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International Monetary Fund
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IMF Approves US$7.2 Billion Three-Year Stand-By Credit for Argentina

The International Monetary Fund (IMF) today approved a three-year stand-by credit for Argentina in an amount equivalent to SDR 5,398.61 million (about US$7.2 billion) to support the government's 2000-02 economic program. The Argentine authorities have indicated that they intend to treat the credit as precautionary. The new stand-by credit replaces the extended arrangement approved on February 4, 1998 (see Press Release 98/01).

In commenting on the Executive Board discussion on Argentina, Stanley Fischer, Acting Managing Director, said:

"The new Argentine government has embarked on a strong economic program aimed at promoting the recovery and sustained growth of the economy, with continued price stability, and an external current account maintained within financeable limits. The program contains a significant fiscal consolidation, which will permit a gradual increase in national savings to finance the recovery of investment and reduce the external debt burden over time. The macroeconomic adjustment is underpinned by comprehensive structural reforms.

"The strengthening of the public finances involves expenditure restraint, a significant additional tax effort, and measures to strengthen tax administration. The authorities have moved decisively in these areas, and most of the envisaged measures under the program are already in place.

"The structural reform agenda is comprehensive and far-reaching. The reforms in the fiscal area, including the proposals to strengthen the social security system and to modify the revenue sharing regime with the provinces, will be essential to secure a lasting improvement in the public finances, as well as to improve the equity and efficiency of both taxation and public spending. The proposed labor market reform and deregulation should help create the conditions for improvements in productivity and increases in employment. Implementation of these structural measures is critical, both to contribute to the sustainability of the fiscal adjustment and to strengthen competitiveness and economic growth," Fischer said.

ANNEX

Program Summary

The macroeconomic discipline imposed by the convertibility regime adopted in 1991, and a wide-ranging structural reform and privatization effort (supported with successive credit arrangements from the IMF) were instrumental in ensuring Argentina's generally strong economic performance during most of the last decade. GDP growth averaged more than 4% a year between 1992 and 1998, and inflation decelerated rapidly to a sustained low rate.

Nevertheless, some weaknesses remained, which made the economy vulnerable to external shocks. Argentina's economic performance deteriorated significantly from mid-1998, reflecting a series of external shocks in the aftermath of the Russia and Brazil crises, including reduced access to financing, the economic downturn of the region, and a significant terms-of-trade loss.

The new government, which took office in December 1999, recognized that a sustained strengthening of macroeconomic policies and a revitalized structural reform effort would be essential to buttress confidence in domestic and foreign financial markets and to facilitate a sustainable recovery of the economy with continued price stability. The adjustment and reform program that the IMF credit will support is based on a rate of **GDP growth** of 3½% in 2000, which would accelerate to 4% in subsequent years as firm implementation of the appropriate policies strengthens confidence and improved competitiveness facilitates further growth of exports.

To these ends, the program targets a 3½% of GDP reduction in the **consolidated public deficit** over the period 2000-02, about half of which is to take place in 2000. The primary balance of the public sector will shift to a surplus of 3¾% of GDP in 2002 from a small deficit in 1999. The authorities expect to achieve these results through the elimination of distortions in the tax system; further broadening of the tax base; strengthening of tax enforcement and compliance; increased transparency and cost effectiveness in the use of public resources; and a reform of fiscal relations between the national and subnational levels of government with a view to increasing fiscal responsibility, transparency, and equity. Primary federal expenditures are budgeted to decline significantly in relation to GDP in 2000, reflecting efforts to reduce personnel spending as well as cutbacks in a wide range of other spending programs, all aimed at promoting cost effectiveness and reducing waste.

Besides initiatives aimed at promoting a lasting improvement in the public sector finances, the wide-ranging program of **structural reforms** includes that of labor market legislation, which seeks to reduce the existing rigidities to create conditions for improvements in productivity and for an increase of employment in the formal sector. Additional reforms are also planned in the social security system to ensure its long-term solvency and to make it more equitable, and in the promotion of competition in sectors that enjoy quasi-monopoly positions or are in need of modernization, such as those in the telecommunications and energy sectors.

The authorities plan to improve and expand **social assistance programs** within the limits of the budget by identifying and eliminating problems of duplication, deficient targeting, and high administrative costs. Efforts in these areas are to include the consolidation of various nutritional programs, currently operating under different agencies, into a federal nutritional system; the continuation of the work to develop a national registry of beneficiaries of social programs; further auditing of executing agencies and the introduction of performance indicators; and improvements in the household survey carried out by the National Institute of Statistics and the Census.

Argentina joined the IMF on September 20, 1956. Its quota[1] is SDR 2,117.1 million (about US$2,832 million). Its outstanding use of IMF credit currently totals SDR 3,102 million (about US$4,150 million).

Argentina: Selected Economic and Financial Indicators

	Average 1993-98	1996	1997	1998	Est. 1999	Proj. 2000
	(Annual percentage change)					
National income and prices						
Real GDP growth	4.4	5.5	8.1	3.9	-3.1	3.4
GDP deflator	1.7	-0.1	-0.5	-2.0	-2.3	0.9
Export volume growth	13.5	6.7	13.9	11.4	0.0	8.2
Import volume growth	14.9	19.6	30.6	8.7	-13.7	10.2
Terms of trade change	1.0	7.8	-1.2	-5.3	-6.4	3.5
Money and credit						
Domestic credit (net)	13.9	9.8	17.4	10.6	3.0	7.4
Private sector deposits	22.5	22.2	26.9	15.1	3.7	10.5
Interest rates (average)						
31-60-day peso time deposits	9.4	7.3	7.0	7.6	7.8	...
30-day peso prime rate	11.7	10.5	9.1	10.6	10.8	...
	(In percent of GDP)					
National accounts						
Gross domestic investment	19.0	18.1	19.4	19.9	18.9	19.4
Public sector	2.0	1.8	2.2	2.1	1.8	1.5
Private sector	17.0	16.3	17.1	17.7	17.1	17.9
Gross national savings	15.6	15.7	15.3	15.0	14.6	14.9
Public sector	-0.3	-1.8	-0.2	-0.1	-2.2	-0.9
Private sector	15.9	17.5	15.4	15.1	16.8	15.8
Public finances						
Consolidated public sector balance	-3.8	-3.6	-2.0	-2.1	-3.8	-2.3
Federal government	-1.0	-2.4	-1.5	-1.3	-2.5	-1.6
Rest of public sector 1/	-2.8	-1.2	-0.5	-0.8	-1.3	-0.7
Public sector debt	37.5	41.1	38.9	41.4	47.2	47.7
External debt	25.4	27.0	25.5	27.6	31.4	32.2
Domestic debt	12.1	14.0	13.3	13.7	15.8	15.5
	(In billions of U.S. dollars, unless otherwise indicated)					
External sector						
Current account	-9.5	-6.5	-12.0	-14.5	-12.3	-13.3
(percent of GDP)	-3.5	-2.4	-4.1	-4.9	-4.3	-4.5
Trade balance	-2.8	0.2	-4.0	-5.0	-2.2	-2.1
Exports (f.o.b.)	21.2	24.0	26.4	26.4	23.3	26.4
Imports (c.i.f.)	-24.1	-23.9	-30.5	-31.4	-25.5	-28.5
Nonfactor services	-2.1	-1.8	-2.3	-2.4	-2.7	-2.8

Factor services	-5.0	-5.3	-6.2	-7.5	-7.7	-8.8
Transfers (net)	0.4	0.4	0.4	0.4	0.4	0.4
Capital account	12.5	9.9	15.6	18.8	14.2	15.8
Of which: foreign direct investment	4.2	4.9	4.9	4.4	10.9	7.1
Overall balance	3.0	3.4	3.6	4.2	1.9	2.5
(In percent of exports of goods and nonfactor services)						
Total external debt	418.4	385.5	402.0	449.8	529.3	501.3
Total external debt service	55.7	55.8	64.2	63.6	81.6	91.9
Public sector external debt service	35.3	33.8	40.1	35.3	46.3	44.2
Of which: interest payments	15.4	14.8	15.9	17.6	21.7	21.7

Sources: Ministry of Economy, Central Bank; and IMF staff estimates.
1/ Includes trust funds, capitalization of interest, and provincial governments' balance.

[1]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.

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Memorandum of Economic Policies

I. Background

1. **The performance of the Argentine economy registered a marked improvement during the 1990's.** This reflected the macroeconomic discipline required by the convertibility regime, the modernization of the productive structure engendered by the rapid growth of investment, structural reforms, and, for most of the period, a favorable international environment. The last decade also saw the consolidation of the institutions and of the democratic process in Argentina, establishing the conditions for sustainable growth.

2. **However, significant disequilibria remained,** which in the second half of the decade were reflected in significant volatility in the performance of the economy and contributed to a slowdown in growth. Open **unemployment remained high,** especially in some regions and sectors of the labor force. The **public finances** registered deficits throughout the last decade, reflecting ineffective tax enforcement and erosion of the tax base, significant increases and widespread inefficiencies in spending, as well as the initial fiscal cost of the social security reform. As a result, the consolidated public sector net debt rose to an estimated 45.7 percent of GDP by 1999. Although this level is not especially high in comparison with other emerging economies, its rapid growth in recent years gives cause for concern. The **current account of the balance of payments** also recorded rising deficits in the second half of the last decade. The underlying disequilibria in these areas were exacerbated by the difficult international environment that prevailed in the more recent years, including the Asian, Russia, and Brazil crises, the large (about 13 percentage points) deterioration of Argentina's terms of trade between 1997 and 1999, and the generalized rise in risk premia for emerging markets, which did not spare Argentina.

3. As a result of these external shocks, and of a weakening of policies, especially during the second half of the year, **the performance of the Argentine economy deteriorated significantly in 1999.** The decline in activity, which had already begun in the second half of 1998, in the aftermath of Russia's crisis, deepened further in the first half of last year, reflecting in particular the decline in demand from Brazil and other countries in the region and tighter financing constraints on the private sector. Although the year ended with indications of a recovery, **real GDP is estimated to have declined by about 3 percent in 1999.** As a result, the rate of unemployment increased to 14.5 percent by August 1999, before declining to 13.8 percent in the last quarter of the year. The recession in the economy and declines in labor costs were reflected in a **1.8 percent fall in consumer prices in 1999.**

4. The significant decline in domestic demand more than offset the adverse impact on the external trade deficit of the sluggish external demand, the depreciation of the Brazilian *real,* and the terms of trade loss. The recession reduced the **trade deficit** to US$2.2 billion from nearly US$5 billion in 1998, with a surplus, albeit small, still being maintained vis-à-vis Brazil. Similarly, **the current account deficit in the balance of payments narrowed** to about US$12 billion (4.3 percent of GDP) in 1999 from US$14.5 billion (4.9 percent of

GDP) in 1998. More than half of this deficit was financed by net **foreign direct investment (FDI)**, which rose to a historical peak, and a significant part of private sector financing reflected intercompany loans. Nevertheless, the total **external debt** (excluding amounts preborrowed and the collateral on Brady bonds) continued to increase, to the equivalent of about 51 percent of GDP, with only 15 percent of this debt in original maturities below one year. On the other hand, the Argentine private sector is estimated to hold financial assets abroad equivalent to some 30 percent of GDP. The gross international reserves of the Central Bank amount to around US$26 billion, covering nearly 100 percent of the monetary liabilities of the Central Bank, and additionally, the banks have a large position in liquid foreign assets.

5. **The public finances deteriorated significantly in 1999,** reflecting the economic downturn, a further weakening of tax compliance, increased interest payments, and overruns in primary expenditures. As a result, and despite higher than expected revenues from concessions (amounting to 0.6 percent of GDP), **the federal government deficit** widened to 2.5 percent of GDP in 1999 (2.7 percent, including the deficit of the health service for retirees, PAMI), from 1.3 percent of GDP in 1998, while the consolidated **deficit of the provincial governments** rose to an estimated 1.3 percent of GDP, from 0.8 percent of GDP in 1998. The **total debt of the provinces** has risen significantly in recent years, exceeding by 1999 the equivalent of 7 percent of GDP, and its service burden is projected to absorb nearly 13 percent of their combined revenues. In some highly indebted provinces, the debt service burden exceeds 30 percent of their revenues.

6. **The banking system maintained the sound conditions achieved during the latter part of the 1990s** and was well positioned to withstand the tightening of external financing conditions in 1999. Notwithstanding the domestic recession and the difficult external environment, **deposits in the banking system** continued to grow in 1999, albeit at a slower pace than in previous years. Argentine banks maintained a cautious lending policy, and raised their holdings of liquid assets to levels well in excess of mandatory liquidity requirements. Nevertheless, the more difficult financing environment and the downturn in economic activity exerted some pressure on the quality of banks' assets. Nonperforming loans rose from 10.3 percent of total risk assets in December 1998 to 11.5 percent of total risk assets in November 1999 (from 4.0 to 4.7 percent net of provisions). The banking system remains, nevertheless, well capitalized, with the capital adequacy ratio (Basle criteria) slightly exceeding 20 percent at end-1999.

II. The Economic Program, 2000-02

7. The new government which took office in December 1999, following a democratic and responsible transition, from the beginning demonstrated its awareness of the difficulties and challenges facing it, and its firm determination to address them quickly and decisively, seeking a broad-based social and political support for this effort. The government is also seeking the support of the international financial community, and in particular of the IMF, through a **three-year stand-by arrangement.**

8. The government sees as its **foremost priority to create the conditions for the**

sustainable recovery of economic activity that is needed to reduce unemployment and poverty in a lasting manner, with continued price stability. These conditions include a **sustained increase in national savings,** to finance the needed growth of investment without further raising the external debt burden on the economy; and a **progressive improvement of the international competitiveness of local production,** within the framework of the convertibility regime to which the government is fully committed. Competitiveness will be strengthened by continued moderation of costs and prices, productivity gains, wide-ranging structural reforms--especially in the labor market, the education and health systems, and the financial system--and by increased competition, as a result of improvements in the regulatory framework.

III. The macroeconomic framework

9. The government believes that a firm implementation of the policies outlined in the paragraphs below will boost confidence both at home and abroad, contributing to increased availability and lower costs of financing for Argentine borrowers. This will enable Argentina to benefit fully in 2000 and beyond from the recovery in foreign demand and improved outlook for its export prices. The government is confident, therefore, that the Argentine economy will record a sustained recovery in 2000, and the official forecast is for real GDP growth of 4 percent. Nevertheless, to strengthen confidence in the feasibility of the targets specified in the program for which the government is seeking the Fund's support, this program is based on a **more conservative assumption of real GDP growth of around 3½ percent in 2000.** In the absence of adverse external shocks, real GDP growth could average at least 4 percent in the subsequent years. These rates of GDP growth, in conjunction with the elimination of long-standing rigidities in the labor market that is being sought through the reform of the labor legislation outlined below, are expected to lead in the years ahead to a sustained rise of employment, and **a significant decline of unemployment.**

10. The adverse impact on the external accounts of the rebound in imports that is foreseen to accompany the economic recovery in 2000 and beyond, should be largely offset by the response of exports to the projected more favorable external environment--including renewed growth and some real exchange rate appreciation in Brazil and a pickup in world trade--and the improvement in the competitiveness of Argentine products. The terms of trade are also expected to benefit from the strength of oil prices and the incipient recovery of other commodity prices. **The trade deficit is, therefore, expected to decline gradually** during the program period, partly offsetting the foreseeable continued increase in net interest payments abroad. Accordingly, the current account deficit in the balance of payments is projected to rise only modestly in relation to GDP, to around 4½ percent of GDP. FDI is projected to continue to cover 40 percent to 50 percent of this deficit. The total external debt is expected to stabilize in relation to GDP during the program period, and to decline gradually thereafter.

IV. Economic policies

11. The government is fully committed to a **sustained effort of fiscal consolidation and**

structural improvement in the public sector finances, which it views as necessary to reduce the growing burden of the public debt on the Argentine economy and on its growth potential. Faced with the substantial deterioration of the public sector finances in 1999, and the risk of a further worsening in 2000 in the absence of early and decisive corrective action, the federal government has moved quickly to **strengthen the initial budget proposal for 2000** through selective cutbacks in spending, and has secured the rapid passage by Congress of a **package of tax measures,** designed to yield Arg$2 billion (0.7 percent of GDP) this year. The tax package includes rate increases affecting the income, excises, fuels, and personal wealth taxes, and a broadening of the base of the value-added and income taxes. Additionally, the government halted the granting of new benefits under long-standing and costly tax incentives regimes for industry and agriculture, and adopted new measures to speed up tax collections. In designing the tax package, the government has endeavored to minimize its impact on the lower income groups and to eliminate distortions. The government has also decided to limit the planned reduction of employer contributions to the social security system to net additions to employment. The government and the provinces have also agreed to **a "federal commitment" (compromiso federal) that sets federal transfers to the provinces in 2000 and 2001** at levels below those that would have been implied by the current rules of the revenue sharing system, and specifies other commitments in regards to the reduction in the provinces' expenditures.

12. As a result of these steps, the government is confident that it will be able to contain the **federal deficit (including the deficit of PAMI) in 2000 to Arg$4.7 billion (1.6 percent of GDP),** in line with the requirements of the fiscal responsibility law enacted in 1999. **The government is also committed to reducing the deficit further in 2001 and 2002, reaching equilibrium by 2003, at the latest,** as required by the same law. In particular, in 2001 it will seek to limit the federal deficit to under 1 percent of GDP. Given the expected disappearance in 2001 of some temporary factors which are boosting revenues this year, achievement of next year's target will require strong and successful efforts to improve tax compliance, broaden the tax base, streamline the federal administration, and reduce inefficiency and waste in public spending, as outlined below.

13. The government is giving high priority to securing a **substantial improvement in tax compliance** by reducing tax arrears, avoidance, and evasion. For these purposes, the government: (a) is continuing efforts to strengthen the operational capabilities of the tax and customs administration, including by increasing flexibility in its manpower utilization; (b) has already sent to Congress bills to speed up the judicial treatment of tax cases, including the establishment of a specialized branch of the judiciary to deal with such cases, and of special national and regional secretariats within the court system to handle the collection of tax arrears; (c) has introduced a program to facilitate the payment of arrears on taxes and social security contributions accrued until October 1999 over a period of up to 60 months with no penalty and at an average interest rate of 10 percent, while at the same time, to reduce moral hazard, it has announced the elimination of other existing forms of tax forbearance; and (d) has sent recently to Congress a bill requiring payments larger than Arg$10,000 to be made through bank instruments, rather than in cash.

14. The **effort to contain federal spending in 2000 and beyond will center on**

streamlining the civil service, including in decentralized entities, and on improving cost effectiveness in the delivery of public services. For this purpose, the government has already eliminated a sizeable number of national secretariats; has implemented significant cuts in personnel with temporary contracts, which had grown rapidly, especially in 1999; and is planning a voluntary separation program and a wide-ranging elimination of existing vacancies. As part of the recently submitted "fiscal emergency" law, it is seeking legal powers to facilitate the redeployment of civil servants. A thorough effort has been initiated within each ministry, under the direction of the Vice-President's office, to identify overlapping spending programs, with a view to eliminating duplication of efforts and reducing costs. The government intends to provide public managers greater responsibility in the allocation of their budgeted resources, together with strengthened accountability for results, and for this purpose intends to improve the available indicators of efficiency and effectiveness of spending programs, building on best international practices in this area. The government is also fully committed to eradicating corruption, increasing transparency and accountability of procurement practices. For this purpose, it is seeking a wide-ranging renegotiation of contracts with its suppliers, and intends to present a new modern federal procurement law.

15. **The government intends to introduce in the next few months a new reform of the social security system aimed at improving the intertemporal solvency of the system.** This reform will center on measures to, on the one hand, reduce the prospective deficit of the public (defined-benefits) component of the system, and, on the other hand, increase competition and promote efficiency in the private (defined-contributions) component of it. The steps that the government intends to take to this effect include: (a) increasing gradually over the next ten years the retirement age for women (currently 60 years); (b) seeking to align more closely the contributive base for the self-employed to their actual incomes; (c) reforming the remaining special pension regimes for selected categories of public employees, with a view to improving equity and reducing their cost to the budget, and (d) strengthening the regulatory framework and oversight for the private pension plans (AFJPs), to promote a reduction in the operating costs of the latter and ensure their long term solvency.

16. In the **health area,** the government intends to promote the consolidation of existing union-run health organizations, many of which are experiencing financial difficulties, and to stimulate efficiency by fostering more effective competition among the remaining ones, and between them and the private HMOs, following a strengthening of the regulatory and supervisory framework for the latter. As concerns the PAMI--the financial situation and quality of service of which has deteriorated sharply in recent years, requiring emergency federal intervention--the government is committed to enacting quickly comprehensive reforms aimed at ensuring its financial viability and improving the quality and cost effectiveness of its services. As first steps in that direction, the government has required the immediate renegotiation of all contracts with suppliers, reducing unnecessary intermediation, and has cut back significantly non-tenured personnel in the entity. It is also analyzing how best to integrate the PAMI with the rest of the health system as from next year. To promote transparency, the government intends to re-incorporate the operations of PAMI into the federal budget for 2001.

17. The government is seriously concerned about the **substantial deterioration of the provincial finances,** especially in 1999, **and is committed to seeking a sustained improvement in these finances,** with full respect of the constitutional autonomy of the provinces. For this purpose, in the context of the "compromiso federal" mentioned in paragraph 11 above, it has secured the agreement of the provinces to enact quickly provincial fiscal responsibility laws, modeled on the federal one, that would ensure a progressive elimination of their budgetary deficits, through the containment of expenditures, improvements in tax enforcement, and increased transparency in their budgetary accounts. A number of highly indebted provinces have already moved to enact fiscal emergency laws, enabling them to cut back excessive payroll and other spending. Other provinces have introduced various revenue-raising measures. The government intends to condition its support of the restructuring of the debt of highly indebted provinces on the latter's agreement for specific and monitorable programs of fiscal adjustment. It will also utilize its authority to approve the resort by provinces to financing in foreign currency (including financing by multilateral organizations), to ensure that new financing is consistent with a sustained decline of provincial deficits in 2000 and beyond. For this purpose, the program establishes **indicative ceilings on the consolidated deficit of the provinces** equivalent to 0.8 percent of GDP in 2000, 0.5 percent of GDP in 2001 and about 0.3 percent of GDP in 2002. In addition, the program sets a performance criterion **for December 2000 for the net change during the year in the debt of the consolidated public sector, including the provinces' debt with commercial banks and that denominated in foreign currency.** The existing system of monitoring of various forms of recourse by the provinces to foreign and domestic financing will be rapidly improved, to permit a timely monitoring of compliance with the program targets.

18. The government recognizes the need to reach early agreement with the provinces on a ***lasting reform of the revenue sharing system*** to become effective after the expiration of the "compromiso federal" at the end of 2001. This reform of the system will aim, among other things, at simplifying the existing rules by determining tax shares in relation to the total tax revenue excluding import taxes--instead of in relation to individual tax categories, as in the current system--and at smoothing the impact of cyclical fluctuations in the tax base on provincial revenues (e.g., by utilizing a moving average of federal revenues as the base for the calculation of the annual federal transfers to the provinces). The reform of intergovernmental fiscal relations will also focus on the need for broadening the base, and increasing the effectiveness of provincial tax systems.

19. The successful implementation of the fiscal consolidation programs for the federal government and the provinces outlined above should allow a **gradual reduction of the ratio of the public debt to GDP** during the program period, even after the payment or securitization of government liabilities related to court rulings or to pending court challenges. In order to correctly assess the extent of these liabilities, and facilitate an appropriate defense of the public interest in pending court cases, the fiscal emergency bill recently submitted to Congress calls for a temporary suspension of such cases.

20. **The main objectives of the government's debt management policy** during the program period are to smooth and lengthen the maturity profile of the debt, minimize its

cost through active liability management, and promote the development of the domestic capital market. An active and transparent dialogue will continue to be carried out with market participants, both at home and abroad, to keep them informed of the government's financing plans as they evolve during the year. It is the authorities' intention to increase, as market conditions permit, the average size of government bond issues, in order to increase their liquidity, and also to maintain an adequate pre-financing cushion. Recourse to short-term financing will continue to be limited, in line with the ceilings established in the program. The government intends to continue the sale of its assets, including remaining shares in privatized financial institutions and enterprises in the energy sector, as well as selected real estate in its patrimony. In 2000, these operations are expected to yield Arg$700 million (0.2 percent of GDP).

21. **Financial policies** will continue to aim at buttressing confidence in the domestic banking system, and creating the conditions for further monetization of the economy and an adequate flow of credit to private sector. The Central Bank (BCRA) intends to keep the coverage of private sector bank deposits with liquid foreign assets at around 35 percent. The strong liquidity position of banks and the continued repurchase of outstanding Fund credit will allow the BCRA to continue reducing its net domestic assets, which are targeted to decline by Arg$1,080 million in 2000.

22. In the area of **financial reform,** the government intends to seek early approval of proposed changes to the BCRA Charter, to strengthen the ability of the latter to deal with potential troubled financial institutions. The BCRA is reviewing the banking regulatory and prudential framework in order to assess its consistency with international standards and best practices in this area. It is also continuing its efforts to strengthen bank supervision further through cooperation agreements with supervisors in main industrial countries and other relevant financial markets, and through appropriate training of its personnel. A system to provide early warning of changes in terms and conditions of access by commercial banks to external credit lines has been in place since late 1999, and is being further improved. The government will present legislation to allow the transformation of the **Banco Nación** into a state-owned corporation, to increase the transparency of its operations, and to limit its exposure to individual debtors who have not received adequate credit ratings. Steps also are being taken to ensure that the loan portfolio of the Banco Nación is adequately provisioned, and the bank is sufficiently capitalized. To **promote the development of the domestic capital market,** the government has set up an interagency committee to review the regulatory framework for banks and nonbank financial intermediaries, with a view better to coordinate and modernize them. It is also seeking to reduce systemic risk and improve the microstructure of the financial system, in particular the trading and settlements systems for securities.

23. In the **labor market** area, the government considers it necessary to modify the legal and regulatory framework, so as to promote a smooth adaptation of this market to changing patterns of demand and production, and to create the incentives to reduce informality and precariousness in employment. For this purpose **the government has recently sent to Congress a new labor legislation reform bill** proposing: (a) the gradual elimination over a two-year period of the "ultractividad" clause which extends indefinitely expired labor

contracts, in the absence of the parties' agreement on a new contract; (b) a decentralization of labor negotiations, granting contracts at the enterprise level legal predominance over sectoral level agreements; (c) the creation of arbitration and mediation services; (d) allowing for the negotiated modification of labor agreements in cases where the economic stability of the firm is threatened; (e) an extension of the probation period for newly recruited workers to six months; and (f) steps to streamline labor registration procedures and modify the existing presumptive taxation system for microenterprises, to extend it to sectors (such as low-income self-employed, and domestic workers), which are currently characterized by high degrees of informality.

24. The government regards the **promotion of competition** in domestic markets, especially in the services sector, as crucial to improve efficiency, consumer welfare, and ultimately the competitiveness of the economy. For this purpose, it has already taken the following steps: (a) the creation of a national secretariat for the defense of competition and of consumers; (b) the issuance of implementing regulations for the existing antitrust and antimonopoly law; (c) the proposal to Congress of a framework law for the federal regulatory agencies; and (d) negotiations with providers of services, e.g., in the telecommunications and energy sectors, which currently enjoy market dominant positions, to secure a reduction of tariffs.

25. The **government also intends to continue an open trade policy both on a multilateral basis and within Mercosur.** With respect to the latter, where trade relations have been affected by the sharp depreciation of the *real* in 1999, the government is placing increased emphasis on institutionalizing mechanisms for the resolution of trade disputes, and on securing greater macroeconomic convergence, through an improved policy dialogue. In this context, the Argentine and Brazilian governments have recently agreed to a comprehensive independent review of investment subsidies, particularly in the sensitive automotive sector, with a view to leveling as much as possible the playing field and eliminating distortions.

Argentina: Quantitative Performance Criteria for 2000-02[1]

(In millions of Argentine pesos or U.S. dollars)

	Jan.-Mar. 2000 Program	Jan.-Jun. 2000 Program	Jan.-Sep. 2000 Program	Jan.-Dec. 2000 Program	Jan.-Dec. 2001 Program[2]	Jan.-Dec. 2002 Program[2]
1. Cumulative balance of the Federal Government	(2,150)	(2,690)	(3,435)	(4,700)	(2,800)	(600)
2. Cumulative primary expenditure of the Federal Government	13,390	26,130	39,840	53,230	...	...
3. Cumulative consolidated balance of the Provincial Governments[3]	...	(1,370)	...	(2,200)	(1,400)	(900)
4. Cumulative change in the debt of	2,860	6,860	4,710	3,400	...	...

5. Cumulative change in the short-term debt of the Federal Government	1,500	1,500	1,500	1,500	...	...
6. Cumulative change in the debt of the Consolidated Public Sector[4]	...	...	6,310	5,400	...	...
7. Cumulative change in the net domestic assets of the Central Bank	(275)	(440)	(850)	(1,080)	...	...

[1]As defined in the attached Technical Memorandum of Understanding.
[2]These targets are indicative at the present time, to be changed to performance criteria during the last review of the program for the preceeding year.
[3]Indicative.
[4]Indicative through September 2000.

Technical Memorandum of Understanding

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria table annexed to the Policy Memorandum.

I. Cumulative balance of the Federal Government. This balance comprises the result of the Federal Government (including PAMI, and excluding transfers of profits from the Central Bank and privatization receipts) and the result of the Central Bank (BCRA). The Federal Government result will be measured from below the line on the basis of: (a) debt information provided by public sector debt reporting system (SIGADE), including all short-term debt of the Federal Government; (b) net asset transactions of the Federal Government as reported by the Secretaria de Hacienda, the Dirección Nacional de Cuentas Internacionales (DNCI), and the Gerencia de Manejo de Reservas Internacionales of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos.

II. Cumulative ceiling on primary expenditures of the Federal Government. This ceiling applies to the noninterest expenditure of the Federal Government.

III. Cumulative balance of the provinces. This balance comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis, according to the information provided by the Sub-Secretaria de Programación Regional (SSPR). This limit will be indicative.

IV. Cumulative change in the debt of the Federal Government. This debt includes all foreign currency denominated and Argentine peso denominated debt obligations and guarantees of the federal government (including public enterprises, PAMI, Inder, and trust funds). These debt obligations are defined to include those with local and foreign financial institutions, international organizations, bonds, and bridge loans. This limit will be adjusted:

(a) downward (upward) for excesses (shortfalls) in privatization receipts relative to the program; (b) upward for amounts related to the restructuring of provincial debt by up to Arg$1.2 billion; (c) upward for debt issued in 2000 for the consolidation of past obligations by up to Arg$1.7 billion, plus debt consolidated by Inder; (d) downward by the net effect of debt cancellations or swaps, and (e) upward for debt issued to finance the Fiscal Stabilization Fund by up to US$385 million in 2000, (f) upward for borrowing up to US$1.3 billion from multilateral agencies on behalf of provinces and official banks (deuda indirecta) in 2000, and (g) with regard to the position in December 2000, upward for borrowing up to US$4 billion related to 2001 financing requirements and deposited at the BCRA. The data used to monitor debt developments will be taken from SIGADE, including all short term debt of the Federal Government. The stock of debt will be valued at end-1999 exchange rates and measured at end-period.

V. Cumulative change in short-term debt of the Federal Government. It includes all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

VI. Cumulative change in the debt of the Consolidated Public Sector. This debt includes the sum of the changes in the debt of the Federal Government as defined in IV. above (including the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt. The debt of the provincial governments and city of Buenos Aires, will be defined to include obligations to local and foreign financial institutions, to international organizations, and bonds (excluding peso denominated bonds placed outside the financial system). The limit on this provincial debt will be adjusted: (a) downward (upward) for excesses (shortfalls) in privatization receipts relative to the program, and (b) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year. The upward adjustment on account of an increase in net deposits of the provinces, which allows for over-borrowing, will be limited to Arg$1 billion. The data used to monitor provincial debt will be provided by the SSPR, the SIGADE and the Central Bank. The stock of debt will be valued at end-1999 exchange rates and measured at end-period. This limit will be indicative for the third quarter of 2000 and binding thereafter.

VII. 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 (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, 1999. 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 cash balance within the Latin America Trade Clearing System (ALADI), excluding the accounting effects on holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds. Liabilities to the IMF will be valued at US$1.37 per SDR. The limit on net domestic assets will be adjusted upward by the equivalent of purchases from the IMF under the arrangement. Also, the limit for December 2000 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (pases activos).

Buenos Aires, Argentina
September 5, 2000

Dear Mr. Köhler:

The attached policy memorandum and annexes update the information contained in our letter of February 14, 2000, and describe the economic policies and objectives of the Government of Argentina for the period 2000–02, supported by the stand-by arrangement from the Fund in an amount equivalent to SDR 5,398.61 million approved on March 10, 2000. The Government believes that these policies will promote sustainable growth of output and employment in conditions of low inflation and external viability, will improve efficiency in the economy in general and in the public sector in particular, and will help address priority social needs.

During the period of the arrangement, the authorities of Argentina will maintain the customary close relations with the Fund and will consult with the Fund in accordance with the Fund's practices on such consultations. It is expected that a review of the program will be carried out with the Fund before February 28, 2001.

Sincerely,

/s/	/s/
Pedro Pou President Central Bank of the Republic of Argentina	Jose Luis Machinea Minister of Economy

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Attachments:
Memorandum of Economic Policies
Technical Memorandum of Understanding

Memorandum of Economic Policies

I. Background

1. The economic program of the Argentine government—which is supported by the International Monetary Fund (henceforth the Fund) with a three-year Stand-By Arrangement (SBA) approved by the Executive Board of the Fund on March 10, 2000—aims at creating the conditions for sustained growth of output and employment with price stability, through an increase in national savings and investment, and through continued improvement in the competitiveness of the economy.

2. The main pillars of this program are a **progressive reduction of the consolidated public sector deficit** (including the provinces) from the relatively high level (4.1 percent of GDP) reached in 1999 to under 3 percent of GDP in 2000, with further reductions in subsequent years, to reach equilibrium by 2003, in line with the requirements of the fiscal responsibility law; **and a wide-ranging structural reform effort** to strengthen the tax administration; improve the management of public spending; make the social security system more equitable, and ensure its long term financial solvency; increase efficiency in the health system; continue strengthening the domestic financial system; modernize the labor legislation, with a view to promoting job creation; and increase competition and efficiency in key sectors of the economy.

3. These policies were outlined in the Memorandum of Economic Policies (MEP) attached to the letter of the Minister of the Economy and the President of the Central Bank of Argentina (BCRA), dated February 14, 2000, requesting the support of the Fund under the SBA. The present MEP reviews the progress to date in implementing these policies, against the background of developments in the economy during the first half of this year, and outlines policies and prospects for the second half.

II. Economic Performance in the First Half of 2000

4. During the first half of 2000, **the Argentine economy continued to recover from the 1999 recession, but at a more gradual pace than anticipated.** Available data show that, after declining by 3.1 percent on average in 1999, **real GDP** rose by about 1.2 percent during the first half of 2000, compared with the same period of 1999. Economic growth remained subdued due to weak domestic demand, especially in the construction sector, and some renewed volatility in external financial markets. As a result , **the rate of unemployment increased to 15.4 percent of the labor force in May 2000**, from 14.5 percent in May 1999. Preliminary estimates indicate that the pick up in economic activity has gathered strength during the third quarter of this year.

5. **The economy has continued to adjust to the external shocks it suffered in recent years through declining domestic costs and prices. Unit labor costs** continue to fall, boosting the competitiveness of Argentine industry. **Consumer prices** declined by 0.9 percent year-on-year by July 2000, while **wholesale prices** increased by 4.1 percent over the same period, pointing to an increase in the relative price of tradable goods. By end-

June 2000, the real effective exchange rate (CPI-weighted) stood 1.7 percent below its level a year earlier.

6. Reflecting the improvement in competitiveness, as well as the weakness of domestic demand, **the external trade balance strengthened substantially**, shifting from a deficit of US$397 million in the first half of 1999 to a surplus of US$896 million in the first half of 2000. **Exports** rose by over 13 percent in value terms over the same period, boosted not only by higher prices, particularly in the oil and gas sectors, but also by a strong performance in volumes of manufacturing exports. In contrast, **imports** increased by less than 2 percent in value during the same period. Despite some deterioration in the balance on factor services, **the external current account deficit** is estimated to have narrowed from US$5.5 billion in the first half of 1999 to US$4.6 billion in the corresponding period of 2000. A large share of this deficit was financed by foreign direct investment (FDI). At end-August, **the gross international reserves of the Central Bank** amounted to US$25 billion, exceeding its monetary liabilities, and, in addition, the commercial banks held liquid assets abroad amounting to US$6.8 billion.

7. The slower than projected recovery of domestic demand and the decline in consumer prices led to **a shortfall in tax revenues** vis-à-vis the program of Arg$600 million during the first five months of 2000. **To ensure that the announced fiscal targets would be met,** the government, together with modifying the schedule for payments of the income tax (a measure estimated to yield about Arg$320 million additional revenues for the year), announced an important **package of spending cuts** (estimated to save about Arg$600 million on an annual basis), including a 12–15 percent cut in salaries of civil servants earning more than Arg$1,000 per month, the restructuring of some public entities, and a rationalization of certain privileged pension benefits. These measures, along with **higher nontax revenue** than envisaged in the original program, and **a high rate of participation in the tax amnesty** announced earlier in the year, made it possible to ensure **compliance with the end-June ceiling on the overall deficit of the federal government.** The end-June cumulative ceilings on the primary expenditure of the Federal Government, and on the change in its total debt were also met.

8. Preliminary information on developments in **the provinces' finances** so far this year, suggest that—despite the adverse impact of the slower than projected growth of the tax base on the provinces' own revenues, and some carryover to 2000 of expenditures committed in late 1999—**the provincial deficit is declining substantially**. This reflects significant efforts to contain spending and increased transfers from the federal government, as agreed under the Federal Pact in December 1999. Primary expenditures are estimated to have declined by 10 percent in the first half of 2000, in comparison with the corresponding period of 1999. The federal government is supporting fiscal and structural adjustment programs in the nine most indebted provinces by using the trust fund for provincial development to refinance outstanding debts of these provinces at more sustainable terms, against the guarantee of the provinces' revenue shares. The government is also working with the World Bank and the IDB to support the adjustment efforts of the larger provinces.

9. **The banking system has maintained the sound conditions achieved in recent years.** Bank deposits grew by about 6 percent during the first half of 2000. The banks' lending

however, has not increased, and their holdings of liquid assets continue to be well in excess of the mandatory liquidity requirements. Their liquidity cover is further buttressed by the existence of the private contingency repo line with international banks amounting to US$6.9 billion. The incipient economic recovery has not yet been reflected in the quality of banks' assets, and nonperforming loans have increased somewhat further; net of provisions, however, they declined from 4.7 percent of total assets in December 1999 to 4.1 percent in June 2000. **The banking system remains well capitalized**, with the capital adequacy ratio (Basle criteria) slightly exceeding 20 percent in June 2000. The end-June ceiling on the net domestic assets of the Central Bank was observed.

10. Important progress has been made in a number of **structural reform** areas. An especially important achievement in this respect was the **approval by Congress of the labor reform** in May. This law lengthens the probation period for newly-recruited workers from one to three months (six months by agreement); provides for the gradual elimination of the *ultractividad* clause that currently extends expired labor contracts indefinitely, until modified by mutual agreement; and stipulates the predominance of collective agreements at the enterprise level over sectoral ones. The law aims to promote a better adaptation of the labor market to changing patterns of demand and production, and reduce informality and precariousness in employment.

11. Significant progress has also been made in **structural fiscal reforms**. As indicated in the previous MEP, the government presented to Congress early in the year a comprehensive law to **strengthen tax enforcement and reduce evasion**. While this law is being considered by Congress, the government enacted by decree some of its key provisions, notably that requiring payments larger than Arg$10,000 to be made through bank instruments, rather in cash. In addition, the government (a) is modifying the tax regime for petroleum products, and is taking steps to reduce evasion in the wheat, meat, and tobacco industries; (b) is continuing to strengthen the operational capabilities of the tax and customs administration; and (c) has secured congressional approval of legislation to speed up the judicial treatment of tax cases, including through the establishment of a specialized branch of the judiciary to deal with such cases, and of special national and regional secretariats within the court system to handle the collection of tax arrears.

12. The government has submitted a **social security reform bill** to Congress aimed at improving the intertemporal solvency of the system and broadening its coverage. This reform entails awarding a pension to senior citizens of more than 70 years of age who do not have other sources of income, the redefinition of the universal pension allowance (PBU), and a progressive benefit schedule for women who retire at 60-65 years of age. Additionally, the government intends to take steps to align more closely the contributive base for the self employed to their actual income, to reform over the medium term the special pension regimes for selected categories of public employees, and to strengthen the regulatory framework for the private pension plans to increase competition and reduce operating costs.

13. **The government is also reforming the health care system**, with a view to increasing solidarity and improving efficiency. In June, the government issued a decree promoting the consolidation of existing union-run health organizations (*obras sociales*) and fostering

more effective competition among the remaining ones, and between them and the private HMOs, effective January 1, 2001. Under the new system, all health care providers will offer basic coverage, and contributions to the Solidarity Fund (which will subsidize provision of benefits for the poor and for catastrophic illness) will be generalized, based on individual income levels. The government is also implementing its program aimed at **ensuring the financial viability of the health system for retirees (PAMI)**, while improving the quality and cost effectiveness of its services. Since the beginning of this year, contracts with suppliers have been renegotiated; its arrears have been significantly reduced; unnecessary intermediation has been eliminated; and non-tenured personnel has been significantly cut back. To further promote transparency, the government will re-incorporate the operations of PAMI into the federal budget in 2001.

III. Policies and Prospects for the Second Half of 2000

A. Macroeconomic Policies and Prospects

14. **The government is fully committed to sustaining its fiscal consolidation efforts** in the rest of this year and beyond, so as to strengthen confidence in domestic and external financial markets, which in turn is a needed condition for a renewed decline in interest rates and a sustainable acceleration in economic growth. However, it recognizes that, notwithstanding the substantial expenditure cuts that have already been implemented, the impact on government revenues of the slower than expected recovery of economic activity cannot be fully offset without risking to abort the incipient recovery. The government is, therefore proposing a modification of the program allowing a slightly larger (about 0.2 percent of GDP) federal deficit than originally planned. At the same time the program's ceiling on noninterest expenditure would be lowered by the equivalent of 0.1 percent of GDP, to reflect the government's expenditure containment efforts. These proposed modifications will continue to be consistent with the fiscal responsibility law.

15. **The federal deficit for 2000 will now be limited to Arg\$5,300 million (1.8 percent of GDP)**. Observance of this target will be permitted by a projected modest strengthening of tax revenue in the second half of the year—reflecting the gradual further recovery in output, some firming of prices, and the effects of the tax amnesty—and by lower than initially programmed expenditures, as a result of the measures announced in May and of additional savings to be obtained in the months ahead, and which are reflected in the modified lower ceilings on primary spending for the third and fourth quarters of the year.

16. Despite the substantial efforts being made by most **provinces** to strengthen their finances, it appears now likely that their consolidated deficit will exceed the indicative target in the program (Arg\$2.2 billion, 0.7 percent of GDP) by the equivalent of about 0.2 percent of GDP, partly reflecting a substantially larger deficit in 1999 than originally estimated. Accordingly the government is proposing that the program ceiling on the increase in the consolidated public sector debt be raised to Arg\$ 7 billion (2.4 percent of GDP). Efforts were made to overcome the technical difficulties encountered in implementing the proposed system to monitor the provinces' foreign exchange-

denominated and domestic bank debt, and the system became operational during August 2000.

17. As indicated in the previous MEP, the targeted reduction of the federal and provincial deficits in 2000—in conjunction with the payment, or securitization of some government liabilities related to court rulings—is still expected to result in a modest increase in the **ratio of the public debt to GDP** this year. Over time, however, adherence to the deficit path mandated by the fiscal responsibility law is expected to result in a progressive decline of the public debt relative to GDP. During the program period, the ongoing efforts to smooth out the maturity profile of the debt, minimize its cost through active liability management, and promote the development of the domestic capital markets, will be continued. The government also intends to maintain its prefinancing cushion at an appropriate level, and to keep its recourse to short-term financing within the limits set in the program. Efforts will continue to be made to sell selected government assets, including remaining shares in privatized companies, and real estate properties. These operations are now expected to yield Arg$0.4billion in 2000.

18. **Financial policies** will continue to aim at buttressing confidence in the domestic banking system and creating the conditions for further monetization of the economy and an adequate flow of credit to private sector. The Central Bank (BCRA) intends to keep the coverage of private sector bank deposits with liquid foreign assets at around 35 percent. The strong liquidity position of banks and the continued repurchase of outstanding Fund credit will allow the BCRA to continue reducing its net domestic assets, which are targeted to decline by Arg$1,080 million in 2000.

19. The government expects the ongoing economic recovery to gather momentum as the year progresses and to result in average **real GDP growth** for 2000 as a whole of about 2 percent. With continued moderation in wage adjustments, the pickup in activity, together with the increased flexibility introduced in the formal labor market by the recent labor reform law, should contribute to a **progressive reduction of unemployment**.

20. The **external trade balance** is projected to register a small surplus, reflecting the sustained growth of export volumes, which would more than offset the gradual recovery in imports in the second half of the year as domestic demand picks up. The terms of trade are projected to improve by nearly 4 percent in 2000, partly because of higher oil prices. The improvement in the external trade balance will more than offset the higher payments of interest and profits abroad, and **the external current account deficit** is expected to narrow to US$10.8 billion (3.7 percent of GDP), from US$12.3 billion (4.3 percent of GDP) in 1999. More than half of the external current account deficit is projected to be financed by net FDI. The **overall balance of payments** is expected to show a sizable surplus in 2000, allowing for a further buildup of international reserves throughout the year.

21. **As regards 2001,** the government is confident that its demonstrated commitment to fiscal discipline and structural reform will, in combination with an expected more stable external environment, help strengthen domestic and external confidence, and facilitate a sustained recovery of credit and of domestic demand. In these circumstances, the government believes that average real GDP growth is likely to accelerate to about 3.7

percent in 2001, while prices will rise by less than 1 percent. On this basis, and in line with the Fiscal Responsibility Law, the government has prepared a budget proposal for 2001, which will be submitted to Congress in mid-September, and will target a reduction in the deficit of the federal government, on a cash basis, to around Arg$ 4.1 billion (1.4 percent of GDP). Attainment of such a target will be made possible by the further strengthening of revenues brought about by the acceleration of economic activity and the effect of the measures to improve tax administration that have been taken, and by a further containment of spending, which will also reflect the full year effect of the expenditure cuts made in 2000. As mandated by the Fiscal Responsibility Law, attainment of this budget target will go a long way to put the public finances on a sustainable medium-term path.

B. Structural Reforms

22. In addition to continuing its efforts to secure early congressional approval of pending reform legislation, **the government will seek further structural reforms in other important areas,** including the system of revenue-sharing (*coparticipación*) with the provinces; administrative reform; the promotion of private investment in infrastructure; steps to alleviate the conditions of the unemployed and the poor; and policies to promote the healthy development of the small and medium enterprises, strengthen competition in the economy, including through further trade openness, and modernize domestic financial markets.

23. **The government is seeking a new agreement with the provinces** that will aim, among other things, at reducing the provinces' overall fiscal deficit, so as to reach equilibrium by 2003; freezing nominal spending at the 2000 levels for a five-year period; adopting limits on the provinces' debt; increasing transparency in the accounts of all levels of government; and establishing a Federal Social Assistance Trust Fund, financed with a portion of the automatic transfers to the provinces and a contribution from the federal government. The agreement also reaffirms the commitment to submit to Congress in the course of 2000 a proposed ***reform of the revenue sharing system***, to become effective after the expiration of the existing Federal Pact at the end of 2001. The main elements of the proposals would be the inclusion of all federal taxes (except taxes on international trade) in the base of the revenue sharing formulas; the shift to a three year moving average in the calculation of the shared revenues, to smooth out the impact of cyclical fluctuations on provincial revenues; and the maintenance of the current distribution of revenues between the federal and the provincial levels of government.

24. In the social area, the government's efforts focus on **improving the conditions of the unemployed and the poor**. The government has increased budgetary allocations under the temporary employment programs, including the *Trabajar* program and the Emergency Employment Program (PEL). The government is also improving the allocation of the resources under these programs by making the selection of beneficiaries more transparent and by focusing on the head of household. To broaden the scope of the programs, entitlements under the *Trabajar* program have been lowered from Arg$200 to Arg$160 a month. Under the pilot *Identidad* program, the government aims at coordinating assistance efforts toward children in urban areas in the nutritional, educational, and health-related sectors. Efforts are also being stepped up to improve the management of emergency

situations, in particular those associated with the consequences of natural disasters. In poor urban areas, the government is promoting the construction of essential sanitary infrastructure and the provision of drinking water.

25. The government is also establishing a framework for delivering higher quality, and more cost-effective, public services by **bringing in the private sector to develop basic infrastructure**. This includes the establishment of a fund with government assets to help provide guarantees to, and lower the financial costs for, the private contractors entrusted with the construction of public infrastructure and/or provision of public services. Under this scheme, private contractors would undertake the construction, maintenance, and operation of public infrastructure, and lease it to the government upon completion.

26. With a view to **fostering the development of the domestic financial market**, efforts are being made to, among other things, introduce new financial instruments, strengthen the regulatory framework for nonbank financial intermediaries, and improve ties with other financial markets in Latin America. The government is seeking congressional approval of proposed changes to the BCRA Charter, with a view to strengthening the ability of the latter to deal with potentially troubled financial institutions. The BCRA is continuing its efforts to strengthen bank supervision further through cooperation agreements with supervisors in main industrial countries and other relevant financial markets, and through appropriate training of its personnel. New legislation aims at enhancing the lending activities of *Banco de la Nación* (BN) toward small- and medium-sized enterprises. The government has strengthened the capital of this bank by transferring to it its shares in the Bank for Investment and External Trade (BICE). In recent months, the management of BN has taken steps to increase the transparency of its operations, limit exposure to individual debtors who have not received adequate credit ratings, and ensure adequate provisioning of its nonperforming portfolio.

27. The government considers the **promotion of competition in domestic markets** critical to improve consumer welfare and the competitiveness of the economy. In the telecommunications sector, the government is taking advantage of the fact that contracts with the two main companies operating in that sector are due to expire by end-2000 to advance the process of deregulation. New entrants will be allowed to operate, and connection fees will be lowered by more than half, while steps are taken to ensure the provision of telephone services in remote areas, leading to significant additional investments in that sector. The government is working in a collaborative manner with the companies operating in utilities sectors, to eliminate the indexation of domestic tariffs to changes in the U.S. consumer price index.

28. In August, Congress approved **a law aimed at promoting the development of small- and medium-size enterprises** while helping correct market imperfections that impede their development. The law includes the creation of two revolving funds to extend guarantees to borrowing by small firms, and to provide risk capital for long term projects. The capital for these funds would be constituted by reallocating part of the capital of the Investment and Foreign Trade Bank (BICE) and cofinancing with multilateral organizations and private commercial banks. There are also provisions for making annual allocations in the budget to provide partial interest rate subsidies to small businesses. The government is also working

closely with the private sector to promote the formation of consortia of small- and medium-size businesses aimed at facilitating their access to foreign markets.

29. The government is pursuing **an open trade policy both within and outside Mercosur**. In this context, it intends to eliminate the 3 percent surcharge on the Mercosur common external tariff starting at the end of this year. The government is also placing increased emphasis on institutionalizing mechanisms for the resolution of trade disputes, and on securing greater macroeconomic convergence, through an improved policy dialogue. The member countries of Mercosur, as well as, Chile and Bolivia, are actively engaged in harmonizing statistics, particularly in the fiscal and balance of payments areas.

Argentina: Quantitative Performance Criteria for 2000–02[1]
(In millions of Argentine pesos or U.S. dollars)

	Jan–Mar 2000	Jan–Jun 2000	Jan–Sep 2000	Jan–Dec 2000	Jan–Dec 2001	Jan–Dec 2002
1. Cumulative balance of the Federal Government[2 3]	(2,150)	(2,690)	(3,850)	(5,300)	(4,100)	(2,400)
2. Cumulative primary expenditure of the Federal Government	13,390	26,130	39,690	52,930	...	...
3. Cumulative consolidated balance of the Provincial Governments[2 4]	...	(1,370)	...	(2,900)	(1,900)	(900)
4. Cumulative change in the debt of the Federal Government	2,860	6,860	5,125	4,000	...	...
5. Cumulative change in the short-term debt of the Federal Government	1,500	1,500	1,500	1,500	...	...
6. Cumulative change in the debt of the Consolidated Public Sector[5]	...	...	7,490	7,000	...	...
7. Cumulative change in the net domestic assets of the Central Bank	(275)	(440)	(850)	(1,080)	...	...

[1]As defined in the Technical Memorandum of Understanding.
[2]Targets for 2001–02 are indicative at present, to be substituted by performance criteria during the last review of the program for the preceeding year.
[3]Indicative targets for 2001–02 based on the fiscal responsibility law.
[4]Indicative.
[5]Indicative through September 2000.

Technical Memorandum of Understanding

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria table annexed to the Policy Memorandum.

1. **Cumulative balance of the Federal Government**. This balance comprises the result of the Federal Government (including PAMI and the Trust Fund for the Development of Infrastructure, and excluding transfers from the Central Bank and privatization receipts) and the result of the Central Bank (BCRA). The Federal Government result will be measured from below the line on the basis of: (a) debt information provided by public sector debt reporting system (SIGADE), including all short-term debt of the Federal Government; (b) net asset transactions of the Federal Government as reported by the *Secretaría de Hacienda*, the *Dirección Nacional de Cuentas Internacionales* (DNCI), and the Gerencia de Manejo de Reservas Internacionales of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos. The limit on the balance of the Federal Government will be adjusted downward (i.e., a deficit would be allowed to widen) by up to Arg$300 million for the amounts paid as severance payments in the context of the retrenchment of personnel program underway in the second half of 2000. Furthermore, the limit will be adjusted upward (a smaller deficit) for the capital gains realized in the sale of financial assets.

2. **Cumulative ceiling on primary expenditures of the Federal Government**. This ceiling applies to the noninterest expenditure of the Federal Government (including PAMI) and will be adjusted upward by up to Arg$300 million for the amounts related to severance payments mentioned in 1 above.

3. **Cumulative balance of the provinces**. This balance comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis, according to the information provided by the Secretaría de Programación Regional (SPR). This limit will be indicative, and will be adjusted upward by up to Arg$80 million for expenditures made from the Public Works Fund of the Province of Mendoza.

4. **Cumulative change in the debt of the Federal Government**. This debt includes the disbursement of all foreign currency denominated and Argentine peso denominated debt obligations and guarantees, as defined in EBS/00/128 (June 30,2000), of the federal government (including public enterprises, PAMI, Inder, and trust funds). These debt obligations are defined to include those with local and foreign financial institutions, international organizations, bonds, and bridge loans. This limit will be adjusted:
(a) downward (upward) for excesses (shortfalls) in privatization receipts relative to the program; (b) upward for amounts related to the restructuring of provincial debt by up to

Arg$1.2 billion; (c) upward for debt issued *in 2000 for the consolidation of past obligations* by up to Arg$1.7 billion, plus debt consolidated by Inder; (d) downward by the net effect of debt cancellations or swaps, and (e) upward for debt issued to finance the Fiscal Stabilization Fund by up to US$385 million in 2000; (f) upward for borrowing up to US$1.3 billion from multilateral agencies on behalf of provinces and official banks (deuda indirecta) in 2000; (g) upward for amounts related to the severance payments referred in 1 above by up to Arg$300 million; (h) downward for the capital gains realized in the sale of financial assets; and (i) with regard to the position in December 2000, upward for borrowing up to US$4 billion related to 2001 financing requirements and deposited at the BCRA. The data used to monitor debt developments will be taken from SIGADE, including all short term debt of the Federal Government. The stock of debt will be valued at end-1999 exchange rates and measured at end-period.

5. **Cumulative change in short-term debt of the Federal Government**. It includes all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

6. ***Cumulative change in the debt of the Consolidated Public Sector***. This debt includes the sum of the changes in the debt of the Federal Government as defined in 4 above (including the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt. The debt of the provincial governments and city of Buenos Aires, will be defined to include obligations to local and foreign financial institutions, to international organizations, and bonds (excluding peso denominated bonds placed outside the financial system). The limit on this provincial debt will be adjusted: (a) downward (upward) for excesses *(shortfalls) in privatization receipts* relative to the program, (b) downward for capital gains realized in the sale of financial assets, and (c) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year, with the exception of the use of deposits from the Public Works Fund of the Province of Mendoza mentioned in 3 above. The upward adjustment on account of an increase in net deposits of the provinces, which allows for over-borrowing, will be limited to Arg$1 billion. The data used to monitor provincial debt will be provided by the SPR, the SIGADE and the Central Bank. The stock of debt will be valued at end-1999 exchange rates and measured at end-period. This limit will be indicative for the third quarter of 2000 and binding thereafter.

7. **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 (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, 1999. *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 cash balance within the Latin America Trade Clearing System (ALADI), excluding the accounting effects on holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds.

Liabilities to the IMF will be valued at US$1.37 per SDR. The limit on net domestic assets will be adjusted upward by the equivalent of purchases from the IMF under the arrangement. Also, the limit for December 2000 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (pases activos)

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

FOR AGENDA

ZOCCALI, A. Guillermo
ROOM HQ 11-320 0451

EBS/00/278

CONFIDENTIAL

December 21, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Argentina—Augmentation of the Existing Stand-By Arrangement—Letter of Intent, Memorandum of Economic Policies, and Technical Memorandum of Understanding**

Attached for consideration by the Executive Directors is a letter of intent from the President of the Central Bank of Argentina and the Minister of Economy of Argentina, together with the memorandum of economic policies and technical memorandum of understanding of the Government of Argentina. This subject, together with the paper on the request by Argentina for an augmentation of the existing Stand-By Arrangement (to be issued shortly), is tentatively scheduled for discussion on Friday, January 12, 2001. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Argentina indicating their preference to publish it.

Questions may be referred to Mrs. Ter-Minassian (ext. 38844) and Mr. Reichmann (ext. 38610).

Att: (1)

Other Distribution:
Department Heads

Buenos Aires, Argentina
December 21, 2000

Dear Mr. Köhler:

In our memorandum of economic policies dated February 14, 2000, we outlined the Argentine government's policy framework for 2000–02, in support of which we requested a three-year stand-by arrangement from the IMF, which we have been treating as precautionary. These policies aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts. The program centered on fiscal consolidation and wide-ranging structural reform efforts.

Although, as outlined in our subsequent policy memorandum of September 5, 2000, substantial progress was made in the implementation of these policies, in recent months adverse domestic and external developments have hindered a sustained recovery of confidence and activity. This, in turn, contributed—in an international environment of heightened market concerns about emerging economies—to a sharp tightening of financing constraints for both public and private Argentine borrowers, making it more difficult to restart growth, and impacting adversely the fiscal performance. The government is reacting to this more adverse environment by strengthening its economic program, as outlined in President De la Rua's speech on November 9, and further detailed in the attached policy memorandum.

To strengthen market confidence in the appropriateness of this policy response, and its prospects of success, we are seeking enhanced financial support from the official and private international community. In particular, we are requesting an increase of the amount made available by the IMF under the stand-by arrangement, from SDR 5,399 million to SDR 10,586 million (500 percent of Argentina's quota), of which SDR 2,117 million would be provided under the Supplemental Reserve Facility (SRF). We are also requesting the World Bank and the IDB to increase their new loan commitments to US$2.4 billion each over the next two years. We have obtained assurances from the government of Spain that it will extend Argentina a loan of up to US$1 billion, to be disbursed pari-passu with the resources under the IMF stand-by arrangement. And we have secured, on a strictly voluntary basis, financing assurances from major domestic and international financial institutions active in Argentina of around US$10 billion.

We trust that the determined implementation of the government's strengthened economic strategy, in conjunction with this enhanced financial support package, will be instrumental in bolstering market confidence in Argentina, facilitating a progressive return of borrowing costs to more normal levels, and a sustained pickup in domestic activity and investment. We will maintain the customary policy dialogue with the Fund in the months ahead, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out with the Fund before May 30, 2000, August 31,2000, November 30, 2000, and February 28, 2001.

Sincerely,

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

/s/
Jose Luis Machinea
Minister of Economy

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Attachments:
Memorandum of Economic Policies
Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICIES

I. BACKGROUND

1. As described in detail in the Memorandum of Economic Policies (MEP) of February 14, 2000, **the economic program of the Argentine government** supported by the stand by arrangement (SBA) from the Fund aimed at creating conditions for a sustainable recovery of output and employment, with continued price stability and improvement in the external accounts, through policies geared to increasing national savings and investment, and promoting further modernization and competitiveness of the economy. Building on the important gains in financial stability and structural reform already achieved under the convertibility regime, these policies centered on a progressive reduction of the public sector deficit (including the provinces) from over 4 percent of GDP in 1999 to under 3 percent of GDP in 2000, with further reductions in subsequent years, to reach equilibrium by 2003; and on a wide-ranging structural reform effort in the public finances, the financial system, the labor market, the health system and other important sectors of the economy.

2. The **progress made in the implementation of these policies** in the first several months of the government's tenure was outlined in the MEP of September 5, 2000, which also reviewed economic developments in the first half of 2000, and prospects for the rest of this year. Economic indicators available at that time, albeit mixed, provided some comfort that a recovery of domestic demand was under way and, in conjunction with a robust volume growth of exports, especially in manufacturing, would lead to a sustained pickup in output in the second half of 2000 and into 2001. This, together with continued expenditure restraint, was expected to facilitate a strengthening of the fiscal performance, and help reduce the federal deficit from the equivalent of 2.5 percent of GDP in 1999 to 1.8 percent of GDP in 2000, and the consolidated provincial deficit from 1.6 percent of GDP in 1999 to 1 percent of GDP in 2000.

3. In recent months, however, **the economy has suffered from a combination of adverse developments**, which have affected significantly the prospects for the rest of this year, and will have inevitable repercussions on growth performance into 2001 as well. Political uncertainties in connection with a cabinet reshuffle affected adversely domestic confidence, and hindered the implementation of some of the government's policies. More importantly, the **external environment deteriorated significantly**, reflecting uncertainties over the course of the U.S. and other major industrial economies; the impact of high oil prices on world growth; and rising borrowing costs, with sharply reduced market access for emerging market economies in general, and Argentina in particular. Spreads on Argentine sovereign bonds rose by more than 200 basis points, and domestic lending rates by over 300 basis points from August to November, contributing to stalling the incipient recovery in domestic demand.

4. As a result of these developments, **real GDP growth** is likely to be near zero for 2000 as a whole, compared with the 1.7 percent expected at the time of the last review of the program. In 2001, the rate of growth is now projected to be around 2.5 percent on average,

but to accelerate during the year as the determined implementation of the strengthened economic policies of the government, and the enhanced international financial support, bolster confidence and promote a more sustained recovery of domestic demand.

5. While the growth performance in 2000 has fallen well short of expectations, **the economy has made significant progress in adjusting to the external shocks** which affected it in the late 1990s, in particular the terms of trade loss, the strength of the U.S. dollar and the depreciation of the Brazilian real. *Domestic costs continued to decline in 1999* and so far in 2000, bolstering competitiveness. Consumer prices dropped by 0.7 percent year-on-year by November 2000, while wholesale prices (in which tradable goods prices have a larger weight) rose by 4.8 percent over the same period, pointing to an increase in the relative price of tradable goods.

6. Reflecting this improvement in competitiveness, and the favorable impact of high energy prices, as well as the stagnation of domestic demand, **the trade balance** shifted from a deficit of US$1.6 billion in the first ten months of 1999 to a surplus of US$0.9 billion in the corresponding period of 2000. Of particular significance is the 12 percent volume growth of manufacturing exports during the same period. The improved trade performance is expected to more than compensate for the increased interest burden of the external debt, resulting in a **significant reduction of the external current account deficit in 2000**, to the equivalent of 3.4 percent of GDP from 4.4 percent of GDP in 1999, and *nearly 5 percent of GDP in 1998*. Notwithstanding the narrowing of the current account deficit—and the fact that some three quarters of this deficit are being covered by foreign direct investment (FDI)—the sharp tightening of external financing conditions in recent months is expected to result in a US$2 billion decline in net international reserves for the year as a whole. Gross international reserves, including the banks' liquidity requirements held abroad, are projected to amount by end-2000 to around US$32.5 billion (nearly 40 percent of M3 or one and half times the country´s short term external debt)

7. The government's effort to reduce the **federal deficit** in 2000 have been increasingly thwarted by the weakness of domestic demand and the continuing decline in consumer prices. Despite the introduction of a sizable package of tax measures in January, overall **tax revenues**, including social security contributions, rose by only about 3 percent through November 2000 compared with the 8.7 percent expected initially and the *nearly 6 percent* projected at the time of the review of the program,. As a result, and despite the government's **efforts to contain primary spending**—including a Arg$300 million cut in the program ceiling on such spending in the second half of the year—the ceiling on the cumulative federal deficit for end-2000 had to be raised by Arg$600 million (0.2 percent of GDP) during the first review of the program, and is now expected to be exceeded by a further Arg$1.4 billion. The government is, therefore, requesting corresponding modifications of the program ceilings on the federal deficit and debt for December 2000. The ceiling on primary spending is expected to be observed, implying a 1.4 percent decline in such spending, compared with 1999.

8. Preliminary information on **developments in the provinces' finances** in 2000 shows that significant progress was made in reducing their consolidated deficit from the relatively high level reached in 1999, although this progress fell somewhat short of expectations in the program. Current estimates point to a decline of this deficit to around Arg$3.4 billion (1.2 percent of GDP), compared with the 1.6 percent of GDP recorded in 1999, and the 1 percent of GDP envisaged in the program. Accordingly, the government is requesting modifications of the ceilings on the provinces' deficit and the consolidated public sector debt for end-2000. The bulk of the adjustments was carried out by the more indebted provinces which entered into agreements with the federal government for support in the refinancing of their debt, in conjunction with specific fiscal adjustment programs. Significant progress in fiscal consolidation was also made by some of the larger provinces, while in others the deficit remained quite large, indicating an urgent need for strengthened efforts by the latter provinces to improve their own-revenue performance and contain spending.

9. The near stagnation in economic activity, and the increase in the cost of credit, especially in recent months, have been reflected in a continuing decline of **domestic bank credit to the private sector**, as well as in an increase in the non-performing loan ratio, accompanied, however, by increased provisions. The capital adequacy ratio (Basel criteria) of the banking system remains relatively high, and bank liquidity generally adequate. Private deposits in the banking system rose by 5 percent during the first nine months of 2000, before declining by about 1.8 percent in October-November.

II. THE POLICY FRAMEWORK FOR 2001 AND BEYOND

10. The government is responding to these worse than expected developments through a **strengthened, growth-oriented economic strategy**, aimed at promoting a sustained recovery of domestic and external confidence, an acceleration of productivity growth and further improvements in competitiveness. This strategy centers on the maintenance of the convertibility regime, which continues to be viewed by the vast majority of the Argentine people as the fundamental guarantee of financial and price stability; a number of policy initiatives signaling a credible commitment to medium-term fiscal sustainability; and a broadening and acceleration of its efforts at structural reform, modernization and opening up of the economy.

11. The government has taken in recent weeks a number of **initiatives to promote a substantial recovery of investment**, which has declined by over 16 percent over the last two years. These initiatives include the elimination of the tax on interest payments by corporations in three steps over the next eighteen months; the extension from four to ten years of the period for loss carryover under the minimum income tax for enterprises; the acceleration of payments of VAT credits for new investments; an increase in selected public work programs aimed at easing infrastructure bottlenecks and stimulating activity in the construction sector; and a build, lease and operate program for basic infrastructure, aimed at facilitating financing for private contractors undertaking the construction of these projects.

12. Together with the efforts to boost investment described above, the government is implementing several **structural measures aimed at promoting competition in domestic markets and facilitating the allocation of capital and labor resources in the economy.** The government will shortly issue enabling regulations to put into effect the Protection of Competition Law, recently approved by Congress, that updates and strengthens antitrust legislation. Also a new regulatory framework will be developed to support the development of the ports system, and the government is proceeding with the implementation of the new regulatory framework for the telecommunications sector, where the work is well advanced and the interest of foreign companies to enter the Argentine market is manifest. To remove some remaining distortions that followed from the privatization process of the early 1990s, the government is reviewing contracts with privatized enterprises in the energy, utility, and transport sectors. Finally, the government has recently completed issuing the regulatory decrees required for the full implementation of the labor market reform that was enacted earlier in the year. These measures, together with the pension and health sector reforms, and the policies to develop the domestic capital markets, more fully described below, are considered fundamental to sustain the expected recovery of output growth,.

13. *In conjunction with an expected easing of financing constraints, as confidence is* bolstered by the implementation of the government's program and the international financial support package, these measures are expected to contribute to a sustained **pick up in domestic demand**, particularly of investment, in the course of 2001. Specifically, growth is projected to recover to over 4 percent by the fourth quarter of next year, albeit remaining on average around 2½ percent. Consumer prices are expected to remain broadly stable, and the GDP deflator to record a small rise in reflection of a projected further improvement in the terms of trade. **Real GDP growth is expected to be sustained at over 4 percent a year over the medium term**, allowing–in conjunction with the increased flexibility in the formal labor market brought about by the implementation of the recent labor legislation reform–for a progressive recovery of employment. Inflation is expected to remain lower than in major partner countries, facilitating further gains in competitiveness over the next few years.

14. The **external trade surplus is expected to increase further in 2001** (to around US$2 billion) as the sustained growth of exports resulting from the strengthening of competitiveness and the coming on stream of investments in the energy, paper, and basic metal industries should more than offset the increase in imports associated with the economic recovery. The current account deficit is expected to decline slightly, to the equivalent of around 3¼ percent of GDP, with the improvement in the trade balance partly offset by the rising burden of net interest payments abroad. Net FDI is expected to continue to cover about 70 percent of this deficit. **Over the medium term, the current account is projected to narrow further, to well under 3 percent of GDP**, reflecting the continued improvement in the trade performance and a deceleration of the growth of net interest payments, in line with the decline of the external debt in relation to GDP, and of interest rates. Some 80 percent of the current account is expected to be covered by FDI, and the remainder by net financial inflows to the private sector, as the public sector gradually reduces its reliance on foreign financing, reflecting the planned fiscal consolidation and the further development of the domestic capital market.

15. A central element of the government's strategy is a continued, and indeed strengthened **commitment to eliminating the fiscal deficit at all levels of government over the medium term**, with a view to facilitating a **sustained reduction of the public debt in relation to GDP**, an important condition for securing a lasting decline of the risk premium on Argentine bonds, and consequently of financing costs for public and private borrowers. The revised federal budget recently approved by congress envisages an only modest reduction of the deficit in 2001, in order to avoid a fiscal contraction in the early stages of the economic recovery. But it also includes a binding commitment—through a revision of the fiscal responsibility law—to a linear decline of the deficit in subsequent years, to zero by 2005. This commitment to fiscal consolidation at the federal level is buttressed by similar commitments undertaken by the provincial governments in the recent **federal fiscal pact**. Projections based on relatively conservative assumptions about GDP growth and the cost of government borrowing over the next few years suggest that such a path of the consolidated public sector deficit should be consistent with a significant decline of the public debt in relation to GDP from 2003 onwards. The fiscal consolidation effort will center on a **freeze of nominal primary spending** at the 2000 level by both the federal government and the provinces in deficit, and on **strengthened structural fiscal reforms**, particularly in the tax administration and the social security. **These efforts are expected to result in a gradual increase of the primary surplus of the consolidated public sector equivalent to more than four percentage points of GDP during the period 2001-05.**

16. The **2001 federal budget** supports the growth-oriented strategy of the government by allowing some scope for the automatic stabilizers to work. Specifically, the federal deficit will be reduced by less than envisaged in the original budget proposal submitted to Congress in September 2000, to around Arg$6.5 billion (2.2 percent of GDP), to accommodate the **lower growth of revenues** entailed by the revised more conservative assumption regarding GDP growth for next year. The revised budget also incorporates the fiscal cost of the measures—referred to in paragraph 10 above—to stimulate investment, and some additional spending (equivalent to about 0.1 percent of GDP) in temporary public employment programs and other social spending aimed at mitigating economic hardship for the most vulnerable groups of society. Federal primary spending is, nonetheless, expected to decline by the equivalent of 0.5 percent of GDP from the 2000 level. As a result, **the primary surplus of the federal government** is projected to rise to 1.7 percent of GDP in 2001 from 1 percent in 2000, and 0.4 percent of GDP in 1999.

17. To ease recent financing constraints and facilitate the rapid return of Argentina to international capital markets, the government has arranged a **financial support package of around US$39 billion from** official and private sector sources, including the requested augmentation of the existing Stand-by Arrangement to 500 percent of quota (equivalent to about US$13.7 billion); understandings with the World Bank and the IDB on new loan commitments amounting to around US$4.8 billion in total over the next two years; a loan from Spain of US$1 billion, and substantial underwriting commitments with market maker banks active in Argentina and the local pension funds. Specifically, in 2001, **the gross financing requirements of the federal government** are projected to amount to around US$27 billion, including the rollover of the US$5 billion outstanding short-term Treasury

bills (Letes). Multilateral and bilateral official sources are expected to finance about 36 percent of such requirements. To fill the remaining part, the government has reached agreements with local banks on a rollover of maturing bonds and purchases of new issues in the amount of US$10 billion, and the local pension funds are expected to purchase about US$3.0 billion of new government bonds. The government is also planning other placements in international capital markets, as well as a number of liability management operations. **The government's financing requirements are expected to decline over the medium term**, as progress is made towards eliminating the deficit by 2005. Public debt management will focus on further smoothing the amortizations profile, as market conditions allow.

18. The **provinces** are expected to reduce their consolidated deficit from the equivalent of 1.2 percent of GDP in 2000 to around 0.9 percent of GDP in 2001. This improvement is to be achieved through both the agreed freeze on primary spending in those provinces in deficit, and through a strengthened performance of own revenues, while transfers from the federal government will remain stable in relation to GDP. In the federal fiscal pact, the provinces have also committed themselves to introducing in their respective legislatures **fiscal responsibility laws** mandating the achievement of budgetary balance by, at the latest, 2005, and to improving the quality, timeliness and transparency of their fiscal accounts. The government will inform the public of progress in the implementation of the federal pact through quarterly reports. The government will also continue to work with the provinces on a more permanent **reform of the revenue sharing system**, with a view to streamlining it, eliminating some of its distortive features, and improving its equity over the medium term.

19. To buttress its commitment to fiscal sustainability, the government is strengthening and accelerating **structural fiscal reforms.** In the **tax administration** area, efforts will focus on broadening the coverage and improving the quality of audits, enhancing cooperation and the exchange of information with the provincial tax administrations, and accelerating the collection of tax arrears. These efforts will be facilitated by a rapid implementation of the measures envisaged in the recently approved anti-evasion law, including making fully operational the special tribunal for criminal tax cases. To minimize moral hazard, the government will eschew new amnesties or other payment facilitation arrangements for overdue taxes, and streamline and increase the transparency of existing ones. Efforts will be made to improve internal controls and supervision in the tax and customs administration, to increase efficiency, as well as to minimize opportunities for corruption. The scope for **simplifying the tax system and reducing exceptions, special treatments, and loopholes** will also be analyzed, with the help of local and outside experts.

20. The government intends to utilize to the fullest extent possible the available instruments to **streamline the public administration** by eliminating redundant entities and programs, minimizing the overlapping and duplication of functions across administrative units and levels of government, and re-deploying civil servants as needed; revising procurement practices and strengthening the evaluation of the cost-effectiveness of spending programs; and making the public administration more service-oriented. Efforts continue to be made to **consolidate and target more effectively a number of small scale social assistance programs**, especially in the areas of nutrition, construction of essential sanitary

infrastructure, and the management of the impact of natural disasters. To this end, the government has already issued decrees to consolidate three nutritional programs and three programs covering education and health for urban youth into more comprehensive and efficient single programs (*Unidos* and *Solidaridad*, respectively). A unified registry of beneficiaries in federal and provincial social programs will be established.

21. With a view to strengthening the intertemporal solvency and equity of the **pension system**, the government replaced a draft law submitted to congress in June with a new proposal for reform of the system. The **new draft bill** proposes to: (a) replace the basic universal pension benefit (PBU) with a sliding-scale supplementary benefit (PS) for new pensions lower than Arg$600 per month; (b) introduce a minimum benefit of Arg$100 per month for all citizens of more than 78 years of age who do not have other sources of income; (c) introduce incentives for women to postpone retirement until 65 years, by progressively increasing the age at which they will qualify for the supplementary benefit; and (d) eliminate the option of joining the public pension system for new entrants into the labor force. The government attaches great importance to the rapid approval and early implementation of the key elements of this reform, given their role in ensuring the medium term solvency of the pension system, and sustainability of the overall fiscal position. The Social Security Agency (ANSES) has been intervened in mid-November, with a view to streamlining it and increasing the transparency and efficiency of its operations. The government intends to seek the support of the World Bank in this task. The government has tabled legislation aimed at strengthening competition among **private pension funds**, reducing administration costs in these funds, and improving their supervision. The government also intends to review the system of family allowances, with a view to streamlining it and reducing the scope for fraud.

22. The deregulation of the union-run **health organizations** (*obras sociales*), which aims at promoting competition and increasing efficiency in the provision of health care, will become effective on January 1, 2001. Under the new regime, individuals will be able to choose their health providers among the *obras sociales* and the private HMOs. All health care providers will be required to offer a basic menu of services at a low per capita premium. They will be allowed to offer additional services for additional voluntary contributions. A redistributive solidarity Fund, funded with mandatory contributions related to the level of income of participants in the system, will be used to finance the automatic subsidy for contributors whose payroll deductions do not cover the basic capita, and for the purchase of insurance for high-cost illnesses. The **health system for retirees** (PAMI) which was intervened last January is being restructured, and steps are being taken to increase its accountability and transparency of operations. To this end, PAMI is being required to obtain the government's approval of its budget, its staffing policy, and its borrowing operations, and will be made subject to the same control and auditing mechanisms that apply to the rest of the public administration. PAMI is also being required to submit monthly reports on its financial position and budgetary execution.

23. **Financial policies** will continue to aim at buttressing confidence in the domestic banking system by maintaining, and strictly enforcing the relatively high liquidity requirements of banks, and continuing to strengthen bank supervision. Draft legislation is

being prepared to facilitate further the process of bank resolution. With a view to **fostering the development of the domestic capital markets**, the government will send to Congress by the second quarter of next year a bill on best practices in the financial sector, increasing the transparency and the requirements for public information about financial transactions, and strengthening corporate governance, particularly in regard to minority shareholders' rights. The government is also introducing measures to harmonize taxation across the financial service sector, and has presented a bill to modernize the regulatory framework in the insurance sector. The government has requested a Financial Sector Assessment Program from the IMF and the World Bank early in 2001.

24. **The government is seeking agreement with other MERCOSUR countries on a reduction of tariff dispersion and of tariff rates.** Agreement has been reached on phasing out the 3 percent surcharge on the Mercosur common external tariff by the end of 2002, thus reducing the average tariff, from 13.3 percent to 10.9 percent. As a first step in this direction, the surcharge will be reduced by 0.5 percentage points on January 1, 2001, and a timetable for further reductions will be announced by June 2001. The government is also placing increased emphasis on institutionalizing mechanisms for the resolution of trade disputes, and has recently taken steps to strengthen convergence with its MERCOSUR partners as well as Chile and Bolivia, through an agreement on common macroeconomic targets and on harmonized statistics, particularly in the fiscal and balance of payments areas.

Corrected: 12/21/00
ANNEX I

Argentina: Quantitative Performance Criteria for 2001-02 1/ 2/

(In millions of Argentine pesos or U.S. dollars)

	Jan-Dec 2000 3/	Jan-Mar 2001	Jan-Jun 2001	Jan-Sep 2001	Jan-Dec 2001	Jan-Dec 2002
1. Cumulative balance of the Federal Government 4/	(6,700)	(2,100)	(3,800)	(5,100)	(6,500)	(5,000)
2. Cumulative primary expenditure of the Federal Government	52,930	13,313	26,173	39,895	53,212	...
3. Cumulative consolidated balance of the Provincial Governments 5/	(3,400)	(600)	(1,400)	(2,000)	(2,760)	(2,000)
4. Cumulative change in the debt of the Federal Government	5,700	2,150	3,900	5,250	6,700	5,000
5. Cumulative change in the short-term debt of the Federal Government	1,500	1,500	1,500	1,500	1,500	...
6. Cumulative change in the debt of the Consolidated Public Sector	9,200	2,750	5,300	7,250	9,460	7,000
7. Stock of net domestic assets of the Central Bank 6/	(1,080)	2,473	2,399	2,097	1,836	...

1/ As defined in the Technical Memorandum of Understanding.

2/ Targets for 2002 are indicative at present, to be substituted by perfromance criteria during the fifth review of the program.

3/ As defined in theTechnical Memorandum of Understanding attached to EBS/00/191.

4/ Indicative target for 2002 based on the fiscal responsibility law.

5/ Indicative.

6/ For January-December 2000 refers to the cumulative change in the net domestic assets of the central bank.

Structural Benchmarks

Tax administration

- Design of a national audit plan, aimed at expanding coverage of desk audits to 100,000 taxpayers by end of 2001 (third review)
- Completing 80,000 desk audits (fifth review)
- Completing 100,000 desk audits (sixth review)
- Issue presidential decree consolidating and streamlining existing tax payments facilities, and forbidding granting of new facilities in conditions not contemplated in the decree (third review)
- Beginning implementation of setting up the Tax Frauds Tribunal (third review)
- Full implementation of the Tax Frauds Tribunal (sixth review)

Social security reforms

- Issuance of implementing regulations for proposed pension reform (third review)
- Preparation of restructuring plan for family allowances (third review)
- Implementation of plan (fourth review)
- Preparation of plan for the Restructuring of ANSES (third review)
- Preparation of detailed action plan to eliminate PAMI's deficit, and implementation of information requirements for PAMI envisaged in 2001 budget (third review)

Provincial finances

- Publication by national Ministry of Economy of quarterly public reports on implementation by the Nacion and each province of commitments undertaken in the pacto federal (starting with third review)

Financial system

- Presentation of bill on best practices in the financial sector and corporate governance (third review)
- Presentation of draft legislation to facilitate the process of bank resolution (fifth review)

Trade policy

- Announcement of timetable for elimination of CET surcharge by end 2002 (fourth review).

Competition and Deregulation

- Issuance of implementing regulations for the Protection of Competition Law (third review)
- Regulatory proposal for ports system (fourth review)
- Implementation of new regulatory framework in the telecommunications sector (fifth review)

Corrected: 12/21/00

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria table annexed to the Policy Memorandum.

1. Cumulative balance of the Federal Government.

Cumulative balance of the Federal Government	Limit (floor, in millions of Arg$)
End-March 2001 (performance criterion)	-2,100
End-June 2001 (performance criterion)	-3,800
End-September 2001 (performance criterion)	-5,100
End-December 2001 (performance criterion)	-6,500
End-December 2002 (indicative)	-5,000

The balance of the Federal Government comprises the results of the Federal Government and of the Central Bank (BCRA). The result of the Federal Government is defined to include: the balances of PAMI, the *Fondo Fiduciario de Infraestructura*, and the issue of bonds in exchange for *Plan Canje* tax certificates; and to exclude transfers from the Central Bank, privatization receipts, and capital gains realized on the sale of financial assets. The result of the Federal Government will be measured from below the line on the basis of: (a) the information provided by public sector debt reporting system (SIGADE), *including all short-term* debt of the Federal Government; (b) net asset transactions of the Federal Government as reported by the *Secretaría de Hacienda*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos. The limits on the balance of the Federal Government will be adjusted downward (i.e., the deficit will be allowed to rise) by up to Arg$ 210 million for the issue of bonds in exchange for *Plan Canje* tax certificates.

2. Cumulative ceiling on primary expenditure of the Federal Government.

Cumulative primary expenditures of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-March 2001 (performance criterion)	13,313
End-June 2001 (performance criterion)	26,173
End-September 2001 (performance criterion)	39,895
End-December 2001 (performance criterion)	53,212

This ceiling applies to the noninterest expenditure of the Federal Government (including the deficit of PAMI) as reported by the *Secretaría de Hacienda*.

3. Cumulative balance of the provincial governments.

Cumulative provincial government balance	Limit (floor, in millions of Arg$)
End-March 2001 (indicative)	-600
End-June 2001 (indicative)	-1,400
End-September 2001 (indicative)	-2,000
End-December 2001 (indicative)	-2,760
End-December 2002 (indicative)	-2,000

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

4. Cumulative change in the debt of the Federal Government.

Cumulative change in the debt of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-March 2001 (performance criterion)	2,150
End-June 2001 (performance criterion)	3,900
End-September 2001 (performance criterion)	5,250
End-December 2001 (performance criterion)	6,700
End-December 2002 (indicative)	5,000

The change in the debt of the government will be defined as the difference between the stock of debt at each relevant date in 2001, valued at end-2000 exchange rates and measured at end of period, and the stock of debt at end-2000. The debt of the Federal Government includes all foreign currency denominated and Argentine peso denominated debt obligations and guarantees, as defined in EBS/00/128 (June 30, 2000) and Executive Board Decision adopted August 24, 2000 and incorporated herein by reference, of the Federal Government (including public enterprises, PAMI, INDER, and trust funds). These debt obligations include those with local and foreign financial institutions, international organizations, bonds and bridge loans. The data used to monitor debt developments will be taken from SIGADE, including all short term Federal Government debt. The limit on the change in federal government debt will be adjusted in the following ways:

(a) upward (downward) by the increase (decline) in the deposits of the Federal Government in the Central Bank, the domestic banking system and abroad, adjusted for any margin observed in the cumulative balance of the federal government performance criterion as defined in 1 above;

(b) upward (downward) for the net increase (decrease) in the valuation of net debt operations —including both placements and amortizations—made after December 31, 2000 in currencies other than the U.S. dollar arising from the difference between actual exchange rates and those of end-December 2000. To ensure the timely calculation of this adjustor, the authorities will provide the Fund with *information on all debt operations* (placements and amortizations) on a weekly basis indicating the currencies and exchange rates at which the operations were carried out.

(c) downward for any privatization proceeds;

(d) by the difference between the result of the Central Bank in 2001 as defined in 1 above and the transfers effectively made by the Central Bank to the Federal Government;

(e) upward, by up to Arg$2.1 billion, for debt issued in 2001 for the consolidation of past obligations(including bonds issued in exchange for *Plan Canje* tax certificates), by up to Arg$ 800 million for consolidation of past obligations of INDER, and by up to Arg$ 400 million for payments due to judicial rulings relating to past claims on the Social Security Administration (ANSES);

(f) downward (upward) by the reductions (increases) in nominal debt arising from debt cancellations or swaps in 2001;

(g) downward for an amount equivalent to the difference between the proceeds from the sale of collateral released through the rescue of Brady bonds in 2001 and the nontax revenue obtained as a result of these operations;

(h) upward for debt issued in 2001 to finance the Fiscal Stabilization fund by up to US$450 million in 2001;

(i) upward, by up to Arg$ 1,850 million, for amounts relating to borrowing in 2001 by the Provincial Development Trust Fund for the restructuring of provincial debt; and

(j) upward, by up to US$1.5 billion, for borrowing in 2001 from multilateral agencies on behalf of provinces, municipalities, and official banks (*deuda indirecta*) in 2001;

5. **Cumulative change in short term debt of the Federal Government.**

Cumulative change in federal short term debt	**Limit (ceiling, in millions of Arg$)**
End-March 2001 (performance criterion)	1,500
End-June 2001 (performance criterion)	1,500
End-September 2001 (performance criterion)	1,500
End-December 2001 (performance criterion)	1,500

The short term of the Federal Government consists of all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

6. Cumulative change in the debt of the Consolidated Public Sector (CPS).

Cumulative change in debt of the CPS	Limit (ceiling, in millions of Arg$)
End-March 2001 (performance criterion)	2,750
End-June 2001 (performance criterion)	5,300
End-September 2001 (performance criterion)	7,250
End-December 2001 (performance criterion)	9,460
End-December 2002 (indicative)	7,000

The change in the debt of the Consolidated public Sector includes the sum of the changes in the debt of the Federal Government as defined in 4 above (including all the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt (including debt to the Provincial development Trust Fund arising from debt restructuring operations). The debt of the provincial governments and the City of Buenos Aires will be defined to include obligations to local and foreign financial institutions (as reported by the Secretaría de Hacienda with respect to the end March, 2001 performance criterion, and subsequently by the Central Bank), to international organizations, and bonds (excluding peso denominated bonds placed outside the financial system). The limit in this provincial debt will be adjusted: (a) downward for any privatization receipts; (b) downward for capital gains realized in the sale of financial assets; and (c) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year. The data used to monitor the provincial debt will be provided by the *Secretaría de Hacienda*, the SIGADE, and the Central Bank. The stock of debt will be valued at end-2000 exchange rates and measured at end period.

7. The net domestic assets (NDA) of the BCRA

The net domestic assets (NDA) of the BCRA are defined, as shown below, 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 limit on NDA will be adjusted upward by the equivalent of purchases from the IMF under the arrangement.

The limit for December 2001 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (*pases activos*).

	2000		2001 ceilings 1/			
	Nov.	Dec.	Mar.	Jun.	Sept.	Dec.
	(In millions of pesos, end of period)					
A. Net international reserves (a-b)	20,267	22,852				
a. Gross international reserves 2/	23,360	25,832				
b. Foreign liabilities 3/	3,093	2,980				
B. Net domestic assets (C-A)	2,705	2,642	2,473	2,399	2,097	1,836
C. Monetary liabilities (c+d+e)	22,972	25,494				
c. Currency issued	13,330	15,078				
d. Government deposits 4/	919	920				
e. Reserve deposits of banks 5/	8,723	9,495				

1/ Performance criteria

2/ Include the BCRA holdings of gold, SDR's, foreign currency in the form of cash and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI), excluding the accounting effects of holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds.

3/ End-December position projected as of December 11, 2000. Liabilities to the IMF valued at US$1.30 per SDR. Excludes purchases from the IMF arrangement.

4/ Includes government and ANSES deposits.

5/ Legal bank reserves and liquidity requirements (reverse repo).

ZOCCALI, A. Guillermo
ROOM HQ 11-320 0451

FOR AGENDA

EBS/01/66

CONFIDENTIAL

May 4, 2001

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Argentina—Third Review Under the Stand-By Arrangement—Letter of Intent and Memorandum of Economic Policies**

Attached for consideration by the Executive Directors is a letter of intent from the President of the Central Bank of Argentina and the Minister of Economy of Argentina, together with the memorandum of economic policies of the government of Argentina. This subject, together with the paper on the third review under the Stand-By Arrangement for Argentina (to be issued shortly), will be brought to the agenda for discussion on a date to be announced. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Argentina indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Reichmann (ext. 38610) and Mr. Traa (ext. 36876).

Att: (1)

Other Distribution:
Department Heads

Buenos Aires, Argentina

May 3, 2001

Dear Mr. Köhler:

Our memorandum of economic policies dated February 14, 2000 outlined the Argentine government policy framework for 2000-02, in support of which we requested a three-year stand-by arrangement from the Fund. This program centers on fiscal consolidation and wide-ranging structural reforms aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts. As outlined in our subsequent policy memoranda of September 5, 2000 and December 21, 2000, substantial progress was made in the implementation of these policies. However, adverse domestic and external developments have repeatedly led to crises that resulted in a sharp tightening of the financing constraints and hindered a sustained recovery of confidence and activity. As a result, the government was not able to observe the deficit, primary expenditure, and debt targets specified under the program for March 31, 2001, for which we are requesting waivers. The government believes that the resumption of strong economic growth and attainment of a sustainable fiscal position are at the core of the success of its program. To that effect, it is implementing a comprehensive package of fiscal and pro-growth, pro-competitiveness measures, which is described in the attached memorandum and annexes outlining the policies of the government for 2001 and beyond.

During the period of the arrangement, we will maintain the customary dialogue with the Fund, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out before September 15, 2001, December 15, 2001, and March 15, 2002.

Sincerely yours,

/s/
Roque Maccarone
President
Central Bank of the
Republic of Argentina

/s/
Domingo Cavallo
Minister of Economy

Mr. Horst Köhler
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, DC 20431

Attachments:
Memorandum of Economic Policies
Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICIES

I. BACKGROUND

1. The economic program of the Argentine government,[1] supported by the current stand-by arrangement (SBA) from the Fund, aims at creating conditions for a sustainable recovery of output and employment, with continued price stability and improvement in the external accounts, through policies geared to increase national savings and investment and promote further modernization and competitiveness of the economy. These policies center on a progressive reduction of the public sector deficit to reach equilibrium by 2005; and on a wide-ranging structural reform effort in the public finances, financial system, labor market, health system, and other important sectors of the economy.

2. **Although important progress was made during 2000 in the implementation of these policies, the financial environment deteriorated significantly toward year-end.** The overall deficit of the combined public sector was reduced from 4.2 percent of GDP in 1999 to 3.6 percent in 2000, including through a decline in nominal noninterest outlays, breaking the upward trend of previous years. The government also adopted several measures aimed at reducing fiscal impediments to investment, including the phased elimination of the tax on interest paid by enterprises and the acceleration of payments of VAT credits to new investment. A deterioration in the external environment and domestic political developments adversely affected confidence in October-November, resulting in a drop in private sector deposits in the banking system, and a widening of spreads on Argentine sovereign bonds. In this difficult context, the government strengthened its economic program and secured enhanced financial support from the official and private international community, thereby contributing to a return of confidence in early 2001. Spreads dropped sharply, interest rates returned to pre-crisis levels, and private sector deposits bounced back, with some indicators pointing to an incipient recovery in domestic demand. In March, however, another sharp deterioration in market sentiment took place, caused by a surprisingly weak fiscal performance in early 2001, renewed political turmoil, and an increase in the perception of risks abroad. The government has moved decisively to address these new difficulties and took important legislative initiatives aimed at boosting competitiveness and promoting investment and growth. These initiatives, which resulted in a rebound in consumer and business confidence indicators, form the core of the program that is described below.

3. **Real GDP contracted by 0.5 percent in 2000, reflecting mainly a sharp drop in investment.** Although industrial production (seasonally adjusted) grew from November to February, this process was partly reversed in March and, during the first quarter of 2001, GDP is estimated to have fallen by more than 1 percent from the same period in 2000. However, domestic costs are declining which, in due course, should contribute to an

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[1] The program is described in detail in the Memoranda of Economic Policies (MEPs) of February 14, September 5, and December 21, 2000.

improvement in competitiveness. Consumer prices dropped by 1.0 percent year-on-year by March 2001, while wholesale prices declined by 0.4 percent over the same period.

4. **For 2001, the program seeks to reduce the overall deficit of the Federal Government** *from the Arg$7.0 billion attained in 2000 to Arg$6.5 billion. During the first* quarter of 2001, however, the deficit of the federal government registered an overrun of Arg$1 billion over the Arg$2.1 billion program ceiling. Two-thirds of this deviation was due to a shortfall in revenue, reflecting delays in the implementation of some revenue measures, a drop in tax compliance in March, and the decline in output. On the expenditure side, a carry-over of outlays from 2000, higher interest costs on the national debt, and spending overruns explained the deviation.

5. **Progress was made in reducing the consolidated deficit of the provinces, which declined from 1.6 percent of GDP in 1999 to 1.1 percent in 2000.** The bulk of the adjustments was carried out by the more indebted provinces which entered into agreements with the federal government for support in the refinancing of their debt, in conjunction with specific fiscal adjustment programs. Significant progress was also made by some of the larger provinces, while in others, including the Province of Buenos Aires, the deficit remained quite large. The program for 2001 contemplates a further reduction of the deficit of the provinces to 0.9 percent of GDP. Preliminary first quarter estimates suggest that, on a commitment basis, the aggregate deficit exceeded the indicative target in the program by a small amount.

6. **During 2000 and the first quarter of 2001, bank credit to the private sector declined, reflecting the weak economic activity.** Private sector deposits rose steadily during the first nine months of 2000 but declined during the last quarter, because of the impact of the October-November crisis. With the return of confidence, deposits bounced back in early 2001, but this recovery was short-lived, and they declined again in March-April. On both occasions, the central bank eased banks' required liquidity ratios on a temporary basis. The capital adequacy ratio (Basel criteria) of the banking system remains comfortable, and banks have been steadily building up provisions to cover the nonperforming loans.

7. **The trade balance improved significantly during 2000, contributing to a narrowing of the external current account deficit from 4.4 percent of GDP in 1999 to 3.3 percent in 2000**, with close to three-fourths of this deficit covered by foreign direct investment. The trade balance improved from a deficit of US$2.2 billion in 1999 to a surplus of US$1.2 billion in 2000, which more than compensated for the increased interest burden of the external debt. Exports rose by 13 percent, reflecting a strong performance of manufactured exports as well as the favorable impact of high energy prices. Exports of manufactured goods rose by 18 percent, as a result of a surge in export volume in several sectors including steel, automobile, and chemical products. Imports contracted by 1.2 percent, reflecting in part depressed investment activity. The external current account deficit in the first quarter of 2001 is estimated at US$2.6 billion (0.7 percent of annual GDP), some US$0.6 billion lower than in the same period a year earlier, largely because of a continued strong export performance. However, financial and political turmoil in March translated into a significant decline in gross official international reserves (including banks'

liquidity requirements held abroad) from US$32.5 billion at end-December 2000 to US$26.0 billion at end-April 2001.

II. THE NEW POLICY PACKAGE AND ECONOMIC PROGRAM FOR 2001 AND BEYOND

8. The government has implemented a wide range of measures to deepen and expand its strategy of ensuring medium-term fiscal sustainability and promoting a sustained recovery of economic activity. The new initiatives—embodied in the competitiveness law approved by Congress on March 28, 2001—include a major effort to strengthen tax revenues, targeted expenditure cuts, and the granting to the executive of special powers to legislate for the period of one year on reforms in the public sector, taxation, and regulation.

9. The new measures the government is putting in place aim to restore confidence, both domestically and externally, accelerate productivity growth, and bolster competitiveness. They continue to be centered on the maintenance of the convertibility regime. The government intends to preserve convertibility's main features, e.g., full foreign exchange backing of the currency, and statutory limitations on central bank financing of the public sector. In addition, the government intends to reinforce convertibility by including the euro alongside the U.S. dollar, and thereby promote greater stability of the effective exchange rate of the peso. Draft legislation has been introduced in Congress specifying that, once parity is established between the U.S. dollar and the euro, the value of the peso will be defined in terms of equal parts of both currencies.

10. The **policies to promote investment** and competitiveness that were put in place during 2000 will be boosted by a number of new measures the government has taken in recent weeks, including the reduction to zero of the extra-Mercosur import tariff on most capital goods, and the granting of tax subsidies for domestic producers of capital goods. At the same time, the extra-Mercosur import tariff on a range of consumer goods was temporarily raised to 35 percent to stimulate domestic production and employment in these sectors, while mitigating the fiscal impact of the tariff reduction on capital goods. These duties will return to Mercosur's common external tariff by the end of 2002. In addition, the government will lead a concerted effort to eliminate distortions and reduce costs in the productive sectors. This effort will center on "competitiveness plans" to be subscribed by the government, business, and labor in specific sectors, and will involve the elimination of distortive taxes and regulations, including by the provinces and municipalities, as well as through agreements with workers in regard to more flexible labor arrangements. The elimination of tax distortions will be gradually extended to the rest of the economy, as fiscal conditions allow. The tax incentives to promote investment described in the MEP of December 21, 2000 are being implemented, as well as a reduction in the VAT rate on capital goods to 10.5 percent, further reducing the financing cost of investment. The government is also accelerating the program of public works aimed at easing infrastructure bottlenecks and stimulating activity in the construction sector. The law authorizing the lease-and-operate programs for basic infrastructure was approved in March.

11. While efforts are proceeding to boost investment spending, the government is implementing several **structural measures aimed at promoting competition in domestic**

markets and facilitating a better allocation of capital and labor resources in the economy. Using the new legislative powers the government has streamlined the anti-trust legislation and issued regulations for the Protection of Competition Law. Similarly, the new regulatory framework of the telecommunications sector is being implemented, permitting the government to proceed in the last quarter of 2001 with the auction of two third-generation telecommunications frequencies. Also, the government has recently issued enabling regulations for the labor market reform, which is proceeding well. All sectors with collective labor contracts that are still subject to the ultra-actividad clause (which retains in effect a pre-existing contract in the absence of a new agreement) will be required to renegotiate such contracts during a period not exceeding two years from end-June 2001, or they will be submitted to binding arbitration. Also, progress is being made to extend social security identification to hitherto unregistered workers affecting, among others, domestic employees. Such programs are now being extended to seasonal, youth, and part-time employees, and those in small and medium-sized enterprises (PYMES).

12. With the policy package now in place, the government expects confidence in the economy to improve and projects a recovery of economic activity through year-end, led by domestic consumption, and complemented later in the year by accelerating investment as the measures described above have their full effects. The government projects that real GDP growth will gradually accelerate to a pace of around 5 percent by year end, corresponding to **output growth in a range of 2–2.5 percent** for the year on average. **Inflation** is expected to remain subdued, owing to the absence of cost pressures, and unemployment is expected to begin declining as the recovery gains pace.

13. The external trade surplus is expected to increase to US$1.8 billion in 2001, as sustained growth of exports resulting from the coming on stream of investments in the chemical, paper and basic metal industries should more than offset lower external sales of agro-industrial products and the increase in imports associated with the expected economic recovery. The external current account deficit is expected to widen slightly, to the equivalent of 3.4 percent of GDP, with the improvement in the trade balance more than offset by a decline in interest earnings abroad. Because of the relatively long maturity of Argentina's external debt, total interest payments on external debt should not be affected significantly by the increase in spreads observed in recent months. Over the medium term, the current account is projected to narrow further, to under 3 percent of GDP, reflecting the continued improvement in the trade performance and a deceleration of the growth of interest payments, in line with the decline of the external debt in relation to GDP and lower interest rates. The bulk of the current account is expected to be covered by FDI, and the remainder by net financial inflows to the private sector, as the public sector gradually reduces its reliance on foreign financing, reflecting the planned fiscal consolidation and the further development of the domestic capital market.

14. The government remains committed to achieving a sustained reduction of the public debt in relation to GDP over the medium term, which it regards as essential to reduce the country's vulnerability to events in the capital markets, and to lower risk spreads, and hence interest costs, for private and public borrowers, thereby promoting a recovery of economic activity. Attainment of these objectives is embodied in the **fiscal responsibility law** that establishes a path for the reduction of the federal budget deficit, including its elimination by

2005. Provincial governments subscribed to a similar undertaking in the **federal fiscal pact**. **The medium-term fiscal consolidation** is based on the freezing of nominal primary spending at the 2000 level by both the federal and provincial governments, and the strengthening of structural reforms, including in tax administration, the social security system, and in the public administration.

15. The deviation from the fiscal deficit target in the first quarter of 2001 reflected the effects from weaker tax performance and from nonimplementation of certain measures that, with unchanged policies, were projected to compound into a cumulative deviation for the year of as much as Arg$3.7 billion. This result is not acceptable to the government as it would violate the targets specified under the **Fiscal Responsibility Law** as well as those under the Fund program. **To ensure the attainment of the fiscal target for 2001**, the government therefore has introduced a package of additional measures amounting to Arg$3.8 billion (1.3 percent of GDP). These measures are centered on the financial transactions tax and the elimination of the VAT exemptions on the revenue side, and targeted tax cuts and improved efficiency on the expenditure side.

- The financial transactions tax went into effect in early April and applies on the debit and credit side of all checking account transactions, with few exemptions (e.g., transactions in household saving accounts, stock market operations, and salary payments). The tax is to expire at end–2002. The rate, initially set at 0.25 percent, was raised to 0.40 percent effective May 1 and the increase can be credited towards VAT and income tax payments. The tax is projected to yield about Arg$2.5 billion for the rest of the year.

- The elimination of VAT exemptions, together with the net effect of the changes in nominal tariffs on consumer and capital goods imports, and some other revenue measures are projected to yield in net terms Arg$0.4 billion in the remainder of 2001.

- Regarding expenditure measures, in April, the government issued an administrative order to cut discretionary expenditures in a number of ministries and agencies, projected to yield Arg$245 million through year-end.

- It also issued three decrees to improve the administration and reduce abuse in the system of family allowance and other selected programs of the social security administration (ANSES), projected to yield around Arg$180 million through year-end.

- In addition, the government will cut Arg$125 million in various programs with attached external financing, and obtain savings of Arg$250 million by clamping down on fraudulent welfare and social insurance claims, as well as unjustified pension payments and transfers to provincial pension funds, and other measures. The reform of the public administration will result in savings of Arg$50 million. The government is confident that with these measures the expenditure target under the program for the year will be attained, but is requesting modifications of the fiscal performance criteria for end-June and end-September.

16. The new measures that have been introduced greatly improve the **outlook for 2002,** when these measures will be in effect for the full year. In addition, the government intends to make a concerted effort to strengthen tax administration, reversing the deterioration that has occurred in this area. Therefore, and notwithstanding a projected increase in the interest bill and the nonrecurrence of certain nontax revenues, the government remains confident of its ability to meet the targets for 2002 specified in the Fiscal Responsibility Law.

17. The **financing plan for 2001** has been modified toward more domestic financing. In April, the government placed US$3.5 billion domestically, which more than compensated for the decision not to seek recourse to the international bond market in the remainder of 2001. Included in this placement was the issue of a bond for US$2 billion that banks can compute towards their liquidity requirements. This bond has a maturity of one year and had not been contemplated in the original financing program; the government request that the performance criterion on the short-term debt of the federal government be modified accordingly. The borrowing needs for 2001 are fully financed with the disbursements from official and bilateral sources, and the commitments of domestic participants already negotiated in December 2000, including through liability management operations. The government continues to attach utmost importance to market-based solutions for the concentration of maturities in the coming years, and is actively pursuing discussions on voluntary public debt exchanges to achieve a more even path of debt service obligations over time.

18. **The government is working with the provinces to strengthen the local public finances.** Preliminary estimates suggest that the provinces incurred a deviation of Arg$70 million from the indicative ceiling for their deficits (commitment basis) of Arg$0.6 billion in the first quarter of 2001, while the net increase in their debt during the same period was Arg$850 million—a deviation of Arg$250 million from the program—because of the cash settlement of certain commitments made in 2000. The adjustment and debt refinancing programs of provincial governments with the central government, now including eleven provinces, are working well, and those provinces are making progress in consolidating their finances. Moreover, in April 2001, the central government concluded an additional **agreement with the province of Buenos Aires**, which envisages the elimination of the fiscal deficit of the provincial government in four annual steps from a target of US$1.7 billion in 2001 to balance in 2005, and includes binding agreements on improving the health of the Bank of the Province of Buenos Aires. The agreement is an important step forward in Argentina's intergovernmental fiscal relations and enhances the coordination between the financing operations of the central and provincial governments. The deficit of US$1.7 billion in the province of Buenos Aires is higher than that projected last December; but stronger balances now expected in other jurisdictions, especially the City of Buenos Aires and the provinces of Mendoza, San Luis and Santa Cruz, make it possible to retain the program's original annual targets for the consolidated provincial deficit. The government requests that the quarterly (indicative) targets for the consolidated provincial government deficits for end-June and end-September be revised slightly to reflect the compensation of the overrun in the first quarter of the year; the target for end-December remains unchanged. The targets on the debt of the consolidated public sector would also need to be modified. In May, the government will publish and post on the internet the first report on the implementation of the federal fiscal pact, explaining the actions taken by provincial governments to improve their legislation and to increase transparency in their operations, and indicating their progress

in containing primary spending and reducing their deficits. In addition, the national government intends to request technical assistance from the Fund to explore possible new mechanisms to strengthen its ability to coordinate and control provincial government borrowing within the framework of the Argentine federal system.

19. To **improve tax administration**, the Internal Revenue Agency (AFIP) has completed the design of the national tax audit plan. Reallocations were made in the staffing of the agency, and to strengthen the internal independence of the auditing units, which have begun implementing the audits of 100,000 taxpayers, as envisaged in program. The program is ahead of schedule and already some 9,100 desk audits have been carried out—yielding, among others, valuable information on the reliability of the information systems—and the program is on track to be finished on schedule by the sixth review of the program. Plans are now being developed to cross-check the information obtained from the financial transactions tax with individual tax payers, which is expected to enhance tax compliance. In addition, the government is making progress in setting up special tax courts, and the judiciary has begun selecting specialized personnel in this area. The government has prepared plans to streamline tax payments facilities arrangements, with a view to increase transparency and reduce discretionality in this process. These plans will be put into effect in the coming months.

20. The government is proceeding with the **reform of the public administration** with a view to streamlining its activities, eliminating redundant entities and programs, reducing overlapping and duplication of functions across administrative units and levels of government, strengthening controls over procurement practices and the cost-effectiveness of spending programs, and boosting efficiency and the quality of services provided by the public administration. The special powers obtained by the Executive to act in these areas will result in a sharp acceleration of this process.

21. In late 2000, the government issued two decrees to reform the **pension system** and the **health organizations** (*Obras Sociales*). As described in the MEP of December 12, 2000 these reforms aim at strengthening the intertemporal solvency and equity of the pension system, and open up the health organizations to competition, while promoting efficiency in the provision of health care. Both decrees have since been challenged in the courts and the government has suspended them from going into effect to help advance a negotiated solution to these challenges, and to prevent inequities resulting from an uneven implementation of the decrees. The government is committed to both initiatives as they represent essential building blocs to improve economic efficiency and fiscal sustainability in the medium term. The decrees are expected eventually to be upheld by the courts. Nevertheless, the government sees now a possibility to obtain agreement in Congress on a draft law to reform the pension system that would not only obey the principles underlying the questioned decree but would improve upon it on several key aspects. The government intends to introduce this draft legislation to congress in the coming months. The restructuring of the **health system for retirees** (*PAMI*) is proceeding well and the transfers (including PAMI's own revenue) from the Treasury to PAMI are limited at US$200 million a month, as was envisaged in the restructuring program.

22. **The government will maintain the strong liquidity and capitalization defenses of the banking system,** which are essential to buttress confidence and permit the recovery of

the economy. The importance of keeping ample liquidity reserves was demonstrated during the recent episode of financial difficulties when, to confront a decline in deposits in March, the central bank could maintain adequate liquidity conditions by reducing the liquidity requirements by two percentage points to 18 percent. During the remainder of 2001, as deposits recover, this reduction will be reversed.

23. The government has also introduced changes to the Charter of the central bank to allow **regulatory changes that will lower costs for banks and remove a number of distortions that inhibited the development of checking accounts.** In particular, the central bank will now distinguish between liquidity requirements applied to time deposits and reserve requirements applied to checking and savings accounts. In regard to liquidity requirements, banks will operate as until today. On reserve requirements, they will be authorized to count cash in vault toward meeting the requirements, as well as to fulfill requirements against peso liabilities with public sector bonds denominated in pesos. The modifications to the Charter of the central bank will also allow it to remunerate reserve requirements. Given the paramount importance of maintaining an adequate level of prudential protection of the banking system, particularly in connection with time deposits, which show the largest reaction to instability in financial markets, the incorporation of cash in vault and government bonds to the reserve requirements will be fully offset by accordingly raising the statutory ratio of liquidity requirements on time deposits. Furthermore, the central bank will not authorize banks during the remainder of 2001 to increase the amount of bonds held as part of their liquidity requirements.

24. With a view to fostering the development of domestic capital markets, the government will enact shortly, with the new delegated powers, **a bill on best practices in the financial sector**, increasing the transparency and the requirements for public information about financial transactions, and strengthening corporate governance, particularly in regard to minority shareholders' rights. Also, recently, a first round of discussions on the FSAP has been held, and the assessment is expected to be completed by the next review of the program.

25. With a view to help reactivate investment spending, the government has reached an agreement with other Mercosur countries to reduce temporarily the custom duties on non-Mercosur imports of capital goods to zero. At the same time, custom tariffs have been increased on a number of consumption good imports, up to a rate of 35 percent. These trade policy changes are estimated to affect about 28 percent of non-Mercosur imports, and to result in a slight increase in Argentina's average tariff from 11.6 percent to 11.8 percent of non-Mercosur imports. They shall not remain in effect beyond end-2002 and do not, in any way, signal a departure from Argentina's commitment, either to Mercosur, or to the recent agreement reached with 34 other countries of the Western Hemisphere, to complete negotiations for the Free Trade Area of the Americas by January 2005.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria table annexed to the Policy Memorandum.

1. Cumulative balance of the Federal Government.

Cumulative balance of the Federal Government	Limit (floor, in millions of Arg$)
End-June 2001 (performance criterion)	-4,939
End-September 2001 (performance criterion)	-6,249
End-December 2001 (performance criterion)	-6,500
End-December 2002 (indicative)	-5,000

The balance of the Federal Government comprises the results of the Federal Government and of the Central Bank (BCRA). The result of the Federal Government is defined to include: the balances of PAMI, the Fondo Fiduciario de Infraestructura, and the issue of bonds in exchange for *Plan Canje* tax certificates; and to exclude transfers from the Central Bank, privatization receipts, and capital gains realized on the sale of financial assets. The result of the Federal Government will be measured from below the line on the basis of: (a) the information provided by public sector debt reporting system (SIGADE), including all short-term debt of the Federal Government; (b) net asset transactions of the Federal Government as reported by the *Secretaria de Hacienda*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos. The limits on the balance of the Federal Government will be subject to the following adjustors:

a) The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by up to Arg$210 million for the issue of bonds in exchange for *Plan Canje* tax certificates;

b) The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by the early payment of accrued interest on bonds surrendered in bond exchanges, and upward by the extinction of the obligation to continue to pay interest on the same bonds after the exchange. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the upward adjustor just mentioned;

c) The end-June 2001 and end-September 2001 limits will be adjusted upward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

d) The end-December 2001 limit will be adjusted downward by fifty percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisioned in the program (US$800 million).

2. Cumulative ceiling on primary expenditure of the Federal Government.

Cumulative primary expenditures of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-June 2001 (performance criterion)	26,657
End-September 2001 (performance criterion)	40,184
End-December 2001 (performance criterion)	53,212

This ceiling applies to the noninterest expenditure of the Federal Government (including the deficit of PAMI) as reported by the *Secretaria de Hacienda*.

3. Cumulative balance of the provincial governments.

Cumulative provincial government balance	Limit (floor, in millions of Arg$)
End-June 2001 (indicative)	-1,450
End-September 2001 (indicative)	-2,080
End-December 2001 (indicative)	-2,760
End-December 2002 (indicative)	-2,000

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis and including all interest on bonds issued by the province of Buenos Aires to recapitalize *Banco Provincia*, according to the information provided by the *Secretaria de Hacienda*. These limits will be indicative.

4. Cumulative change in the debt of the Federal Government.

Cumulative change in the debt of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-June 2001 (performance criterion)	5,039
End-September 2001 (performance criterion)	6,399
End-December 2001 (performance criterion)	6,700
End-December 2002 (indicative)	5,000

The change in the debt of the government will be defined as the difference between the stock of debt at each relevant date in 2001, valued at end–2000 exchange rates and measured at end of period, and the stock of debt at end–2000. The debt of the Federal Government includes all foreign currency denominated and Argentine peso denominated debt obligations and guarantees, as defined in EBS/00/128 (June 30, 2000) and Executive Board Decision adopted August 24, 2000 and incorporated herein by reference, of the Federal Government (including public enterprises, PAMI, INDER, and trust funds). These debt obligations include those with local and foreign financial institutions, international organizations, bonds and bridge loans. The data used to monitor debt developments will be taken from SIGADE, including all short term Federal Government debt. The limit on the change in federal government debt will be adjusted in the following ways:

a) Upward (downward) by the increase (decline) in the deposits of the Federal Government in the Central Bank, the domestic banking system and abroad, adjusted for any margin observed in the cumulative balance of the federal government performance criterion as defined in 1 above;

b) Upward (downward) for the net increase (decrease) in the valuation of net debt operations—including both placements and amortizations—made after December 31, 2000 in currencies other than the U.S. dollar arising from the difference between actual exchange rates and those of end-December 2000. To ensure the timely calculation of this adjustor, the authorities will provide the Fund with information on all debt operations (placements and amortizations) on a weekly basis indicating the currencies and exchange rates at which the operations were carried out.

c) Downward for any privatization proceeds;

d) By the difference between the result of the Central Bank in 2001 as defined in 1 above and the transfers effectively made by the Central Bank to the Federal Government;

e) Upward, by up to Arg$2.1 billion, for debt issued in 2001 for the consolidation of past obligations (including bonds issued in exchange for *Plan Canje* tax certificates, and for the capitalization of interest on previously issued consolidation bonds), by up to Arg$800 million for consolidation of past obligations of INDER, and by up to Arg$400 million for payments due to judicial rulings relating to past claims on the Social Security Administration (ANSES);

f) Downward (upward) by the reductions (increases) in nominal debt arising from debt cancellations or swaps in 2001;

g) Downward for an amount equivalent to the difference between the proceeds from the sale of collateral released through the rescue of Brady bonds in 2001 and the nontax revenue obtained as a result of these operations;

h) Upward for debt issued in 2001 to finance the Fiscal Stabilization fund by up to US$450 million in 2001;

i) Upward, by up to Arg$1,850 million, for amounts relating to borrowing in 2001 by the Provincial Development Trust Fund for the restructuring of provincial debt; and

j) Upward, by up to US$1.5 billion, for borrowing in 2001 from multilateral agencies on behalf of provinces, municipalities, and official banks (*deuda indirecta*) in 2001;

k) Upward by the early payment of accrued interest on bonds surrendered in bond exchanges, and downward by the extinction of the obligation to continue to pay interest on the same bonds after the exchanges. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the downward adjustor mentioned in the last sentence;

l) The limits for end-June 2001 and end-September 2001, downward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

m) The end-December 2001 limit will be adjusted upward by 50 percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisioned in the program (US$800 million).

5. Cumulative change in short term debt of the Federal Government.

Cumulative change in federal short term debt	Limit (ceiling, in millions of Arg$)
End-June 2001 (performance criterion)	3,500
End-September 2001 (performance criterion)	3,500
End-December 2001 (performance criterion)	3,500

The short term of the Federal Government consists of all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

6. Cumulative change in the debt of the Consolidated Public Sector (CPS).

Cumulative change in debt of the CPS	Limit (ceiling, in millions of Arg$)
End-June 2001 (performance criterion)	6,639
End-September 2001 (performance criterion)	8,524
End-December 2001 (performance criterion)	9,460
End-December 2002 (indicative)	7,000

The change in the debt of the Consolidated public Sector includes the sum of the changes in the debt of the Federal Government as defined in 4 above (including all the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt (including debt to the Provincial development Trust Fund arising from debt restructuring operations). The debt of the provincial governments and the City of Buenos Aires will be defined to include obligations to local and foreign financial institutions (as reported by the Secretaria de Hacienda with respect to the end March, 2001 performance criterion, and subsequently by the Central Bank), to international organizations, and bonds (excluding peso denominated bonds placed outside the financial system). The limit in this provincial debt will be adjusted: (a) downward for any privatization receipts; (b) downward for capital gains realized in the sale of financial assets; (c) upward by the nominal value of the bond issued by the province of Buenos Aires to clean up bad loans from the balance sheet of Banco Provincia, net of the book value of any loans that, having become nonperforming after March 31, 2001, may be acquired by the provincial government as part of this operation; and (d) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year. The data used to monitor the provincial debt will be provided by the *Secretaría de Hacienda*, the SIGADE, and the Central Bank. The stock of debt will be valued at end–2000 exchange rates and measured at end period.

7. The net domestic assets (NDA) of the BCRA

The net domestic assets (NDA) of the BCRA are defined, as shown below, 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 limit on NDA will be adjusted upward by the equivalent of purchases from the IMF under the arrangement.

The limit for December 2001 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (*pases activos*).

	2000		2001 ceilings 1/			
	Nov.	Dec.	Mar. (prel.)	Jun.	Sept.	Dec.
	(In millions of pesos, end of period)					
A. Net international reserves (a-b)	20,267	22,852				
a. Gross international reserves 2/	23,360	25,832				
b. Foreign liabilities 3/	3,093	2,980				
B. Net domestic assets (C-A)	2,705	2,642	2,152	2,399	2,097	1,836
C. Monetary liabilities (c+d+e)	22,972	25,494				
c. Currency issued	13,330	15,078				
d. Government deposits 4/	919	920				
e. Reserve deposits of banks 5/	8,723	9,495				

1/ Performance criteria

2/ Include the BCRA holdings of gold, SDR's, foreign currency in the form of cash and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI), excluding the accounting effects of holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds.

3/ End-December position projected as of December 11, 2000. Liabilities to the IMF valued at US$1.30 per SDR. Excludes purchases from the IMF arrangement.

4/ Includes government and ANSES deposits.

5/ Legal bank reserves and liquidity requirements (reverse repo).

STRUCTURAL BENCHMARKS

Tax administration

- Implementation of plans to streamline tax payments facilities arrangements (4^{th} review)
- Completing 80,000 desk audits (5^{th} review)
- Completing 100,000 desk audits (6^{th} review)
- Full implementation of the Tax Frauds Tribunal (6^{th} review)

Social Security Reforms

- Implementation of restructuring plan for family allowances (4^{th} review)
- Submission to congress of draft law on pension reform (4^{th} review)

Provincial finances

- Publication by the Ministry of Economy of quarterly public reports on the implementation by the federal government and each province of commitments undertaken in *pacto federal* (starting with 3^{rd} review)

Financial system

- Presentation of draft legislation to facilitate the process of banking resolution (5^{th} review)

Trade policy

- Announcement of the timetable for the elimination of the CET surcharge by end 2002 (4^{th} review)

Competition and deregulation

- Regulatory proposal for ports system (4^{th} review)
- Implementation of new regulatory framework in the telecommunications sector (5^{th} review)

Argentina: Quantitative Performance Criteria for 2001-02 1/ 2/

(In millions of Argentine pesos or U.S. dollars)

	Revised Program			
	Jan-Jun 2001	Jan-Sep 2001	Jan-Dec 2001	Jan-Dec 2002
1. Cumulative balance of the Federal Government	(4,939)	(6,249)	(6,500)	(5,000)
2. Cumulative primary expenditure of the Federal Government	26,657	40,184	53,212	...
3. Cumulative consolidated balance of the Provincial Governments 3/	(1,450)	(2,080)	(2,760)	(2,000)
4. Cumulative change in the debt of the Federal Government	5,039	6,399	6,700	5,000
5. Cumulative change in the short-term debt of the Federal Government	3,500	3,500	3,500	...
6. Cumulative change in the debt of the Consolidated Public Sector	6,639	8,524	9,460	7,000
7. Stock of net domestic assets of the Central Bank	2,399	2,097	1,836	...

1/ As defined in the Technical Memorandum of Understanding.

2/ Targets for 2002 are indicative at present, to be substituted by performance criteria during the fifth review of the program.

3/ Indicative.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/01/150

CONFIDENTIAL

August 30, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Argentina—Fourth Review Under the Stand-By Arrangement—*Letter of Intent, Memorandum of Economic Policies, and Technical Memorandum of Understanding***

Attached for consideration by the Executive Directors is a letter of intent from the President of the Central Bank of Argentina and the Minister of Economy of Argentina, together with the memorandum of economic policies and the technical memorandum of understanding of the government of Argentina. This subject, together with the paper on the fourth review under the Stand-By *Arrangement for Argentina (to be issued shortly)*, is tentatively scheduled for discussion on Friday, September 7, 2001. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Argentina indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Reichmann (ext. 38610) and Mr. Thornton (ext. 38683).

Att: (1)

Other Distribution:
Department Heads

Buenos Aires, Argentina
August 30, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Köhler,

1. The economic policy framework of the government of Argentina for the period 2000–02, in support of which we requested a three-year Stand-By Arrangement from the Fund, was outlined in our memorandum of economic policies dated February 14, 2000. These policies center on fiscal consolidation and wide-ranging structural reforms aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts.

2. Substantial progress has been made in the implementation of these policies, as described in the policy memoranda accompanying the previous reviews under this program. Nevertheless, adverse domestic and external developments have continued to impede a sustained recovery of confidence and have led to a sharp tightening of financing constraints for both public and private Argentine borrowers, making it more difficult to restart growth and affecting adversely the fiscal performance. Confronted in early July with a sharp worsening of financing conditions, the government decided to move boldly to correct the fiscal imbalance and set the public finances on a sustainable path. To this end, it proposed, and obtained legislative approval for, a zero-deficit law designed to maintain fiscal equilibrium from July onwards. Firm and continued implementation of this law, to which the government, as well as the provincial governments, is fully committed, will result in a major strengthening of the fiscal adjustment, and therefore in the attainment of fiscal balance and a sustainable public debt position much earlier than anticipated in our original program. On the basis of this new program, and to strengthen market confidence in the appropriateness of this policy response, and its prospects of success, we are requesting an increase in the amount made available by the IMF under the Stand-By Arrangement, from SDR 10,586 million to SDR 16,937 million (800 percent of Argentina's quota), of which SDR 6,087 million (288 percent of quota) would be provided under the Supplemental Reserve Facility (SRF).

3. We trust that the determined implementation of the government's strengthened economic strategy, in conjunction with this enhanced financial support package, will bolster market confidence in Argentina, facilitating a progressive return of borrowing costs to more normal levels, and a sustained recovery of domestic activity and investment. We will

maintain a close policy dialogue with the Fund, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out before December 15, 2001 and March 15, 2002.

Sincerely yours,

/s/
Roque Maccarone
President
Central Bank of the
Republic of Argentina

/s/
Domingo Cavallo
Minister of Economy

Attachments:
Memorandum of Economic Policies
Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICIES

I. BACKGROUND

1. Despite a difficult environment, the government implemented decisively the measures agreed under the program and the quantitative targets for end-June were met, some with large margins. However, financial market sentiment about Argentina took a negative turn in July: spreads on Argentine bonds reached peak levels, bank deposits and international reserves declined, interest rates rose sharply, and the government lost access to the credit markets. The government responded quickly to this deterioration with measures aimed at eliminating the fiscal deficit and speeding up structural reform. This memorandum of economic policies (MEP) describes recent developments and the policies adopted by the government to strengthen the program.

II. RECENT DEVELOPMENTS

2. In recent months, the government has moved to address a series of adverse developments:

- **Economic activity continues to be weak**. Real GDP declined by 2.1 percent (year-on-year) in the first quarter of 2001, after falling by ½ percent in 2000. However, indicators of economic activity, such as industrial production and construction activity showed modest increases in the second quarter. Despite the creation of 275.000 jobs relative to the previous year, the unemployment rate rose to 16 percent in May from 15 percent a year earlier. Consumer prices fell further in July 2001 to 1.1 percent below their level a year earlier, while wholesale prices fell by 1.8 percent.

- **Financial market indicators deteriorated sharply** in recent months, with spreads on Argentine bonds widening to over 1,700 basis points in July, before narrowing subsequently; domestic interest rates increased; and international agencies downgraded Argentina's debt further in the same month.

- **Despite the weak economy, the fiscal targets of the program for June were met with comfortable margins.** Tax revenue was Arg$160 million lower than programmed, reflecting also the deterioration in financing conditions, and continued difficulties with tax compliance. In response, the government introduced additional expenditure cuts and the deficit and primary expenditure targets of the program for end-June were met with a margin of Arg$130 million and Arg$227 million, respectively. The provinces also met the fiscal target for June with some margin. The deterioration in tax revenues quickened in July as financial conditions worsened; tax revenues were lower by 8.7 percent (year-on-year) and the fiscal deficit for the month reached about Arg$1.2 billion on a cash basis.

- **The banking system came under pressure.** Although external credit lines and banks'nonperforming loans have remained relatively stable in recent months, liquidity has been under pressure from a drain on private sector deposits after many years of sustained growth. These deposits fell by Arg$6.6 billion in the first semester of the year and declined further by Arg$5.4 billion in July. Banks have responded in part by cutting credit to the private sector (down 8 percent in the first seven months of 2001) and seeking liquidity assistance from the central bank.

- **The external trade surplus has strengthened,** as a result of a marked drop in imports and a solid performance of exports. The trade surplus in the first half of 2001 was US$2 billion, 130 percent higher than that for the same period last year.

3. A number of significant policy measures have been introduced in recent months:

- **The new convertibility law was approved by congress** in June linking the peso to an equally weighted euro-US$ basket when the two currencies reach parity. The new mechanism preserves all the features of the previous regime, but allows for a more stable nominal effective exchange rate.

- **A compensation mechanism for foreign trade in nonenergy goods was introduced** designed to improve competitiveness and rationalize trade policy. The mechanism, which is administered through the federal government's budget, provides exporters with a reimbursement, and charges importers a duty, equivalent to the difference between the present exchange rate and that on a corresponding equally weighted euro-US$ basket (about 5 percent at mid-August); the mechanism also reduces the dispersion of import tariffs and export rebates. The maximum import tariff for non-Mercosur trade was reduced by 7 percentage points (to 28 percent) to ensure that the tax scheme did not breach the WTO binding tariff. The compensation mechanism will disappear as the euro reaches parity with the U.S. dollar, which will result in a lower average level of import tariffs than was the case prior to its introduction.

- **A series of competitiveness plans were launched** aimed at improving profitability in the sectors most affected by the recession. Common elements to all the plans include the exemption from the tax on interest paid and from the minimum corporate income tax, and allowing employer's social security contributions to be credited against VAT payments. The sectorial implementation of these plans allows to trigger deregulation and tax reductions at the provincial level as well as enhanced labor flexibility, without granting benefits beyond those that will be present in the simplified tax structure to which the system is expected to converge.

- **A fiscal package was introduced in June** aimed at strengthening the public finances and promoting private consumption; it included: (i) an increase in personal and family income tax deductions and in the tax-free allowance for luncheon vouchers; (ii) the unification of employer social security contributions at 16 percent (employers that experienced an increase in the payroll tax as a result could offset the increase against VAT liabilities); (iii) an increase in taxes on diesel fuel, allowing the original level to be credited against the VAT, and a reduction in gasoline taxes (to be effective in 2002); (iv) plans to move the VAT from an accrual to a cash basis; and (v) a reduction in the VAT rate to be applied to agriculture (to a rate still to be decided) and (vi) a further broadening of the coverage of the VAT (transportation, cable T.V., printed press, and others).

- **An exchange of debt** was completed in June involving bonds with a face value of US$29.5 billion; the exchange reduced contractual debt service obligations in 2001–05 by about US$12 billion by shifting principal payments beyond this period, capitalizing interest, and using step-up coupons. The debt exchange raised average duration by close to three years.

- **To ease banks' liquidity difficulties** stemming from the deposit drain, in July the central bank cut liquidity requirements on time deposits by 1 percentage point (to 21 percent), injecting about Arg$1 billion into the system; in addition, banks were permitted to use the "float" to meet the liquidity requirements, and up to 70 percent of liquidity requirements on time deposits could be met with peso balances, rather than U.S. dollar balances.

III. The Government's Revised Program for 2001

4. **The macroeconomic framework for 2001** was revised in light of the performance in the first half of the year (Box 1). Real GDP growth is conservatively projected to be: negative for the year as a whole driven by weak consumption and investment. The deflation of consumer prices would continue for the third consecutive year. The external current account deficit would narrow markedly, mainly reflecting a sharp improvement in the trade balance. With economic activity declining, imports (f.o.b.) are projected to fall by 7 percent (in U.S. dollar terms), whereas exports would broadly maintain the 4 percent rate of growth recorded in the first half of the year (6 percent in real terms, despite negative shocks affecting meat, soybean, and fish exports). Our program would be consistent with some recovery of central bank international reserves in the final months of the year, although by year-end they are projected to be about ~~US$8.5~~ US$4.5 billion down from end-2000.

Box 1. Revised Macroeconomic Scenario, 2001

	Revised	Original
	(Annual percentage change)	
Real GDP	-1.4	2.0
GDP deflator	-0.3	0.2
	(In billions of U.S. dollars)	
External current account balance	-8.1	-10.0
In percent of GDP	-2.9	-3.4
External trade balance	3.1	2.0
Memorandum item:		
Gross international reserves at the central bank, US$ billions	~~18.5~~ 22.5	25.9

5. On unchanged policies, the revised macroeconomic scenario, the deterioration of financing conditions, tax reductions associated with the competitiveness plans, and delays in the sale of third generation telecommunications frequencies were projected to reduce programmed fiscal revenues by about Arg$3.2 billion (about 1 percent of annual GDP) in the second half of 2001. The resulting fiscal deficit would have exceeded the targets specified in the fiscal responsibility law and under the Fund program and—in the current circumstance of lack of access to financial markets—would not have been possible to finance.

6. Confronted with this situation, and to establish a definitive solution to the fiscal problem, on July 11 the government announced a new economic package seeking a **major strengthening of the fiscal effort** centered on the rapid elimination of the federal government deficit, much earlier than envisaged in the Fund supported economic program. Legislation was sent to congress that would require the federal government to limit expenditures to the available revenue; congress approved this **zero-deficit law** at the end of July. The law mandates the Secretary of the Treasury to introduce across-the-board proportional cuts in primary expenditures (including wages, pensions, and purchases of goods and services) to ensure that the federal government budget is balanced on a cash basis, initially for the period August–December 2001.

7. To comply with this law, we are implementing a number of measures. **On the revenue side**, the financial transactions tax, which can be partially credited against the VAT and income tax, was increased to 0.6 percent, and exemptions from the tax were reduced. Payroll taxes on firms in the services sector were raised by 4 percentage points. In addition, the government has delayed the planned reduction in income and gasoline taxes, and the shift in the VAT from an accrual to a cash basis.

8. As part of the program, the government will continue to make steady **progress in tax administration**. In this area, specialized tax tribunals to deal with tax evasion cases that exceed Arg$1 million are being established and are expected to be fully operational by the turn of the year. In addition, the internal revenue agency (AFIP) has completed the national tax audit plan and is strengthening the independence of the auditing units; about 40 percent of the 100,000 audits of taxpayers envisaged in the program have been completed, and the authorities are confident that all the audits will be completed on schedule by the sixth review of the program. The enforcement of tax collections is to be strengthened through: (i) cross-checking the information obtained from the financial transactions tax with tax returns submitted by individual taxpayers, which is expected to increase tax compliance; (ii) prosecuting banks that do not cooperate with tax administration efforts to seize funds held in bank accounts of taxpayers who refuse to pay their tax debts; (iii) recovering tax debts by executing levies on debtors of delinquent taxpayers; and (iv) establishing cooperative arrangements with provincial governments to facilitate access by federal tax officials to information in provincial property and vehicle registers in order to secure payment of outstanding debts. VAT compliance will be increased by launching an intensive program of audits focusing on excess credit entitlements and of inspection visits to control compliance with basic VAT bookkeeping and invoice requirements. Also, a special audit program, including issue-oriented and comprehensive audits, will be conducted on the country's 2,500 largest taxpayers.

9. Achieving the fiscal target also will depend critically on efforts **on the expenditure side**. Consistent with revenue projections (Box 2), the government will cut primary expenditure by about Arg$2.3 billion in the second half of the year. To achieve this, the government is taking a number of measures: (i) a Arg$1.3 billion reduction in primary expenditure, which went into effect in July, that included a 13 percent cut in wages and pensions above Arg$500 a month and a 30 percent cut in the contractual wage bill; (ii) additional savings in the area of the social security system (arising from measures described in paragraph 13 below) of Arg$170 million. In the event that tax revenue for the remainder of the year continues to fall short of the levels included in the 2001 budget, as was already the case in July, and therefore, the federal government cannot allocate resources for the additional transfers required to comply with the tax sharing floor set in the Federal Fiscal Pact of December 2000, we will seek to rebalance the terms agreed in the pact, to yield net savings of up to Arg$900 million over the remainder of 2001. Additional measures will be implemented if needed to comply with the zero-deficit law.

Box 2. Federal Government: Revision to 2001 Deficit Projection
(In Argentine peso billions)

	First Semester	Second Semester	Year
Revenue shortfall (-)	-0.2	-3.2	-3.3
Primary expenditure cuts (-)	-0.2	-2.3	-2.5
Changes in net interest payments	0.5	-1.3	-0.8
Net effect of adjusters (see TMU – EBS/01/66)	-0.5	0.5	0.0

10. The spending cuts that are being implemented are projected to reduce primary spending to well below the program targets for the remainder of 2001, which will permit a tightening of the expenditure ceiling for end-September and end-December. The revised target will need to be indicative because in case of a better than programmed performance of tax revenue the government is required by the zero-deficit law to reverse some of the cuts in wages and pensions (as long as the fiscal balance is maintained). The adjustment measures being put in place will ensure the observance of the program fiscal target for end-December 2001 (a deficit not to exceed Arg$6.5 billion on a cash basis). However, given the sharp drop in revenue occurring in the third quarter of the year, the ceiling on the deficit for end-September will need to be raised by Arg$350million to Arg$6.6 billion.

11. **The provincial governments** are supporting the adjustment effort of the federal government by implementing a number of measures to eliminate their fiscal deficits. These measures include the elimination of some exemptions from provincial taxes, wage reductions, incentives for early retirement, and administrative reforms. Provinces are implementing significant reforms in the political sphere which will result in important savings in the operating expenditures of provincial legislatures and municipal councils. As in the case of the federal government, these steps are expected to ensure achievement of the program targets for the provincial deficit in the remainder of the year. To deal with the deterioration of financing conditions, provincial governments will continue privatization actions, including sanitation and energy companies and provincial lotteries; and, within the limits specified in their own legislation, will pay part of the wage bill and debt to suppliers with provincial bonds. The federal government will assist in this regard by allowing these bonds to be used in the payment of federal taxes, up to a fixed amount equivalent to the provincial wage bill of one month. These payments, accounted separately for each province, will be deducted from the federal tax revenue shared with each province. In May 2001 the government published and posted on the internet the first report on the implementation of the federal fiscal pact, explaining the actions taken by provincial governments to improve their legislation and to increase transparency in their operations, and indicating their progress in containing primary spending and reducing deficits; the second quarterly report was published in August 2001.

12. Achieving fiscal balance in 2002 will require substantial additional adjustment effort. Fiscal revenue next year is projected to remain at about the same level as 2001, with gains resulting from higher economic activity and improved tax administration compensating for the loss of one-off revenues received this year, and the full year impact of growth enhancing measures introduced during the last ten months. Primary expenditure will be reduced by about Arg$6 billion (2 percent of GDP) compared to the projected outturn for 2001,to be achieved through the application of the instruments provided by the zero deficit law and further progress in improving tax administration, public sector reform, and savings in the social security administration. We are confident that the spending reductions being implemented, together with those planned for next year, will put the public finances on a sustainable path much more quickly than envisaged previously under the program. The government expects to achieve fiscal balance in 2002, excluding the capitalization of interest arising from the 2001 debt exchange.

13. Notwithstanding the current difficult financial conditions, the government is confident of securing a voluntary rollover of obligations maturing during the remaining months of 2001. The **gross borrowing requirement of the nonfinancial public sector** for the period August–December 2001 is estimated to be Arg$9.2 billion, of which Arg$4.3 billion reflects the roll over of short-term treasury bills. The financial program is covered through scheduled disbursements from official sources, understandings reached with local banks and pension funds to refinance maturing treasury bills as well as some short-term placements with local institutional investors. We expect that firm implementation of the fiscal measures, and the prospect of early elimination of the fiscal deficit, to result in a major improvement in market confidence, allowing the government to re-enter international bond markets in 2002.

14. **Private sector involvement** in financing the fiscal program in 2001 is expected to reach about US$15 billion, comprising the bond placements in international and domestic markets noted above, and amortization savings resulting from the June debt exchange of US$3.7 billion. In addition, we expect to utilize the contingent repo facility with international banks of about US$1.2 billion. We are also considering launching another debt exchange operation in the coming months. To facilitate any such exchange, we may request an acceleration of up to US$3 billion of the proposed augmentation of the program.

15. The government has introduced a facility that will allow the collateralization of interest coupons on bonded debt. This facility will receive sovereign bonds from current holders and it will issue: (i) a sequence of prepaid tax receipts in exchange for the interest coupons and (ii) a claim for the principal. The holders of the prepaid tax receipts will be allowed to use them to pay their taxes at the time the coupons mature. At current depressed bond price levels, this scheme will allow tax payers to reduce future tax liabilities, while strengthening the guarantees on government debt, without affecting the budget balance.

16. The strong **liquidity and capitalization defenses of the banking system** established in recent years have been vital in helping banks weather the recent financial turbulence. To ensure the integrity of these defenses, as deposits recover during the remainder of 2001, the government intends to return the liquidity requirement ratio to 22 percent. Reflecting these developments, the *NDA ceiling under the program has been modified*. Scheduled disbursements from the Fund in the remainder of 2001 (taking into account the proposed augmentation) amount to about US$7.4 billion and will contribute to a strengthening of international reserves of at least US$4 billion. In the future, liquidity assistance by the central bank will be provided through selective discount and repo operations at interest rates that preclude arbitrage opportunities. Banks with persistent liquidity problems will be given liquidity support provided they agree with the central bank on measures to strengthen their balance sheet. In addition, during the remainder of 2001, the central bank will not authorize banks to increase the amount of bonds held as part of their current level of liquidity reserves.

17. Steps have been taken to **strengthen the public banks**. As part of its recapitalization plan, in July the Banco Provincia (BPBA) exchanged with the province of Buenos Aires (PBA) its nonperforming loans for a provincial bond. The bank also began to provision its

exposure to the PBA, and changes were made to the statutes governing the bank to limit loan exposure to individual clients and provide for the prosecution of negligent managers. Additional measures to strengthen the public banks are: (i) to accelerate the schedule for full compliance of BPBA with prudential regulations to no more than two years; (ii) to ensure that they comply in a timely manner with the reporting requirements of the central bank; (iii) to request the commissioning, before the end of the year, of an independent external audit of BPBA to assess the economic and financial condition of the bank; and (iv) with respect to Banco Nación and the other public entities, the central bank will adopt the measures required to attain similar objectives of transparency and efficiency, with due regard to the particular circumstances of each entity.

18. In order to provide a stronger and more sustainable basis for the finances of the overall public sector over the medium term, the government will seek to **reform the revenue sharing arrangement** between the federal government and the provinces to: (i) simplify the system, including by reducing revenue earmarking; (ii) make it more transparent; (iii) make transfers less cyclical and consistent with macroeconomic constraints; and (iv) allow for a better match of each province's share with its own revenue effort. Constitutionally, unanimous agreement of all the provinces on the draft legislation will be needed. The government intends to reach such agreement on or about November 30, 2001, with a view to submitting the proposed legislation to the congress in December.

19. The hard budget constraint imposed by the zero-deficit law generates strong incentives within the Public Administration to accelerate the pace of reform. Since the approval of this law, the **reform of the public administration has progressed** significantly in several areas: the executive boards of many decentralized agencies have been reduced to just three executive directors, and seven public entities have been merged or closed to eliminate waste and redundant entities; public procurement policies have been strengthened by the introduction of an electronic purchasing system for public goods and services, which is expected to generate eventual savings of 10–15 percent on total purchases (Arg$200–300 million a year); and program managers are being made more accountable by establishing a direct link between the financing of their programs and the results obtained. A 30 percent reduction in total contractual-workers' compensation has been introduced. Other actions include a new law aimed at strengthening the operations of regulatory agencies, steps to streamline a number of ministries, and new regulations tightening the conditions governing public sector employment.

20. **The social security administration (ANSES) has been strengthened** to reduce the abuse of family allowances and other programs: the mechanism of compensated allowances (whereby small firms are allowed to pay to ANSES their contributions on a pre-set basis) has been discontinued; spousal benefits have been consolidated to avoid duplication of benefits for dependents; a minimum contributing wage of Arg$100 a month has been established. The first two measures are yielding savings of some Arg$6.5 million a month; and public employees are no longer allowed to draw a pension and at the same time remain employed by the federal government. Also, its newly appointed management is taking steps to: (i) limit operational expenditures of ANSES to no more than Arg$150 million per year (already there

has been a streamlining of management and staff positions and a sharp reduction of contractual personnel); (ii) to eliminate abuses in former provincial pension funds which were transferred to the federal government by auditing beneficiaries receiving pensions exceeding Arg$500 per month, and (iii) strengthening controls to reduce evasion at the level of social security contributions.

21. In the area of labor **market reform**, the ministry of labor has initiated the renegotiation of expired labor contracts, which is expected to result in greater flexibility in employment practices. In addition, plans are being developed to increase the labor market skills of new job seekers and the unemployed by allowing employers to offer them temporary employment contracts at a reduced wage and benefit level.

22. Mercosur has been reaffirmed as the mechanism for trade integration. During the recent Asuncion summit, the presidents of the Mercosur countries agreed to speed up trade negotiations with other interested partners, including the FTAA Initiative. The agreement included the creation of a Mercosur trade-negotiating unit to accelerate integration with major trading partners and the establishment of a high-level commission to review the common external tariff. It was also agreed to speed up the resolution of a number of controversies, in particular those surrounding the auto-sector. It is the intention of the Argentine authorities to strengthen Mercosur and to promote further initiatives aiming at increased macroeconomic coordination in the region.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria for the economic program described in the Memorandum of Economic Policies.

1. **Cumulative balance of the Federal Government.**

Cumulative balance of the Federal Government	Limit (floor, in millions of Arg$)
End-September 2001 (performance criterion)	-6,601
End-December 2001 (performance criterion)	-6,500
End-December 2002 (indicative)	-2,290

The balance of the Federal Government comprises the results of the Federal Government and of the central bank (BCRA). The result of the Federal Government will cover government activities as specified in the 2001 budget, and will include: the balances of PAMI, the Fondo Fiduciario de Infraestructura, and the cash-flow balance of trust funds established for the administration of federal tax debts and credits; the issue of bonds in exchange for *Plan Canje* tax certificates, and in settlement of any other overdue government obligations; and exclude transfers from the central bank, privatization receipts, and capital gains realized on the sale of financial assets. The result of the Federal Government will be measured from below the line on the basis of: (a) the information provided by the public sector debt reporting system (SIGADE), including all short-term debt of the Federal Government and, in 2001, excluding the capitalized interest in the amounts detailed in adjustor 4.o below; (b) net asset transactions of the Federal Government as reported by the *Secretaría de Hacienda*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos. Starting in 2002, interest capitalization on government bonds will be counted as expenditure. The limits on the balance of the Federal Government will be subject to the following adjustors:

a. The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by up to Arg$2.1 billion for the settlement in 2001 of contested obligations incurred before December 10, 1999 as specified in the Economic Emergency Law of December 1999 and described in 4.e below (excluding overdue FONAVI transfers); this amount would include up to Arg$210 million for the issue of bonds in exchange for *Plan Canje* tax certificates.

b. The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by the early payment of accrued interest on bonds surrendered in bond exchanges, and upward by the extinction of the obligation to continue to pay interest on the same bonds after the exchange. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the upward adjustor just mentioned;

c. The end-September 2001 limits will be adjusted upward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

d. The end-December 2001 limit will be adjusted downward by 50 percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisaged in the program (US$800 million).

2. **Cumulative ceiling on primary expenditure of the Federal Government.**

Cumulative primary expenditures of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-September 2001 (indicative)	39,194
End-December 2001 (indicative)	50,684

This ceiling applies to the noninterest expenditure of the Federal Government (including the deficit of PAMI) as defined in 1 above and reported by the *Secretaría de Hacienda*. The limits on the primary expenditure of the Federal Government will be adjusted: upwards by the equivalent of the adjustments included in 1.a above.

3. **Cumulative balance of the provincial governments.**

Cumulative provincial government balance	Limit (floor, in millions of Arg$)
End-September 2001 (indicative)	-2,080
End-December 2001 (indicative)	-2,760
End-December 2002 (indicative)	-2,000

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis and including all spending that provincial governments may decide to pay with bonds (such as salaries paid with Patacones) and all interest on bonds issued by the province of Buenos Aires to recapitalize *Banco Provincia (BPBA)*, according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

4. **Cumulative change in the debt of the Federal Government.**

Cumulative change in the debt of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	6,751
End-December 2001 (performance criterion)	6,700
End-December 2002 (indicative)	2,290

The change in the debt of the government will be defined as the difference between the stock of debt at each relevant date in 2001, valued at end-2000 exchange rates and measured at end of period, and the stock of debt at end-2000. The debt of the Federal Government includes all foreign currency denominated and Argentine peso denominated debt obligations and guarantees, as defined in EBS/00/128 (June 30, 2000) and Executive Board Decision adopted August 24, 2000 and incorporated herein by reference, of the Federal Government (including public enterprises, PAMI, INDER, and trust funds, such as, but not limited to, any trust fund that may be established to administer federal tax debts and credits). These debt obligations include those with local and foreign financial institutions, international organizations, bonds, and bridge loans. The data used to monitor debt developments will be taken from SIGADE, including all short-term Federal Government debt. The limit on the change in federal government debt will be adjusted in the following ways:

a. Upward (downward) by the increase (decline) in the deposits of the Federal Government in the central bank, the domestic banking system and abroad, adjusted for any over compliance in the cumulative balance of the Federal Government performance criterion as defined in 1 above;

b. Upward (downward) for the net increase (decrease) in the valuation of net debt operations—including both placements and amortizations—made after December 31, 2000 in currencies other than the U.S. dollar arising from the difference between actual exchange rates and those of end-December 2000. To ensure the timely calculation of this adjustor, the authorities will provide the Fund with information on all debt operations (placements and amortizations) on a weekly basis indicating the currencies and exchange rates at which the operations were carried out.

c. Downward for any privatization proceeds;

d. By the difference between the result of the central bank in 2001 as defined in 1 above and the transfers effectively made by the central bank to the Federal Government;

e. Upward, by up to Arg$2.1 billion, for debt issued in 2001 for the consolidation of past obligations (including bonds issued in exchange for *Plan Canje* tax certificates, for the capitalization of interest on previously issued consolidation bonds, and for settling past obligations recognized in Decree 799/2001—excluding FONAVI—), by up to Arg$800 million for consolidation of past obligations of INDER, and by up to Arg$400 million for payments due to judicial rulings relating to past claims on the Social Security Administration (ANSES);

f. Downward (upward) by the reductions (increases) in nominal debt arising from debt cancellations or swaps in 2001;

g. Downward for an amount equivalent to the difference between the proceeds from the sale of collateral released through the rescue of Brady bonds in 2001 and the nontax revenue obtained as a result of these operations;

h. Upward for debt issued in 2001 to finance the Fiscal Stabilization fund by up to Arg$450 million in 2001;

i. Upward, by up to Arg$1,850 million, for amounts relating to borrowing in 2001 by the Provincial Development Trust Fund for the restructuring of provincial debt;

j. Upward, by up to US$1.5 billion, for borrowing in 2001 from multilateral agencies on behalf of provinces, municipalities, and official banks (*deuda indirecta*) in 2001;

k. Upward by the early payment of accrued interest on bonds surrendered in bond exchanges, and downward by the extinction of the obligation to continue to pay interest on the same bonds after the exchanges. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the downward adjustor mentioned in the last sentence;

l. The limits for end-September 2001, downward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

m. The end-December 2001 limit will be adjusted upward by 50 percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisioned in the program (US$800 million).

n. Upward (downward) by the issue (redemption) of securities recognizing tax credits issued by any trust fund established to administer federal tax debts and credits;

o. The limits for end-September and end-December 2001, upward by up to Arg$36 million and Arg$1,061 million, respectively, for interest capitalized on the promissory note 2003 and Global bonds 2018 and 2031 (all issued in the June 2001 debt swap).

5. **Cumulative change in short term debt of the Federal Government.**

Cumulative change in federal short term debt	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	3,500
End-December 2001 (performance criterion)	3,500

The short term of the Federal Government consists of all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

6. **Cumulative change in the debt of the Consolidated Public Sector (CPS).**

Cumulative change in debt of the CPS	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	8,876
End-December 2001 (performance criterion)	9,460
End-December 2002 (indicative)	4,290

The change in the debt of the consolidated public sector includes the sum of the changes in the debt of the Federal Government as defined in 4 above (including all the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt (including debt to the Provincial development Trust Fund arising from debt restructuring operations). The debt of the provincial governments and the city of Buenos Aires will be defined to include obligations to local and foreign financial institutions (as reported by the *Secretaría de Hacienda* with respect to the end March, 2001 performance criterion, and subsequently by the central bank), to international organizations, and bonds (including bonds issued to settle commitments made in the current fiscal year, such as, but not limited to, Patacones issued in partial payment of salaries, but excluding other peso denominated bonds placed outside the financial system). The limit in this provincial debt will be adjusted: (a) downward for any privatization receipts; (b) downward for capital gains realized in the sale of financial assets; (c) upward by the nominal value of the bond issued by the province of Buenos Aires to clean up bad loans from the balance sheet of Banco Provincia (BPBA), net of the book value of any loans that, having become nonperforming after March 31, 2001, may be acquired by the provincial government as part of this operation; and (d) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year. The data used to monitor the provincial debt will be provided by the *Secretaría de Hacienda*, the SIGADE, and the central bank. The stock of debt will be valued at end-2000 exchange rates and measured at end period.

7. **The net domestic assets (NDA) of the BCRA**

The net domestic assets (NDA) of the BCRA are defined, as shown below, 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 limit on NDA will be adjusted upward by the equivalent of purchases from the IMF under the arrangement in excess of US$4 billion.

The limit for December 2001 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (*pases activos*).

	2001		2001 ceilings 1/	
	Mar.	Jun.	Sept.	Dec.
A. Net international reserves (a-b)	15,442	12,966		
a. Gross international reserves 2/	23,040	21,557		
b. Foreign liabilities 3/	7,595	8,591		
B. Net domestic assets (C-A) 4/	7,136	8,549	10,635	9,675
C. Monetary liabilities (c+d+e)	22,581	21,515		
c. Currency issued	13,554	13,067		
d. Government deposits 5/	1,116	474		
e. Reserve deposits of banks 6/	7,911	7,974		

1/ Performance criteria

2/ Includes the BCRA holdings of gold, SDR's, foreign currency in the form of cash and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI), excluding the accounting effects of holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds.

3/ Liabilities to the IMF valued at US$1.30 per SDR. For September and December 2001, it excludes purchases from the IMF arrangement in excess of US$4 billion.

4/ Includes claims on the government on gross basis.

5/ Includes government and ANSES deposits.

6/ Legal bank reserves and liquidity requirements (reverse repo).

STRUCTURAL BENCHMARKS

Tax administration

- Implementation of plans to streamline tax payments facilities arrangements (5^{th} review)
- Implementation of plan to strengthen tax collections described in paragraph 8 of the Memorandum of Economic Policies (5^{th} review)
- Completing 80,000 and 100,000 desk audits (5^{th} and 6^{th} review, respectively)
- Full implementation of the Tax Frauds Tribunal (6^{th} review)

Social security reforms

- Implementation of restructuring plan for family allowances (5^{th} review)

Provincial finances

- Submission to congress of draft legislation agreed with the provinces to reform the revenue sharing arrangement (5^{th} review)
- Continuing publication by the Ministry of Economy of quarterly public reports on the implementation by the federal government and each province of commitments undertaken in pacto federal (5^{th} review)

Financial system

- Strengthening compliance with prudential and reporting requirements of the public banks and the commissioning of an external audit of the BPBA, as described in paragraph 17 of the Memorandum of Economic Policies (5^{th} review)

Press Release No. 01/37
September 7, 2001

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

IMF Augments Argentina Stand-By Credit to $21.57 Billion, and Completes Fourth Review

The Executive Board of the International Monetary Fund (IMF) today approved an augmentation to SDR 16.94 billion (about US$21.57 billion) of Argentina's stand-by credit initially approved on March 10, 2000 and augmented on January 2001 (see Press Release 00/17 and Press Release 01/3). Today's decision, which was made in conjunction with the completion of the fourth review of Argentina's program supported under the original stand-by credit, makes SDR 4.94 billion (about US$6.3 billion) available immediately, of which SDR 3.97 (about US$5.05 billion) are under the new augmentation. An additional drawing of SDR 976.2 million (about US$1.24 billion) would be made available later in 2001 following the completion of the fifth review of the program. Further credit will be made available, according to a schedule yet to be specified, in 2002 (SDR 5.44 billion or about US$6.93 billion), and in 2003 (SDR 764 million or about US$ 973 million). Up to the equivalent of US$3 billion of the drawings scheduled for 2002 may be brought forward to support a voluntary and market-based operation to improve Argentina's debt profile.

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and acting Chair, said:

"The Fund welcomes the major strengthening of the fiscal effort in the reformulated program of the Argentine authorities which should restore macroeconomic stability and address important structural impediments to a recovery of investment and output.

"The strengthened program aims at restoring the credibility of the fiscal position and the convertibility regime through a fiscal policy geared to the immediate elimination of the federal government deficit as mandated by the "zero-deficit law" approved by congress in late July 2001. The provincial governments are also expected to continue to undertake a substantial fiscal adjustment.

"Firm implementation of fiscal consolidation is needed to ensure the sustainability of the public debt and to produce a lasting decline in the risk premium on Argentine debt and of domestic interest rates, thereby creating the conditions for a recovery of economic activity. The Fund welcomes the free-trade initiatives underway, which will enhance the prospects of sustained, rapid economic growth in Argentina.

"The Fund welcomes the authorities' initiatives to enact further structural reforms aimed at putting the public finances on a sustainable basis. These initiatives include steps to improve tax administration and strengthen tax compliance, a reform of the revenue sharing arrangements between the federal government and the provinces, the streamlining of public administration, and overhauling the social security administration. In addition, the Fund notes the importance of the measures to strengthen the public banks, make labor markets more flexible, and improve the effectiveness of the social safety net. Rapid progress in these areas will be key to lasting success of the program.

"Argentina's convertibility regime and the liquidity defenses of the banking system are important pillars of the country's economic strategy and have been vital in helping withstand turbulent financial conditions. The Fund, therefore, welcomes the authorities' reaffirmation of their commitment to these policies.

"The program also provides for increased voluntary private sector involvement to secure external financing from the combination of bond placements and the expected drawdown of the contingent repo facility with international banks. The Fund welcomes the authorities' efforts to engage creditors in a voluntary market-based debt operation aimed at achieving a lasting easing of financing requirements in the future, and looks forward to an outcome that will support medium-term financing sustainability.

"In strengthening the program, the Argentine authorities have responded promptly and appropriately in difficult circumstances. Their efforts, and the program, deserve the strong support of the international community," Ms. Krueger said.

ANNEX

Program Summary

Despite the augmentation of IMF financial support of the Argentine program approved in January 2001, doubts about the sustainability of the country's public debt resurfaced following the authorities' failure to sustain the fiscal policies underlying the program. A ministerial crisis in March—reflecting the lack of political consensus on needed spending cuts—and the continued weakness of the economy further contributed to erode confidence.

A new economic team appointed in March sought to address these doubts by obtaining limited emergency powers to legislate by decree on tax policy and on the reform of the public sector. Measures were also adopted to tighten fiscal policy, improve competitiveness, and jump-start economic growth. The new policies failed, however, to restore confidence and the authorities were faced with the virtual refusal of the domestic financial sector to continue financing the government. Spreads on Argentine bonds, which had narrowed to about 880 basis points following approval by the IMF of the program's third review in May, widened to over 1700 basis points in July amidst increased volatility before narrowing to around 1,400 basis points in August.

In response to these developments, the authorities announced a major strengthening of the fiscal effort to restore credibility of the fiscal position and the convertibility regime, which regulates foreign exchange transactions, and requested a further augmentation of the IMF support to dispel doubts about the government's ability to avoid a debt default and to calm the fears of depositors.

The authorities' revised program centers on a fiscal policy geared to the immediate elimination of the federal government deficit, in line with the requirements of the "zero deficit" law. New revenue measures in the program include an increase in the financial transactions tax by 0.2 percent (to 0.6 percent) with the elimination of all exemptions. The authorities have also reversed the reduction in gasoline taxes, suspended the increase in income tax deductions and postponed indefinitely the planned move of the VAT from an accrual to a cash basis. In addition, primary spending will be cut by a number of measures which include an across-the board cut of 13 percent in unprotected primary spending, including wages and pensions.

The announced policies, if firmly implemented, are expected to result in a lasting decline in the risk premium on Argentine debt and of domestic interest rates, thus creating conditions for a modest recovery of real GDP growth in the final quarter of 2001 which would pave the way for growth of about 2.5 percent in 2002.

The poor are protected from the worst effects of the spending cuts by the floor on salary and pension cuts, and by the maintenance of targeted subsidies. Given the magnitude of the fiscal adjustment, however, emphasis will be put on more efficient use of resources through better targeting and by concentrating the administration of a variety of social programs under a single facility.

Argentina joined the IMF on September 20, 1956. Its quota[1] is SDR 2.117 billion (about US$2.695 billion). Its outstanding use of IMF credit currently totals SDR 6.494 billion (about US$8.267 billion).

Argentina: Selected Economic Indicators

	1997	1998	1999	2000	Q1 2001	Prog 2001
(Annual percentage changes; unless otherwise indicated)						
National income and prices						
Real per capita GDP	6.7	2.6	-4.6	-1.7	...	-2.6
GDP at current prices	7.6	2.1	-5.2	0.6	-2.6	-1.7
GDP at constant prices	8.1	3.8	-3.4	-0.5	-2.1	-1.4
Consumption	7.9	3.1	-2.6	1.0	-0.8	-1.0
Investment	17.7	6.5	-12.8	-8.6	-9.2	-7.7
Net exports (contribution to growth)	-1.8	0.0	1.4	0.3	0.1	0.8
Exports	12.0	9.9	-1.4	2.2	1.0	5.9
Imports	26.6	8.1	-11.7	-0.5	0.1	-0.8
GDP deflator	-0.5	-1.7	-1.9	1.1	-0.5	-0.3
Industrial production (average)	8.7	1.6	-6.4	0.0	0.0	...
Consumer prices (average)	0.6	0.9	-1.2	-0.9	-1.4	-0.6
Consumer prices (end-of-period)	0.3	0.7	-1.8	-0.7	-1.0	0.0

External sector (in terms of U.S. dollars)

Exports, f.o.b.	11.0	0.0	-11.8	13.2	3.8	3.7
Imports, c.i.f.	28.1	3.1	-18.7	-1.2	-2.9	-3.9
Export volume	15.0	11.6	-0.6	2.0	1.4	4.8
Import volume	31.1	8.7	-13.8	-1.0	0.1	-3.8
Terms of trade (deterioration -)	-1.2	-5.5	-5.9	10.4	5.5	-0.6
Real effective exchange rate						
Average (depreciation -)	3.0	3.5	12.4	-0.7	2.1	...
Year-end (depreciation -)	5.0	0.3	12.6	1.7	4.4	...
Money and credit						
Banking system						
Net domestic assets	16.1	14.6	4.7	3.3	3.2	5.0
Of which:						
Credit to private sector	18.6	10.8	-2.1	-3.8	-4.8	-6.0
Money and quasi-money (M2)	20.3	24.7	-2.4	-2.5	-7.0	-9.0
Velocity (GDP relative to M2)	8.5	8.0	7.6	7.8	7.5	8.5
Interest rate (30-day deposit rate, in percent) 1/	7.0	7.6	8.0	8.3	8.7	...
(In percent of GDP)						
Public sector savings	-0.4	-0.5	-2.6	-2.5	...	-2.3
Federal government primary balance	0.4	0.9	0.4	0.9	-0.2	1.5
Federal government overall balance	-1.6	-1.3	-2.5	-2.4	-1.1	-2.7
Consolidated public sector primary balance	0.3	0.5	-0.8	0.5	...	1.5
Consolidated public sector overall balance	-2.1	-2.1	-4.2	-3.6	...	-3.7
Gross domestic investment	19.5	19.9	17.9	16.0	...	14.9
Gross national savings	14.7	15.1	13.7	12.8	...	11.9
Current account deficit	-4.2	-4.8	-4.2	-3.2	-4.4	-2.9
Public sector external debt (end-of-year)	25.6	27.8	30.1	29.9	30.6	32.1
(In percent of exports of goods and nonfactor services; unless otherwise indicated)						
Public sector interest payments 2/	24.3	25.4	31.0	41.3	...	42.0
Outstanding use of Fund resources						
(in percent of quota at end-of-period)	283.0	251.5	154.1	183.3	276.0	587.3
Gross foreign exchange reserves 3/	9.6	9.9	12.2	12.5	0.0	10.4

Source: Ministry of Economy; and IMF staff estimates.

1/ Average interest rate on 30- to 59-day time deposits in national currency. The rate is weighted by deposit amounts.

2/ Starting in 2001, includes capitalized interest.

3/ In months of imports of goods and nonfactor services.

1 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.

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