations of regulatory agencies charged with overseeing private providers of public and infrastructure services. Draft legislation will be submitted to Congress to ensure consistency among these entities in the areas of administrative procedures, economic and technical standards, appeal processes, and the disclosure of information, as well as rules regarding consultations with provinces and consumer groups. Also, as part of continuing efforts towards the **modernization of the State**, steps will be taken in 1999 to: (a) improve

procedures in the areas of control and auditing; (b) expand the training program for public sector personnel working in these areas; (c) set up new rules regarding employment incompatibilities (to avoid potential conflicts of interest), administrative enquiries, and patrimonial responsibilities for misconduct of public employees; and (d) build up, with assistance from the World Bank, the capacity of the Public Ethics Office.

24. In the **health care** area, during 1999 the government will take steps, with assistance from the World Bank and the IDB, to help develop a competitive managed care market for providing health care services to pensioners, and to reform the operations of the redistribution fund of the labor-managed health care providers (Obras Sociales), which compensates them for the costs of insuring workers with low income. Also, the government will strengthen the regulatory framework for health insurance, including through the introduction of new prudential and consumer protection norms for private health care providers and through the dissemination of information on the basic characteristics and performance of the different Obras Sociales.

25. The government remains committed to improving the timeliness and coverage of economic **statistics**. Important progress was made in this area in 1998 with the production of more frequent labor market surveys, the production of semi annual data on private sector external indebtedness and debt service, and comprehensive revisions to the balance of payments statistics. In 1999, the government intends to complete, as contemplated under the Fund's SDDS, the preparation and publication of quarterly national accounts statistics in current prices. Also, it intends to complete work on a new input-output matrix. In addition, with the strengthening of the data processing system for international trade, it will seek to reduce the lag in the publication of monthly trade data. With assistance from the IMF, the government will establish in the near future a monitoring system for short-term external interbank credits.

Argentina: Quantitative Performance Criteria for 1999

	Jan-Mar99 Program	Jan-Jun99 Program	Jan-Sep99 Program	Jan-Dec99 Program
	(In millions of pesos or U.S. dollars)			
1. Cumulative deficit (-) of the Federal Government 1/	(1,300)	(1,675)	(2,300)	(2,950)
2. Cumulative ceiling on noninterest expenditures of the Federal Government 2/	9,500	18,800	28,700	38,050
3. Cumulative change in the net domestic assets of the Central Bank 3/	(200)	(325)	(590)	(690)
4. Cumulative net disbursements of external and domestic debt of the public sector 4/	2,500	5,200	5,200	4,000
5. Cumulative net increase in short-term public sector debt 5/	1,000	1,000	1,000	1,000
Indicative targets				
1. Combined deficits of Federal and Provincial Governments	...	(2,475)	...	(4,400)

1/ The Federal Government balance comprises the result of the nonfinancial public sector (measured from below the line and excluding transfers of profits from the central bank), that of the Central Bank (BCRA), and the deficits of the provincial pension funds incorporated to the Federal Government. It excludes receipts from privatization. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) and on government bond holdings of the BCRA minus net interest on swap operations.

2/ The ceiling excludes expenditure of transfers to provinces of coparticipated revenue, minimum guarantee, and special laws (current and capital).

3/ The net domestic assets (NDA) of the BCRA are defined as the difference between monetary liabilities and net international reserves (NIR) of the BCRA, both measured on the basis of end-of-period data. The monetary liabilities include currency issued, legal bank reserves, liquidity requirements at the BCRA (reverse swap operations) and public sector deposits (government and Anses) at the BCRA. NIR is defined as gross liquid international reserves of the BCRA less foreign liabilities, and will be valued at exchange rates of December 31, 1998. Gross liquid international reserves include BCRA holdings of gold, SDR's, foreign currency in the form of cash, deposits abroad, and government securities of investment grade of OECD countries, and Argentina's net balance within the Latin American Trade Clearing System (ALADI), and exclude central bank holdings of government bonds. Liabilities to the IMF will be valued at US$1.35 per SDR. The ceiling will be adjusted upwards by the equivalent to any purchase from the IMF under this agreement. Measurement of net domestic assets throughout the year will be adjusted downward (upward) for the equivalent to any excess (shortfall) in the end-1998 stock of swaps (pases activos) with respect to the projected level of Arg$275 million. Measurement for December 1999 also will be adjusted downward for up to Arg$ 300 million on account of temporary liquidity needs reflected in an equivalent increase in swaps (pases activos).

4/ 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, the BCRA, and other official banks. The limit includes disbursements of loans related to Obras Sociales, the provincial pension fund, the settlement of the debt of PAMI and INDER, as well as bridge loans associated with privatizations. It excludes all debt issued for the consolidation of domestic arrears mandated by Judicial Court decisions, and borrowing by the foreign trade bank BICE. Measurement of disbursements will be adjusted downward (upward) for any shortfall (excess) in privatization receipts relative to the program. The data used to monitor external and domestic debt developments will be taken from the debt reporting system (SIGADE) and the balance of payments accounts and will exclude government's debt placements with the Fund for Provincial Development and the Fund for Provincial Infrastructure linked to the privatizations of YPF and BHN. The stock of debt will be valued at 1998 exchange rates and measured at end of period.

5/ The ceiling includes the net change in all domestic and foreign public and publicly guaranteed debt with a maturity of one year or less.

Argentina: Structural Benchmarks

I. By the third review (August 1999)

1. Presentation of a proposal to reform the system of tax revenue sharing with the provinces.
2. Leasing of telecommunication frequencies.
3. Implementation of new monitoring systems for the external debt and the finances of provincial administrations.
4. Implementation of the enabling regulations for the labor statute for small and medium size firms.
5. Congressional approval of the proposed changes of the BCRA charter and the financial entities law.
6. Congressional approval of the fiscal responsibility law.
7. Submission to Congress of a proposal to transform the Banco Nacion into a state-owned corporation.
8. Submission to Congress of social security reform proposal.
9. Complete sale of first package of shares of National Mortgage Bank.

II. By the fourth review (February 2000)

1. Implementation of the tax administration program
2. Congressional approval of the social security reform.
3. Congressional approval of the new law for Banco Nacion.
4. Elimination of the 3 percent import surcharge.

International Monetary Fund

Buenos Aires, Argentina
May 10, 1999

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

Dear Mr. Camdessus:

1. Notwithstanding the strong performance of its economy in recent years, Argentina has not been immune to the contagion effects of the Russian and Brazilian crises. After three years of rapid economic growth, real activity took a downward turn in mid-1998 reflecting a decline of international capital inflows, higher interest rates, and a drop in export demand. Real GDP fell by 3.5 percent in the last two quarters of 1998 (seasonally adjusted), although for the year as a whole it still grew by 4.2 percent, and is estimated to have fallen by an additional 2.8 percent in the first quarter of 1999. Preliminary indications also point to a decline of employment in recent months, after growing at an annual rate of more than 6 percent in the past two years. Consumer price inflation has been negligible. Import growth has turned negative since the last quarter of 1998 and contributed to a narrowing of the trade deficit from a peak of US$5.9 billion in October 1998 (on a 12-month basis) to US$5.1 billion in February 1999. For 1999 as a whole, the trade deficit is projected to narrow further to under US$4 billion. Nevertheless, reflecting a further significant increase in net interest payments abroad, the current account deficit is expected to improve only slightly to about 4.1 percent of GDP. Foreign direct investment is projected to cover over 40 percent of this deficit.

2. In contrast to the aftermath of the 1994 Mexican crisis, confidence in the local financial sector has remained strong, with private deposits growing at an

annualized rate of around 6 percent since mid-1998, despite the slowdown in economic activity. This factor is expected to facilitate a recovery from the crisis in the second half of this year. There are already some signs that the economy has begun to turn around stimulated in part by improved access to international capital markets, recent positive developments in Brazil, and a more positive outlook for commodity prices. However, while a gradual recovery of the economy now seems likely, real GDP is still expected to decline by 1.5 percent in 1999, compared with the 2.5 percent growth assumed in the program designed last December.

3. The lower pace of economic activity will have a marked negative impact on the public finances, with federal government revenues now expected to fall short of the original program projections by some Arg$3 billion. The government managed to compensate for the revenue shortfall that occurred in the first quarter of the year, and met all program performance criteria. However, a full offset of the revenue shortfall will not be possible in the remainder of the year without seriously impairing the quality of public services and aggravating the economic downturn. Given the government's demonstrated expenditure restraint in recent years, it considers that there would now be a strong case for accommodating the cyclically induced drop in revenue by allowing a corresponding increase in the program target for the federal deficit. Nevertheless, to ensure that the financing of the deficit does not crowd out private sector borrowing, and to underscore its commitment to fiscal discipline, even under adverse macroeconomic developments, the government intends to take measures to keep the federal deficit to Arg$5,100 million (1.5 percent of GDP). The table attached to this letter presents the modified program targets. To ensure achievement of the new deficit target, noninterest expenditures of the federal government (excluding mandatory transfers to provinces) have been lowered by Arg$450 million with respect to the original program target. The government has maintained access to international capital markets and has succeeded already to secure financing to cover its borrowing needs (including those entailed by the new deficit target) almost through the third quarter of 1999.

4. The existence of a floor on revenues transferred by the federal government to the provinces will only in part shield the latter from the downturn in fiscal revenues. However, as a result of spending restraint, the consolidated provincial deficit is still expected to decline from Arg$1,875 million in 1998 (0.6 percent of GDP) to under Arg$1,700 million (0.5 percent of GDP) in 1999. The proposed system to monitor the level and composition of financing to the provinces on a more timely basis is being put in place, and is expected to begin operating in May.

5. The government recognizes the importance, in these times of political transition, of giving clear and strong signals of Argentina's determination to carry forward and deepen the fundamental reform process that the country has been pursuing. To this end, the government remains fully committed to the structural reform program outlined in the letters of December 3, 1997 and January 11, 1999 and is seeking support across the political spectrum to ensure substantive further progress in the implementation of the structural reform agenda. The government is working with the lower chamber of Congress to speed up discussion of the fiscal convertibility law described in the policy memorandum attached to the January letter, and expects this bill to get final congressional approval by August 1999. This law will set limits on the growth of the public debt and public sector spending, and establish a fiscal stabilization fund to smooth out the impact of cyclical fluctuations and/or external shocks on tax revenue. In addition, work is being finalized on a detailed proposal to reform the tax sharing regime with the provinces. This proposal, which will serve as the basis for discussions with provincial authorities and legislators intended to begin in May 1999, seeks to simplify the sharing arrangements between the federal and provincial levels of the government (the primary distribution system); improve equity and efficiency in the distribution of revenues among provinces (the secondary distribution system); and replace some inefficient provincial taxes by a VAT surcharge.

6. Progress has been, or continues to be made in the implementation of other reforms envisaged in the original program. Measures were put in place further to strengthen tax administration, and a reform of the tax code in being prepared

with the intention of presenting it to Congress before November 1999. A substantial package of shares (28 percent) of the **National Mortgage Bank** was sold in January 1999. The **leasing of telecommunications frequencies** has been delayed by judicial challenges and is now expected to be completed in the second half of the year.

7. In the **financial sector area**, and as described in the aforementioned policy memorandum, the Central Bank continues with its efforts to strengthen bank supervision. The bills to modify the Central Bank charter and the financial entities law are being discussed in Congress, and their passage is expected by end-November 1999. Draft legislation to transform the Banco de la Nacion into a public corporation has been prepared and will be submitted to Congress in May. Also, the Central Bank is working, with assistance from the Fund, to strengthen by end July 1999 the monitoring of conditions of access by commercial banks to external credit lines.

8. The government has begun work on an important further **reform of the social security system** aimed at preventing a deterioration of its finances over the medium term. The proposed reform will include a tightening of eligibility requirements for the basic pension benefit (PBU), a sort of minimum pension, by transforming it from a universal to a means-tested benefit. Draft legislation on this reform will be submitted to Congress by end July 1999.

9. In the area of **labor market reform**, as envisaged in the program, the government implemented in early 1999, new regulations for the small-and medium-size enterprise law (Ley PYME) designed to enhance labor flexibility in this area. Also, two special labor statutes ("estatutos especiales", that maintain particular privileges in certain sectors) have been abolished and replaced by arrangements involving negotiations between the relevant parties; most of the remaining statutes are expected to be eliminated in the coming months. In addition, the government intends to submit to Congress in coming months a proposal for a new capitalized severance payment system along the lines recently presented to the World Bank in the context of the SSAL program. The reduction in labor taxes included in the tax reform approved in 1998 is

contributing to ameliorate the adverse effects on employment of the current downturn in economic activity. The government intends to keep to the schedule of reductions of employers' social security contributions envisaged in the tax reform approved at the end of 1998, but recognizes that present budgetary constraints do not permit other initiatives to promote employment that would carry an additional cost to the budget.

10. The government of Argentina believes that the policies described in this letter are consistent with the thrust of the economic program for the period 1998-2000 that is supported by the extended arrangement from the Fund. Together with the progress made so far in the implementation of this program, these policies provide a firm basis for concluding the third review under the arrangement. The government will continue to maintain close contacts with the Fund and will consult on the adoption of measures that may be needed, in accordance with the Fund's practices on such consultations. A fourth review of the program will be carried out with the Fund before end-November 1999.

Sincerely yours,

/s/

Pedro Pou
President
Central Bank of the
Republic of Argentina

/s/

Roque Fernandez
Minister of Economy and
Public Works and Services

Argentina: Quantitative Performance Criteria for 1999

	Program			
	Jan-Mar 99	Jan-Jun 99	Jan-Sep 99	Jan-Dec99
(In millions of pesos or U.S. dollars)				
1. Cumulative deficit (-) of the Federal Government[1]	(1,300)	(2,850)	(4,200)	(5,100)
2. Cumulative ceiling on noninterest expenditures of the Federal Government[2]	9,500	18,750	28,450	37,600
3. Cumulative change in the net domestic assets of the Central Bank[3]	(200)	(325)	(590)	(690)
4. Cumulative net disbursements of external and domestic debt of the public sector[4]	2,500	6,800	7,350	6,150
5. Cumulative net increase in short-term public sector debt[5]	1,000	1,000	1,000	1,000
Indicative targets				
1. Combined deficits of Federal and Provincial Governments	...	(3,750)	...	(6,800)

[1]The Federal Government balance comprises the result of the nonfinancial public sector (measured from below the line and excluding transfers of profits from the central bank), that of the Central Bank (BCRA), and the deficits of the provincial pension funds incorporated to the Federal Government. It excludes receipts from privatization. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) and on government bond holdings of the BCRA minus net interest on repos.
[2]The ceiling excludes expenditure of transfers to provinces of coparticipated revenue, minimum guarantee, and special laws (current and capital). This ceiling will be adjusted upward by any excess with respect to the revenue projections gross of "devoluciones" (Arg$28,055 million, Arg$42,790 million, and Arg$57,625 million in the second, third, and fourth quarter of 1999, respectively) up to the ceiling in the original program. The resulting maximum cumulative adjustment will be Arg$50 million, Arg$250 million, and Arg$450 million in the second, third, and fourth quarter, respectively.
[3]The net domestic assets (NDA) of the BCRA are defined as the difference between monetary liabilities and net international reserves (NIR) of the BCRA, both measured on the basis of end-of-period data. The monetary liabilities include currency issued, legal bank reserves, liquidity requirements at the BCRA (reverse repos) and public sector deposits (government and Anses) at the BCRA. NIR is defined as gross liquid international reserves of the BCRA less foreign liabilities, and will be valued at exchange rates of December 31, 1998. Gross liquid international reserves include BCRA holdings of gold, SDR's, foreign currency in the form of cash, deposits abroad, and government securities of investment grade of OECD countries, and Argentina's net balance within the Latin American Trade Clearing System (ALADI), and exclude central bank holdings of government bonds. Liabilities to the IMF will be valued at US$1.35 per SDR. The ceiling will be adjusted upward by the equivalent to any purchase from the IMF under this agreement. Measurement of net domestic assets throughout the year will be adjusted downward (upward) for the equivalent to any excess (shortfall) in the end-1998 stock of repos (pases activos) with respect to the projected level of Arg$275 million. Measurement for December 1999 also will be adjusted downward for up to Arg$300 million on account of temporary liquidity needs reflected in an equivalent increase in repos (pases activos).

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[4]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, the BCRA, and other official banks. The limit includes disbursements of loans related to Obras Sociales, the provincial pension fund, as well as the settlement of the debt of PAMI and INDER and bridge loans associated with privatizations. It excludes all debt issued for the consolidation of domestic arrears mandated by Judicial Court decisions, and borrowing by the foreign trade bank BICE. Measurement of disbursements will be adjusted downward (upward) for any shortfall (excess) in privatization receipts relative to the program. The data used to monitor external and domestic debt developments will be taken from the debt reporting system (SIGADE) and the balance of payments accounts and will exclude government's debt placements with the Fund for Provincial Development and the Fund for Provincial Infrastructure linked to the privatizations of YPF and BHN as well as debt placements related to tax credit refunds. The stock of debt will be valued at 1998 exchange rates and measured at end of period. Measurement of the debt for December 1999 will be adjusted downward for any borrowing up to US$2.5 billion related to 2000 financing requirements deposited at the BCRA.
[5]The ceiling includes the net change in all domestic and foreign public and publicly guaranteed debt with a maturity of one year or less.