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EBS/83/8
Correction 1

CONFIDENTIAL

January 21, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Staff Report for the 1982 Article IV Consultation and Request for Stand-By Arrangement

The following corrections have been made in EBS/83/8 (1/10/83):

Page 7, 3rd full para., lines 5 and 6: delete "(Export taxes...the exchange system.)"

Page 40, lines 1 and 2: for "be established...December 31, 1983." read "practices and restrictions...December 31, 1983."

Page 41, item on multiple currency practices: delete para. a and para. b

Add main para.: "Argentina maintains...credit is discounted."

para. a: "Rebate rates...range of rates."

para. b: "Argentina also...to new markets."

Page 42, last para., last 2 lines: for "review with...December 31, 1983." read "review. Freedom...December 31, 1983."

Page 61, item 7, line 8: for "export taxes and rebates" read "export rebates"

Corrected pages are attached.

Att: (5)

had necessitated bail outs by the Central Bank at great costs in terms of monetary expansion and inflation. For some time, this diagnosis had been widely shared in Argentina, and the authorities responsible for economic management during July and August of 1982 acted on it by radically altering economic policies.

Given the limited supply of resources after two years of severe recession and the perceived need to revive economic activity and improve the labor market situation, the view was taken that policies should engineer a large one-time transfer of resources from savers to debtors. The agricultural sector, whose relative position had been strengthened greatly from mid-1981 by the large exchange rate adjustments of that year, also was called upon to assist temporarily in alleviating the corporate and public sector's financial situation. The instrumentation of this policy of resource transfer was to rest, in the short run, on certain exchange and trade measures and on far-reaching adjustments in the mechanisms of financial intermediation.

On July 5, 1982, the foreign exchange market was split into a commercial market for trade transactions and a financial market for other permitted transactions. The rate in the commercial market was set initially at $a 20,000 per U.S. dollar, representing a 21 per cent devaluation of the peso from its last quotation on the unified market; thereafter, the commercial rate was adjusted daily (Chart 1). The financial peso was allowed to float for several weeks and was then pegged at about $a 39,000 per U.S. dollar. Restrictions on access to the financial market promptly gave rise to a parallel market in which the peso quotation for a time exceeded $a 60,000 per U.S. dollar.1/

In conjunction with the devaluation, taxes on agricultural exports were raised from 10 per cent to a range of 20-25 per cent, and taxes on other traditional exports were raised from a range of 0-5 per cent to 10 per cent. Tax rebates for promoted exports were reduced somewhat from a range of 5-14 per cent to a range of 0-10 per cent. The import restrictions which had been introduced on a temporary basis in the second quarter were formalized in July and, in addition, minimum financing terms of up to five years were introduced for capital goods imports.

The new economic team also introduced an array of measures intended to induce capital inflows or prevent capital outflows. Special schemes were put into place whereby the private sector could clear amounts in

1/ All payments through the financial market other than freight, insurance, loan amortization and interest, and certain other selected service payments continued to require prior authorization from the Central Bank. After August 6, these provisions were liberalized somewhat to permit automatically the transfer of pensions and, up to certain specified limits, the sale of exchange for foreign travel, medical treatment, and transfers to students and dependent family members abroad.

arrears at preferential exchange rates by bringing in an equivalent amount of funds under a swap contract with the Central Bank, or by accepting marketable U.S. dollar-denominated Government of Argentina bonds (BONEX) in lieu of foreign exchange. A new exchange rate guarantee scheme was also introduced for private sector loans, whether or not in arrears, registered with the Central Bank prior to the devaluation; to be eligible for this scheme, the debtor had to obtain a loan extension of at least one year. The guaranteed exchange rate was the predevaluation rate, indexed thereafter by the inflation differential between Argentina and the United States.

The private sector responded strongly to these various preferential schemes. During the third quarter, outstanding swaps increased by almost US$800 million, and approximately US$1 billion in arrears and other payments were cleared through sales of BONEX. Also, by the time the new exchange rate guarantee scheme was terminated in October, more than US$4 billion in guarantees on previously unguaranteed debt had been granted under this program.1/ These measures--which could give rise to a potentially massive domestic credit expansion and international reserve loss when these mechanisms are unwound in the future--enabled the authorities to reduce private sector arrears from US$1.6 billion in June to about US$600 million in September; at the same time, however, public sector arrears mounted, rising from US$500 million at the end of June to almost US$1.2 billion in September.

The modification of the exchange and trade system was paralleled by a major domestic financial reform aimed at: (1) reducing the real domestic debt of a private sector burdened with high debt to capital ratios; (2) discouraging short-term speculative financial operations (credit and deposit operations had been conducted within a range of 7-30 days in Argentina since late 1978) and encouraging financing of production and investment; and (3) defusing the potential for largely unchecked credit expansion inherent in the government guarantee of bank deposits.

All bank deposits outstanding on June 30, 1982 were made subject to a 100 per cent reserve requirement; banks were given rediscount facilities for an equivalent amount less their outstanding loans to the public sector (which were to be taken over by the Central Bank) to refinance outstanding personal or corporate loans over a five-year period ("basic" loan). In order to reduce such debts in real terms, the interest rate on the refinanced loans initially was set at 6 per cent a month, well below the prevailing inflation rate.

Meanwhile, with the help of an array of new financial instruments, the financial system was to be assured greater permanence of the funds that it attracted. These new instruments would be in accord with the

1/ These guarantees were in addition to those extended in the second half of 1981 (for the equivalent of US$5 billion) which began to come due in November-December 1982. Approximately US$1 billion of these loans were rolled over with guarantees during 1982.

the rate of interest on 30-day regulated deposits will be set within 1 percentage point below the lending rate. This formula sets a floor to regulated interest rates; these rates will be managed flexibly with a view to achieving the targeted improvement in the overall balance of payments and the projected increase in domestic financial savings.

b. The growth in the net domestic assets of the Central Bank will be limited to the growth in currency issue plus specified peso amounts for each quarter which are consistent with the overall balance of payments target, with an upper limit defined in terms of the currency issue for end December 1982; specifically, over the 15-month period from end 1982 to end March 1984, the increase in net credit of the Central Bank will be limited to currency issue plus $a 24.3 trillion, or 220 per cent of currency issue at end December 1982 plus $a 24.3 trillion, whichever is lower.

c. Notwithstanding the remonetization of the economy and the substantial reduction in the deficit of the nonfinancial public sector that has been projected, the financial program implies that credit to the private sector will be sharply constrained. A recovery in private sector activity greater than the one envisaged in the program would thus require a repatriation of private capital.

3. Wages

Wage policy is to be geared to the achievement of a significant deceleration of inflation. The Government is to abstain from intervening in the process of wage determination in the private sector. In the Government, wage indexing is to be discontinued in the first quarter of 1983, with only one adjustment, of 12 per cent, to be granted in February. From the second quarter, wage raises will be granted quarterly and at rates consistent with the decline in the rate of inflation which is being sought.

4. External sector

a. Exchange rate policy will be managed flexibly to ensure the attainment of the balance of payments objectives of the program: as a minimum, the exchange rate will be adjusted to offset domestic inflation. Interest rate and exchange rate policy will be coordinated in order to stem capital flight and facilitate the attainment of the balance of payments objective without undue compression of the current account.

b. The system of special rebates for exports to new markets, a multiple currency practice, will be terminated by February 28, 1983; all external payments arrears will be eliminated by June 30, 1983; and the minimum financing requirements for imports other than capital goods are to be eliminated according to a schedule which is a performance criterion under the stand-by arrangement. All other multiple currency practices and restrictions on payments and transfers for current international transactions are to be eliminated according to a schedule to be established during the May review with the Fund. Freedom for current payments and transfers is to be established by no later than December 31, 1983. The standard clause on restrictions and multiple currency practices is included as a performance criterion.

c. As adjustment proceeds, import restrictions are to be relaxed with a view to rationalizing the structure of protection and improving resource allocation. The May 1983 review will encompass a discussion of trade policies.

d. The net increase in the external indebtedness (excluding official reserve liabilities of the monetary authorities) of the public sector over the period of the stand-by arrangement is to be limited to US$2 billion; borrowing from all sources and of all maturities is covered by this limit. Also, to assist in the effort to improve the maturity profile of the external debt, the program includes a limit on the net increase in maturities of the public sector debt falling due before the end of the first quarter of 1987. The purpose of this subceiling is to ensure that no more than US$500 million of the US$2 billion overall increase in the public sector's indebtedness will fall due within three years of the expiration of the proposed stand-by arrangement.1/

1/ For a description of how this subceiling has been specified, see footnote 3, Table 7.

Argentina: Exchange and Trade System

A detailed description of the exchange and trade system maintained by Argentina is provided in Appendix A to the paper on recent economic developments that accompanies this report. A list of selected changes introduced in the exchange and trade system over the course of 1982 is provided in that same appendix.

The exchange system currently in effect in Argentina involves the following multiple currency practices and restrictions on payments and transfers for current international transactions subject to Fund approval under Article VIII, Sections 2 and 3 of the Articles of Agreement.

1. Multiple currency practices

Argentina maintains a system of rebates for certain exports which is implemented through the exchange system. These rebates are set as a percentage of the export value, and the exchange proceeds must be surrendered as a condition for payment of the rebate. In the general case, the rebates are paid to the exporter by the intervening bank at the time the exchange proceeds are surrendered or the letter of credit is discounted.

a. Rebate rates of 5 or 10 per cent presently apply to certain promoted exports. In addition, exports originating in and shipped through ports located in specified less developed regions of Argentina are eligible for rebates of 5 to 9 per cent. The Argentine authorities have committed themselves, pending the review with the Fund in May 1983, to continue to operate this system only within the existing range of rates.

b. Argentina also maintains a system whereby special rebates of 5 per cent are provided for fixed periods for exports to new markets.

2. Exchange restrictions

a. An exchange restriction arises from the existence of arrears on current payments and transfers. Total external payments arrears amounted to US$1,976 million at the end of November 1982.

b. Sales of exchange to effect the transfer of profits, dividends, royalties, and payments for technical assistance have been suspended since April 20, 1982.

c. Prior Central Bank approval is required for the sale of exchange to effect certain transfers and payments related to services. Such approval is required for sales of exchange beyond certain specified limits for foreign travel, foreign study, family remittances, and foreign medical treatment. In the present circumstances, such authorization is not automatically granted for all bona fide current payments and transfers.

d. The sale of exchange is not currently permitted for the repayment of foreign loans for which the domestic borrower obtained an exchange rate guarantee during 1981. These loans had a minimum maturity of 540 days and, in some instances, were related to current trade finance. The foreign creditor must reschedule such loans, either by accepting a U.S. dollar-denominated Government of Argentina debt instrument, or by renegotiating the loan directly with the domestic borrower according to minimum terms established by the Central Bank of Argentina.

e. Minimum foreign financing terms of between one and five years have been established for imports of capital goods valued at more than US$50,000.

f. Minimum foreign financing terms have been established for most imports other than capital goods as follows:

(i) Goods on the "negotiated" list shipped from and originating in member countries of the Latin American Integration Association (LAIA) may be paid for against shipping documents;

(ii) Other goods shipped from and originating in LAIA, as well as goods shipped from and originating in the member countries of the Central American Common Market, Cuba, Haiti, Panama, or the Dominican Republic are subject to minimum financing terms of 90 days; and

(iii) Imports from all other countries are subject to minimum financing terms of 180 days.

In view of the discriminatory nature of this restriction, Fund approval has not been requested.

Argentina maintains an additional multiple currency practice related to capital transactions. The Central Bank of Argentina has undertaken foreign exchange swap arrangements with private domestic borrowers; the premia charged for such swap arrangements are set well below the recent or expected rate of depreciation of the peso and, therefore, these arrangements cannot be deemed to be reasonably related to normal forward exchange operations. As of the end of 1982, approximately US$1.3 billion of such swap arrangements were outstanding.

The Argentine authorities have undertaken to terminate the system of special rebates for exports to new markets by February 28, 1983; to eliminate all payments arrears by June 30, 1983; to eliminate the 90- to 180-day minimum financing requirement for noncapital goods imports according to a schedule which is a performance criterion under the proposed stand-by arrangement; and to eliminate all other multiple currency practices and restrictions on payments and transfers for current international payments according to a schedule on which understandings are to be reached during the May review. Freedom for current payments and transfers is to be established by no later than December 31, 1983.

comprehensive review of the Argentine exchange and trade system and reach understandings with the Fund on a schedule for the elimination of existing multiple currency practices and restrictions on payments and transfers for current international transactions and of the consequent distortions. The Government will terminate the system of special rebates for exports to new markets by February 28, 1983, although rebates authorized before that date will continue in effect until their pre-established expiration dates. The Government will reduce the minimum foreign financing requirement for private imports, now at 180 days, to no more than 150 days by March 31, 1983, to no more than 120 days by June 30, 1983, and to no more than 90 days by September 30, 1983, and it will eliminate this requirement entirely by December 31, 1983.

7. During 1983 and through April 1984, the Government will not introduce or modify any multiple currency practice with the following exceptions: (a) any modification in a multiple currency practice which reduces the differential between the effective exchange rate applied for a given transaction and the official buying or selling rate for the peso in the unified exchange market; and (b) pending the completion of the review mentioned in paragraph 6 above, the continued operation of the existing system of export rebates within the existing range of rates, including the reclassification of exports within that range of rates.

8. All external payments arrears will be eliminated as quickly as possible and, in any event, by June 30, 1983. Once eliminated, foreign exchange will be provided freely at the official exchange rate for all bona fide current international payments. However, reasonable limits may be applied on the automatic allocation of foreign exchange for foreign travel and remittances in order to prevent disguised capital outflows.

9. The Government intends to initiate shortly discussions with its foreign creditors with a view to achieving a restructuring of Argentina's external public and private debt that would produce an amortization profile attuned to Argentina's repayment capacity.

Sincerely yours,

Julio Gonzalez del Solar
President of the Central Bank
of the Republic of Argentina

Jorge Wehbe
Minister of Economy

Table 1. Argentina: Net International Reserves as of September 30, 1982

(In millions of U.S. dollars)

Assets	3,304
Gold 1/	185
Foreign exchange	421
ALADI	140
Investment realizable in foreign exchange	2,310
SDRs	--
IMF reserve position	248
Liabilities	5,005
ALADI	62
Liabilities to IMF	--
Arrears	1,709
Swaps	1,156
BONEX against pesos 2/	1,464
Reserve loans from residents 3/	141
Other external obligations of the Central Bank in foreign currencies	473
Net international reserves	-1,701

1/ Valued at US$42 per fine troy ounce.
2/ Excludes external bonds issued against pesos in settlement of exchange guarantees issued by the Central Bank.
3/ External obligations of residents, the foreign currency proceeds of which were surrendered to the Central Bank without the borrowing entity receiving the counterpart in peso financing.