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Minutes of Executive Board Meeting 90/166

10:00 a.m., November 28, 1990

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	
C. S. Clark	
Dai Q.	
T. C. Dawson	
	F. Moss, Temporary
	G. H. Spencer
R. Filosa	
M. Finaish	T. S. Allouba, Temporary
	I. H. Thorlàksson
	B. Goos
J. E. Ismael	T. Sirivedhin
A. Kafka	
	J.-F. Cirelli
	S. Rouai, Temporary
	L. J. Mwananshiku
	P. Wright
	G. P. J. Hogeweg
	J.-C. Obame, Temporary
	R. Marino
A. Végh	A. G. Zoccali
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present
IBRD: R. S. Newfarmer, Latin America and the Caribbean Regional Office. Asian Department: S. N'guiamba. European Department: M. Russo, Director. Exchange and Trade Relations Department: E. Brau, Deputy Director; T. Leddy, Deputy Director; A. Basu, M. V. Carkovic. External Relations Department: H. P. Puentes. Fiscal Affairs Department: G. A. Mackenzie. Legal Department: J. K. Oh. Research Department: M. P. Dooley. Treasurer's Department: W. J. Byrne. Western Hemisphere Department: S. T. Beza, Counsellor and Director; M. Caiola, Deputy Director; J. Ferrán, Deputy Director; A. S. Linde, C. M. Loser, C. G. Muñiz, A. M. Wolfe. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: L. E. Breuer, M. B. Chatah, C. D. Cuong, A. Gronn, Z. Iqbal, J.-L. Menda, A. Napky, D. Powell, H.-J. Scheid. Assistants to Executive Directors: B. Abdullah, T. Berrihun, B. Bossone, J. A. Costa, E. C. Demaestri, N. A. Espenilla, Jr., S. K. Fayyad, B. R. Fuleihan, S. Gurumurthi, M. E. Hansen, O. A. Himani, L. I. Jácome, C. J. Jarvis, P. K. Kafle, R. Meron, L. J. Morelli, M. Nagakawa, J.-P. Schoder, N. Sulaiman, Tin Win, J. C. Westerweel.

1. ARGENTINA - 1990 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT - REVIEW AND MODIFICATION OF PERFORMANCE CRITERIA; AND EXCHANGE SYSTEM

The Executive Directors considered the staff report for the 1990 Article IV consultation with Argentina and the second review under the 17-month stand-by arrangement approved on November 10, 1989, together with Argentina's request for a modification of the stand-by arrangement (EBS/90/191, 11/12/90; Cor. 1, 11/26/90; and Cor. 2, 11/27/90). They also had before them a background paper on recent economic developments in Argentina (SM/90/221, 11/26/90).

The staff representative from the Western Hemisphere Department said that since the staff report had been issued, some additional information had become available regarding economic performance. On the basis of data through the third week of November, the rate of price increase for the month was expected to be in line with the program. Measured in terms of the combined retail and wholesale price index, inflation in November had declined to 3.6 percent from 5.2 percent in October. Wholesale prices had risen by 1.5 percent in November compared with 2.6 percent in October, and consumer prices had risen by 5.8 percent in November compared with 7.7 percent in October and 15.5 percent in August and September. Exchange purchases by the Central Bank in the market during October and so far in November were on target.

On November 14, the Argentine authorities had met with the banks' working committee for Argentina, the staff representative commented. The Argentine delegation had reported on recent developments, including the closing on November 8 of the sale of the state telephone company (ENTEL) and had anticipated the conclusion of the transfer of the national airline (Aerolineas), which had taken place in the past week. The Committee had been informed that the privatization of those two companies had involved the cancellation of $7.3 billion of external bank debt of Argentina, including $1.3 billion in arrears. The authorities had also announced the decision to broaden the scope of the privatization program to achieve further debt reduction in the period ahead.

The committee had reported to the banking community that the Argentine Government had made the sixth monthly payment of $40 million at the beginning of November, the staff representative continued. The committee had indicated to the Argentine representatives that regular payments of interest constituted a positive step, and had suggested that the amount of such payments should be increased as soon as possible to make progress in Argentina's efforts to normalize relations with its commercial bank creditors.

The staff understood that the authorities and the committee would meet again in early 1991, at which time the issues under discussion, particularly waivers for further privatizations and partial payments of interest would be considered, the staff representative from the Western Hemisphere Department remarked.

Mr. Zoccali made the following statement:

On behalf of my Argentine authorities, I would like to express appreciation to management and the staff for their constant support and technical assistance during the period under review, which is still considered to be the intensive care stage in the difficult process of consolidating stabilization and structural reform in the country.

As my authorities are in broad agreement with the staff appraisal and recent economic developments are well described in the staff papers, I will concentrate my comments on a few salient features of the program. The priorities initially established are reducing the rate of monthly price increases to low levels by the end of 1990, laying the basis for sustained growth with external viability, and restoring relations with external creditors. These priorities have been continually reaffirmed by the authorities' quick and effective policy responses in the face of potentially derailing slippages.

The framework for pursuing these objectives has been the reinforcement of the role of free markets with the broad liberalization of activities, a sweeping redefinition of the role of the state through privatization and deregulation, and adherence to the basic tenets of macroeconomic discipline, including a move toward a more independent central bank. The clearest indication of that change is the coexistence of market-determined interest rates, prices, and private sector wages with a unified floating exchange rate.

Since the turnaround in early March, economic developments have generally followed a convergent trend. As Directors will recall, the starting point was hyperinflation and recession stemming from substantial domestic and external imbalances and widespread skepticism. End-of-June criteria under the arrangement were in general observed, with substantial margins in respect of the targets for central bank net domestic assets and net international reserves.

Although some slippages in policy implementation have been observed during the third quarter of this year, the rate of inflation has continued to decelerate since September. The external accounts also showed a marked improvement. The trade surplus continues to be significant, notwithstanding the deterioration in the terms of trade. In this connection, the public sector has been able to cover payments to external creditors, and the Central Bank has further replenished its stock of liquid international reserves through purchases of foreign exchange in an unrestricted market, backed by a sustained primary fiscal surplus and an incipient remonetization process.

In short, tighter fiscal policy, with rigid observance of expenditure limits and wage restraint in the public sector, has increased the effectiveness of monetary policy. It also undoubtedly initiated a favorable change in market expectations conducive to the consolidation of the adjustment effort in the fourth quarter under the program.

Fiscal policy continues to be viewed by the authorities as the core of the stabilization program, and substantial efforts are directed toward this area. Fiscal measures taken since last September include substantial increases in fuel and other public sector prices, increased expenditure control, and a tightening of wage policy with nominal increases well below inflationary levels. The Government strengthened the authority and the regulatory means of the Ministry of Economy in order to ensure public enterprise compliance. In addition, the coverage of the value-added tax was extended to include services, and the rate was raised from 13 percent to 15.6 percent in October.

With respect to monetary policy, the authorities have been consistent in restraining domestic credit. In fact, money creation was principally attributable to foreign exchange purchases during the past few months. This is now being carefully monitored in view of the already high coverage ratio of reserves to the monetary base and the need to avoid excessive liquidity injections that could undermine the declining inflationary trend.

Finally, general compliance with privatization schedules has led to the transfer of ownership to domestic and foreign shareholders. The transfer of the national telephone company and the national airline took place during November. These transactions resulted in significant cash revenue for the Treasury, as well as initial debt reductions in excess of $7.3 billion. It is also worth highlighting the widespread potential implications of the privatization program announced by the authorities for enhancing medium-term competitiveness and external viability. These include all areas of domestic production in which the Government is currently involved. Other targeted privatizations, through sales or concessions, are in different stages of implementation and include, inter alia, the central oil-producing areas, the major road networks, railroads, petrochemical, and carbochemical concerns, gas and electric utilities, steel and smelting refineries, shipyards, port and hydroelectric facilities, and other services.

Notwithstanding the many achievements mentioned above, my authorities are fully aware of the difficulties that lie ahead. Output losses were costly, and real wages declined to low levels. In additional, domestic financing of public sector borrowing requirements remains restricted, and headway in remonetization is realistically expected to be slow. Under these circumstances, until the fiscal adjustment is consolidated, spurts of price, exchange, and financial instability may be rekindled in the future.

For these reasons, the authorities remain committed to undertaking further measures that may be necessary to secure the basic objectives of the program. Measures under consideration aim at strengthening tax administration, more effective control over transfers to provincial governments, maintaining a forward-looking wage policy, and rationalizing and restructuring the public sector work force. Additional reforms in the financial and trade areas are also viewed as necessary for longer-term competitiveness and effective integration of the Argentine economy into world markets.

Regularizing relations with external creditors remains of great importance to my authorities in their difficult struggle to restore confidence and sustainable growth. Substantial progress has been made in re-establishing relations with official creditors and with multilateral institutions. These advances have not been limited to the implementation of reschedulings and the elimination of arrears, but have also included understandings with important Paris Club creditors on bilateral investment guarantees. Negotiations with international financial institutions on near-term financial support for other vital reforms are at an advanced stage. They include the restructuring of provincial economies as well as negotiating targets for the respective provincial administrations.

The dialogue with commercial bank creditors has continued in the context of a sustained level of partial interest payments on refinanced public external debt by Argentina and of the increasingly favorable voluntary response to the privatization program. Recent meetings have mutually recognized the still very heavy debt burden and urgent need to re-establish sustained growth and investment. Capital reflows, including positive net flows from multilateral financial organizations and market-based debt and debt-service reductions, are an essential supplement to the authorities' commitment to sustainable future interest payments. Access to set-asides and other resources aimed at this objective, together with the proceeds from privatizations, are deemed to be consistent, effective means for bringing about external medium-term viability. Forthcoming meetings with the banks' working committee will further address these issues with a view toward maintaining the momentum of the progress already achieved.

My authorities look forward to continued close collaboration with the Fund and will shortly request an extension of the resident representative posting in Argentina.

Mr. Kafka made the following statement:

The task of stabilizing the Argentine economy has proven to be extremely difficult in spite of the courageous efforts of the authorities. This is not surprising, in view of Argentina's long history of virulent inflation and the failure of previous attempts at stabilization. In recent months there have been clear signs of improvement in several economic indicators. In this context, I endorse the authorities' request for a waiver for the nonobservance of end-September performance criteria and the modification of the present stand-by arrangement. Since I am in broad agreement with the staff's evaluation of recent developments in the Argentine economy, I will only emphasize a few points.

The early success of fiscal policy owing to the strong measures taken at the beginning of March 1990 was followed by some relaxation of the policy stance during the third quarter. Fiscal and wage restraints were, however, strengthened again in September and October, leading to the realization, in November, of the lowest price increase in almost a year, while the external sector was further strengthened.

In light of these events, the central element of the continued stabilization effort should remain a prudent wage and fiscal policy. On the latter, I share the staff's view that success will depend on the authorities' ability to increase fiscal revenues and on the improvement of the financial performance of public enterprises. In this respect, I welcome the Government's efforts to privatize a number of state enterprises, not only as a means of improving the fiscal accounts, but also as a clear sign of the authorities' commitment to greater economic efficiency.

Despite the strengthening of the international reserve position and stabilization of the exchange rate, further real appreciation of the domestic currency should be avoided in order to protect the projected external account equilibrium and to discourage short-term destabilizing capital inflows. However, foreign exchange acquisitions by the Central Bank can counteract monetary restraint, unless such acquisitions reflect the primary public sector surplus.

The improvement in Argentina's relations with foreign creditors is welcome. The Paris Club rescheduling has almost been completed, and debt-equity swaps in the context of the privatization of public enterprises create favorable conditions for further negotiations with commercial banks. These should comprise a mutual agreement on debt and debt-service reduction operations as enhancements become available. The reductions are necessary to reach external viability in the near future, according to medium-term projections, and to restore positive rates of per capita real GDP growth from 1991 onward, after three consecutive years of high negative values. In the meantime, Argentina should continue to make only partial interest payments in relation to medium- and long-term commercial debt, without taking risks that could reduce international reserves below a safe level and, hence, threaten the success of the current stabilization effort.

I want to refer briefly to the change in the staff's perception regarding real GDP growth in the period 1991-96 toward substantially lower levels than those considered previously, even assuming that debt reduction is achieved. The argument used by the staff to support the more pessimistic perception, in the sense that the economy may take longer than was earlier expected to respond to structural changes, is not sufficiently explained, although it may possibly be correct. Is it that private economic agents may withhold investment until uncertainty relative to the success of the stabilization program and the structural reforms is totally eliminated? Or, is it simply because aggregate demand will have to continue to be sharply restricted even after stabilization is achieved to avoid a new surge in inflation and, hence, will restrain economic growth? Or, is it for some other reason? In any event, it is notable that the change in the staff's perception occurs at a time when the Argentine economy is more stable. In addition, it contrasts with the more uniform approach taken by the staff in other cases, where it is taken for granted that the economy will achieve high rates of growth once stabilization is reached and structural change measures are implemented. In concluding, I support the proposed decision.

Mr. Filosa made the following statement:

From the outset, the stand-by arrangement for Argentina that was initiated in November 1989 has been one of the most difficult cases before this Board. On the technical side, it presented very delicate problems and raised highly uncertain prospects. However, as Mr. de Groote well stated at the first review of the arrangement (EBM/90/82, 5/25/90), other crucial factors also had to be taken into account, namely, general political developments in the country and in the region; the need to rehabilitate the Argentine economy; and, the fact that the arrangement constituted an absolute precondition for the provision of external financing by other sources.

Indeed, Argentina needed the Fund at that time--as it does today--and for this reason my authorities, not without reservations and after long consideration, decided to support this difficult undertaking, as they intend to do today.

When the arrangement was approved, this chair took the view that the prompt adoption of the measures envisaged in the agreed package, as well as a continued and strict adherence to such measures, were necessary prerequisites for the ultimate success of the stabilization program. This chair believed that credibility was key if the then new Administration was to affect public expectations so as to save the economy from the ravages of hyperinflation, stagnation, and mounting external debt. I cannot possibly overemphasize the importance that my authorities attach to this aspect. For this reason, the risk of recurrent policy slippages or implementation delays, which may irremediably damage public confidence in the program, remains for this chair the most serious cause for concern.

I am encouraged by the significant progress made on many fronts since the inception of the arrangement, and I am truly convinced of the willingness of the authorities to carry out their difficult endeavor. I have also noted with satisfaction the rapid response of the economy to the policy measures that have been successfully implemented. Nevertheless, I cannot but look with great apprehension at the signs of economic fragility showing up as rebounds in inflation or capital outflows in response to the authorities' failure to undertake certain needed actions in a timely manner. In fact, substantial instability still dominates the macroeconomic setting of the country owing to deep-rooted hyperinflationary expectations and precarious public confidence with respect to the firmness of government policies. The economy thus remains highly sensitive to even minor changes in policy signals, as shown, for instance, by the high volatility of the inflation rate in response to delays in the implementation, or the temporary relaxation of, financial policies. Such extreme vulnerability is, of course, compounded by the risk that the international financial community might lose faith in the authorities' ability to pursue a strong stabilization program.

In this light, I am very much concerned that the authorities have sometimes appeared unable to implement important policy decisions in a timely fashion. I refer, for example, to the difficulties to enact Decree 435, which aims at giving the Ministry of Economy control over the public enterprises, as well as the long delays in extending the coverage of the value-added tax to services, raising the value-added tax rate, and putting into effect the urgent measures to improve the tax administration system. All such delays and slippages have resulted in significant divergencies between the actual and programmed performance of the key program variables. I am thus concerned that the recurrent nonobservance of performance criteria may eventually undermine the overall effectiveness of the arrangement, even if the authorities are ready to take ex post corrective steps. My fears are indeed confirmed by the staff's recognition that the fiscal problems experienced in the third quarter of the year have affected confidence and spurred capital outflows that are not expected to be reversed within the year.

It is thus now more than ever necessary that the authorities carefully avoid any future policy shortcoming. In that connection, I should add that the signal to the economy from the proposed modified arrangement would have been substantially reinforced by prior actions.

As to the content of the modified policy package, the burden of adjustment continues to fall almost entirely on fiscal policy. A large primary surplus is necessary because noninflationary domestic financing is unavailable, owing to the debt conversion undertaken at the beginning of the year, and because the remonetization of the economy can be accomplished without being noninflationary only if the Central Bank's foreign exchange purchases do not exceed government saving. Moreover, only a consistent primary surplus can support a sustained flow of external debt repayments and acquisitions of foreign exchange reserves. In this respect, it is regrettable that even assuming that all agreed measures will be put in place as anticipated, the primary surplus for 1990 as a whole is expected to be smaller than the 4 percent envisaged in May.

Because the program has only one anchor--restrictive fiscal policy--it is very much open to risk. In this connection, I wonder what is the staff's perception of the Government's ability to implement in a timely manner the provisions of Decree 1757, aimed at improving the performance of the public sector; how fast and effective the envisaged rationalization of ministerial departments and decentralized entities is expected to be; and, whether the Government will be in a position to enforce the public wage policy as planned.

I am glad to see that the privatization program is being pushed through successfully and is being intensified. Furthermore, considering the "once-and-for-all" nature of the fiscal benefits from privatization, I wonder how the budget adjustments will be consolidated after the sale of assets is completed. In my view, the proceeds from privatization should be seen more as a financing item in the budget than as a source of revenue to cover excessive expenditures. The staff might want to comment on this.

I also have some reservations with regard to the spending measures the authorities intend to adopt, specifically, those with respect to social security, local government, and provincial banks. Although such measures have merit, the staff report gives the impression that they are still at the level of good intentions rather than concrete proposals. In fact, it appears that the time schedule as well as the implementation procedures have yet to be agreed. In particular, it is surprising that although about 50 percent of central government revenues are absorbed by the provincial governments, all the measures contemplated in the field of public finance relate exclusively to the Central Government. I believe that this issue should be addressed very seriously.

On monetary policy, I have three specific points to raise. First, I note with dissatisfaction that during the third quarter of 1990, reserve requirements were lowered to ease pressure on interest rates. This is exactly the kind of signal the authorities cannot afford to send to the public when trying to counteract hyperinflationary expectations.

Second, the program assumes that by end-December 1990, M1/GDP and M2/GDP ratios will be at their July levels. Such an assumption would amount to a monetary stance that would accommodate any level of inflation from now to December. I would appreciate some clarification on this point.

Third, replacing the Central Bank as the principal institution for channeling domestic savings to productive activities, as well as reducing the outstanding balances on subsidized lines of credit and allowing interest rates to be market determined are crucial factors in the restructuring of the financial sector. Such measures would not only eventually improve the allocative functions of financial markets but, in the short run, they would also be highly instrumental in fostering the adjustment process. The authorities should give priority to their urgent implementation.

As to the external sector, this chair fully shares the authorities' view that foreign reserves should be kept at a high level in order to sustain confidence in the economy and avoid sudden portfolio shifts out of austral-denominated assets. This chair also supports the Government's commitment to maintain an unrestricted access to the foreign exchange market for both current and capital account transactions.

With regard to the financial viability of the program, the two alternative scenarios presented by the staff, and, in particular, the large sensitivity of both scenarios to changes in assumptions regarding the external environment, clearly indicate the importance of prompt debt-reduction operations for the success of the program. This chair hopes that negotiations with commercial banks will proceed as expeditiously as possible. In this respect, I very much appreciate the information that the staff has just given to us. It is encouraging to hear that discussions with the banks will resume early in the next year.

As to medium- and long-term debt obligations, it is clear that only partial payments can be made to the banks at this stage. In this context, it is encouraging that, since last June, Argentina has maintained its commitment to make monthly interest payments and that the authorities have indicated their intention to consider increasing the amount of these payments. This chair urges the authorities to do so and to agree with the banks on a financial package that would be consistent with the basic requirements of the program.

My authorities very much hope that Argentina can solve its urgent problems. As I recalled earlier, a year ago they supported the Argentine Government in its request for Fund assistance, notwithstanding the many uncertainties surrounding the arrangement originally proposed. Last May, they again extended their support to Argentina for a request for a modification of the arrangement. On both occasions, such support has been granted on the perception that the new Administration would commit itself to the agreed policy package and would honor such commitment. Today, my authorities still have that perception and, indeed, many of the courageous steps taken so far by Argentina have proven that perception to be correct. On this basis, this chair can endorse the proposed decision. It does so, however, on the understanding that the Argentine authorities will avoid further policy shortcomings that could derail the adjustment process from its envisaged path.

Mr. Dawson made the following statement:

At the outset, I would like to make a somewhat modest complaint. The background paper for the 1990 Article IV consultation with Argentina was circulated to the Board only two days ago. I understand that there will sometimes be short deadlines for program reviews, but I would ask that, if at all possible, supporting documentation for an Article IV consultation be made available more than 48 hours before its consideration by the Board.

Argentina's latest request for modifications in its stand-by arrangement continues an unfortunate sequence of erratic policy discipline, missed targets, and program modifications. Prior to the last review and modification of the program in late May, Argentina began a brief record of policy performance. Following the Board's approval of the program modifications, fiscal performance began to weaken as early as June. Major fiscal slippages subsequently emerged in the third quarter: the primary surplus was less than one third of the programmed level; the large margin on net international reserves built up in the second quarter was dissipated in the third; and, most program targets were missed.

On the basis of corrective measures taken in early September, the Board is asked to approve a new set of program modifications. While these revisions leave the fourth quarter program more or less intact, they make no attempt to compensate for the slippages of the previous quarter.

As disappointed as my authorities are in Argentina's third quarter fiscal performance, they recognize that progress is being made under the stand-by arrangement. Inflation has declined; the privatization program is proceeding very well and has garnered tangible international support; and, there has probably been a greater degree of policy discipline with a Fund-supported program than there would have been without one.

But clearly, a more consistent fiscal policy stance is needed if Argentina is to make lasting progress in controlling inflation, increasing economic output, and resolving its debt problems. The staff has enumerated the steps that need to be taken to increase government revenues and control expenditure, especially in the public sector enterprises. This chair supports these measures and urges the authorities to act upon the Fund's advice.

With regard to monetary policy, there seems to have been the same on-again-off-again approach to credit expansion as there was in fiscal policy, although perhaps to a lesser degree. In general, the conduct of monetary policy could be improved by according greater independence to the Central Bank. My authorities hope that the reform of the central bank charter will be adopted shortly.

Attainment of the program's target for the primary fiscal surplus takes on special significance because of the authorities' desire to relate the size of Argentina's primary surplus to its ability to service its external debt. Clearly there is a relationship between the public sector's ability to mobilize domestic resources and the country's ability to service public sector obligations. But the focus on the primary surplus as the measure of a country's debt-service capacity fixes too much attention on what may be an arbitrary figure and obscures the importance of the underlying revenue and expenditure decisions, which, after all, determine the size of the primary surplus. I therefore wonder how it is determined that a primary surplus of less than 3 percent of GDP represents the maximum feasible primary surplus for Argentina and the maximum extent of its capacity to service external debt, while Mexico was able to achieve a primary surplus on the order of 7 percent. The focus on the primary surplus also tends to obscure the fact that the overall public sector deficit has to be financed, and that in Argentina's case, it is financed primarily through arrears. Also, the preliminary surplus objective is currently 3 percent of GDP, compared with an earlier objective of 5.6 percent, owing to a downward adjustment for exchange rate considerations. Some explanation on the rationale underlying that adjustment would be appreciated.

I note that when it comes to its own obligations, the Fund seems to take a broader, more traditional view of Argentina's capacity to repay, which includes the strength of the balance of payments and the Central Bank's reserve position, but makes no mention of the size of Argentina's primary surplus.

As to financing assurances and Argentina's relations with its commercial bank creditors, this chair has always considered progress in negotiations with commercial banks to be an important element in its ability to support Argentina's use of Fund resources. While the dialogue with banks has continued, it is not clear that progress has been made, at least on the level of payments. This chair has always been reluctant to state "how much is enough," but it is hard to make the case that $40 million a month is sufficient. I understand that the authorities have indicated some willingness to consider increasing the level of payments next year. Could the staff or Mr. Zoccali elaborate on the authorities' intentions and views?

In sum, it should be clear from my remarks that my authorities are not fully satisfied with Argentina's past performance, nor with the progress in commercial bank discussions. Their support of the modifications of the program and the completion of the review is based on the view that the Fund-supported program has helped Argentina improve its policy performance, and not on the view that the program is either particularly successful or strong.

As the staff report makes clear, one of Argentina's most important medium-term objectives is to achieve a meaningful debt and debt-service reduction. My authorities strongly support this objective. However, it is difficult to see how Argentina will be able to muster the necessary domestic resources and international support without substantial improvement in its policy performance. It is hoped the next review will confirm a sustained improvement in Argentina's adjustment effort and provide stronger evidence of progress in negotiations with commercial banks. I support the proposed decisions.

The Chairman said that Mr. Dawson's observation with respect to the late issuance of the background paper had been duly noted. By way of explanation, the greater the Fund's involvement in supporting the difficult, complex programs of member countries, the greater was the desire on the part of the staff to provide to the Board the fullest information on recent developments. Consequently, the work of finalizing staff papers had become even more complex. Of course, the staff would try to issue background documentation on a more timely basis in the future.

Mr. Kafka remarked that Mr. Dawson's comparison of the targeted size of Argentina's primary surplus with that of Mexico was of particular interest. To make such comparisons meaningful, one factor that had to be taken into account was the nature of government in different countries. Some governments were, for various reasons, able to make their will prevail in a fashion which other governments were not able to do because they had to negotiate with a strong parliament or congress.

Mr. Dawson said that he agreed with Mr. Kafka's observation. His own authorities had encountered that difficulty themselves. He noted, however, that the concept of primary surplus was rarely applied to the U.S. deficit.

Mr. Marino made the following statement:

The recent experience with the stabilization measures adopted by the Argentine authorities last September is encouraging. The rate of inflation has decelerated, a significant trade surplus has been achieved, international reserves are growing, the demand for money is recovering, tax revenues are improving, and the public sector has been able to cover payments to external creditors. These achievements are indeed remarkable considering the setbacks suffered by the adjustment program introduced in July 1989 and, more generally, in view of the many attempts that Argentina has made to stabilize its economy. The turnaround in the inflation and balance of payments performance attests to the swiftness with which transactors respond when there is a perception that the policies adopted by the authorities are consistent and viable. However, as is painfully evident from previous stabilization episodes, the response of economic agents is even quicker when policies are perceived to be inconsistent and unsustainable. Therefore, the most important message that this chair could convey to the Argentine authorities is the great value of sustained policies and perseverance with adjustment measures.

Accordingly, this chair welcomes the authorities' recent efforts to deepen their adjustment measures by fortifying the traditional pillars of stabilization through fiscal strengthening, a bold privatization effort linked to external debt reduction, a comprehensive deregulation program, and trade liberalization.

On the fiscal front, it is encouraging to see that the aim for the fourth quarter of 1990 is to achieve a primary fiscal surplus that will be sufficient to cover programmed payments to external creditors and allow for the accumulation of international reserves as contemplated under the program. However, it is cause for concern that the source of the increase in the primary surplus will be mainly the public enterprises, based on the assumption that the newly established monitoring and control procedures will be applied effectively and yield good results. It can be somewhat risky to rely heavily on untested monitoring procedures. Perhaps the staff could indicate how the new monitoring procedures have worked in September and October and what contingent actions will be taken if the procedures do not give the expected results.

In view of the tight internal and external financing constraint that the Government will face for some time owing to the debt conversion operation at the end of 1989 and the status of relations with commercial bank creditors, the authorities' decision to focus on the primary fiscal surplus as perhaps the only instrument still available to use as an anchor in the system is adequate and realistic. In this regard, the considerable turnaround expected in the primary balance from a deficit of one half of one percent of GDP in 1989 to a surplus of 3 percent of GDP in 1990 is welcome, although it is lower than the target established last May. Along these lines, I wonder what level of primary fiscal surplus is implicitly assumed in the projections for the medium-term scenario that would signal to transactors that financial policies are sustainable. Perhaps the staff has explored the use of the methodology proposed in a recent paper issued by the Research Department on the domestic public debt of externally indebted countries to obtain a benchmark figure for the required primary surplus that is consistent with a stable macroeconomic framework.

The broadening of the Government's privatization program with the use of the proceeds earmarked to reduce public debt will undoubtedly help to improve Argentina's fiscal accounts and thus consolidate the required fiscal adjustment. The reduction of debt by $7.3 billion through the sale of ENTEL and Aerolineas is a good example of the potential of the privatization process to help alleviate the debt overhang. These two operations alone represent nearly a 20 percent reduction in Argentina's outstanding debt to banks. If the privatization program for 1991-92 is fully carried out and a similar reduction of external debt is achieved, Argentina will have advanced a long way toward the resolution of its debt problems. With regard to the external sector, I would emphasize the importance of trade liberalization in fostering competition, efficiency, and growth. The discipline that external competition exerts on domestic producers contributes also to achieve the anti-inflationary objective. Therefore, I would encourage the authorities to continue with their trade liberalization efforts, particularly the elimination of the remaining quantitative import restrictions.

As to exchange rate policy, the appreciation of the austral is a matter of concern. However, as Mr. Zoccali has pointed out, there is a need to strike a balance between reserve accumulation and the liquidity that might be injected into the system as a result. Therefore, if the anti-inflationary objective is the first priority, some real appreciation of the austral might be inevitable. As long as the external accounts are strong, the appreciation of the real exchange rate can be tolerated. However, this stance of exchange rate policy can be sustained only if backed by a strong fiscal position--namely, by a substantial primary surplus and by strict adherence to an incomes policy that helps contain wage pressure, such as the forward-looking policy contemplated in Argentina's program.

To conclude, Argentina has made important progress in its stabilization efforts. Its relations with external creditors have improved, the fiscal adjustment is under way, and structural reforms are gaining momentum. However, the results in terms of economic growth will not materialize overnight since investment and savings continued to be depressed. Nevertheless, the authorities have to persevere with a consistent, sustainable set of policies to eliminate the grave problems that have plagued their economy for many years now. With these remarks, I can support the proposed decision.

Mr. Cirelli made the following statement:

Developments since the last review again underline the difficulty of rapidly transforming the economy, eliminating inflation, and restoring the soundness of financial policies. Unfortunately, the strengthening of adjustment measures prior to the request for a modification of the program last May was followed by policy slippages in the months thereafter. These disappointing slippages resulted, during the third quarter in particular, in a weakening of the fiscal accounts and in an acceleration in the inflation rate.

At the same time, it must be acknowledged that much progress has been registered since the beginning of the year. The monetary reform has broken the hyperinflationary mechanism; the privatization program has proceeded expeditiously and will help to alleviate the considerable debt burden--and here, I recognize that the doubts that I expressed in that respect at the last review were broadly unfounded--and, structural reforms, particularly the liberalization of prices and wages, are most encouraging. Moreover, the fiscal measures taken in September are in the right direction and have started to bear fruit, as evidenced by the decline of the rate of inflation in October and again in November to about 5-6 percent.

I agree with the thrust of the staff appraisal and with most of the comments made by previous speakers. As to the main areas of the revised program, more than ever, the success of the adjustment program depends entirely on the authorities' ability to generate a primary surplus consistent with their external obligations. The results achieved so far seem to allow for the servicing of external obligations resulting from the debt to official creditors, the multilateral institutions, and last year's conversion operation in dollar-denominated bonds, but do not allow for the full repayment of other obligations, particularly those to commercial banks. Moreover, the primary surplus includes significant amounts resulting from privatizations, which may not be sustained in the future. Therefore, it seems that the underlying effort has to be strengthened further in the months ahead.

Indeed, in the light of the initial program and the first review, it appears that the fiscal adjustment for 1990 will have been weaker than expected. The primary surplus may reach 2.9 percent of GDP in 1990, instead of an initially envisaged 6.1 percent and a revised objective of 5.6 percent. On the revenue side, instead of an expected increase of 8 percent of GDP, revenues of the nonfinancial public sector will increase by only 1 percent, reaching a level below that prevailing in previous years. On the expenditure side, progress should be better than expected. The bulk of the improvement, however, has resulted from the curtailment of capital expenditures and transfers to provinces, while social security expenses have increased again.

A firmer fiscal policy restraint is therefore crucial. The policy package introduced in September contains encouraging elements: an increase of 30 percent in public sector prices, an extension of the value-added tax to most services, and an increase in its rate. Furthermore, it appears that during the past week, the Government has gained support for the reduction of public sector employment. This will certainly constitute an important task in the future. But I also agree with the staff that some measures that are qualitative in nature need to be implemented with determination, particularly the new monitoring and control procedures for the public enterprises as well as the plans to transfer spending programs to provinces. The success of the program will also depend on the authorities' ability to slow social security outlays and to resist any excessive wage increases in the public sector.

As to monetary policy, the benefits of the monetary reform seem to have by far surpassed its drawbacks. By eliminating the huge deficit of the Central Bank, the reform has suppressed a major source of money creation and the basic mechanism of hyperinflation. The authorities, however, have no access to sources of noninflationary financing, which again underscores the need for a consistent budgetary surplus. On the present course of monetary policy, I agree with the staff that the authorities should maintain the legal reserve requirement at a sufficiently high level, since it is currently the key instrument of monetary policy. Furthermore, the authorities should pursue their objective of developing an efficient capital market in order to replace the Central Bank as the center of the intermediation system.

As regards exchange rate policy, the authorities are now confronted with a sharp appreciation of the austral in real terms to an historically high level. So far, the impact on the external accounts appears to have been limited: the current account is expected to be balanced, and the trade account will reach a surplus of $6.3 billion. This situation could, however, be reversed, with damaging consequences for the economy. For the time being, it appears that the authorities have little room for maneuver; indeed, in the absence of further fiscal efforts, any excessive buildup of reserves cannot but result in money creation. I can, however, understand the authorities' temptation to pursue the buildup of reserves in order to increase confidence in their policies.

One way to counteract the appreciation of the currency would be to pursue forcefully the opening of the economy, thereby raising the low level of imports. The staff report is encouraging with respect to the progress registered so far in the area of trade reform. I would encourage the authorities to implement further plans in this area, particularly to achieve the dismantling of quantitative restrictions. The authorities are to be commended for their achievements in other structural areas. The liberalization of the economy, with complete market-determined prices, including wages and interest rates, will contribute to reduce the major distortions in the economy.

The staff's medium-term scenarios deal with the difficulties facing Argentina in the coming years. It is clear that in the absence of further fiscal adjustment, Argentina will not have the capacity to fully repay its external obligations. The scenarios suggest that in the current circumstances, the most favorable course of action is to pursue the privatization program so as to reduce the stock of debt and proceed to additional debt buy-backs, thus retaining what has been called a "phased approach." Even then, exceptional financing will be needed until the end of the program period. Could the staff comment on the financing envisaged for next year? As the current program expires in February 1991, I would be interested to learn from the staff what course of action is contemplated with respect to the Fund's involvement in 1991.

In any event, a rapid agreement between commercial banks and the authorities will be crucial, and I encourage the authorities to resume actively their negotiations with commercial banks in view of the fact that progress has been modest since the last review of financing assurances. In the light of these comments and, in particular, the wish to see the firm and lasting implementation of financial discipline in Argentina, I can support the proposed decisions.

Mr. Al-Jasser made the following statement:

Argentina has undergone a major transformation since July 1989. Against daunting odds, the authorities have shown considerable determination, and there appears to be a strengthening of the social contract with the various groups affected by the Government's measures. In particular, there has been a perceptible attitudinal change. The once-impregnable state enterprises are being privatized and autonomized. The confidence in the austral is returning. The much-needed adjustment in incomes, although painful, has been recognized as essential and has been accepted.

The Government's ability to quickly make the required changes in policy, while not losing sight of the basic objectives of the adjustment program, augurs well for an eventual economic recovery. As a consequence, over the past six months performance criteria have largely been met. However, inflationary expectations persist, and full confidence in the newly emerging economic management remains fragile. Much remains to be done, and conditions are not yet fully established for a return to sustainable economic growth without inflation. Nonetheless, one can see light at the end of the tunnel.

I broadly agree with the staff's appraisal and share the views expressed by earlier speakers on the need for vigilance against any slippage on the fiscal and credit policy fronts if targets for the remainder of the current arrangement are to be realized. However, there is a need to build upon these steps for a durable future. Weak fiscal discipline remains Argentina's Achilles' heel. Steps taken in early September, although substantial and adequate to meet objectives for end-1990, will need to be supplemented for a longer-term correction. In this context, the process of public sector reform, although commendable, will need to be strengthened.

Since I agree with the staff's appraisal, I will emphasize only a few areas where additional steps are needed to consolidate corrections instituted in September 1990.

Any additional tax measures would be less productive without steps to strengthen tax administration. It would be helpful to know what is holding up compliance by major taxpayers, and whether the Fund's technical assistance can accelerate this process. Moreover, following the extension of the value-added tax to services, what additional steps can be contemplated for revenue generation?

Revenue measures need to be fully supported by an aggressive reduction in public expenditures and a shift in their composition. At this stage, much of the primary budgetary surplus is to be generated by state enterprises. While the upward price adjustment of goods and services by such enterprises may be helpful for the fourth quarter, these measures will not be adequate for the longer run. Steps will be needed to reduce the operating costs of such enterprises. Moreover, a more basic restructuring of expenditures, along with a further cutback in state employment, is called for. In this context, I endorse the staff's call for accelerating the process of transfering expenditures to provincial administration. Similarly, the authorities will need to hold the line on wage increases and other benefits in the public sector.

The floating exchange rate system, which was instituted in December 1989, appears to have helped to protect against flight from the austral and has facilitated the incipient remonetization process. I wonder whether the large real effective appreciation of the austral during 1990 has had, or is likely to have, any effect on Argentina's trade flows. To what extent has this policy contributed to inflationary tendencies? Moreover, it would have been helpful if Argentina's exchange rate policy had been assessed in a regional context. Recent exchange rate developments reinforce my convictions with respect to the use of domestic policies to move to a stable exchange rate as quickly as possible. This should be one of the objectives of the new program.

The central role of regularizing debt-service payments to commercial banks, along with a mutually acceptable reduction in debt and debt service, cannot be overemphasized for Argentina. It is gratifying to note that Argentina has been paying interest to commercial banks. Substantial progress during the planned early 1991 meetings with commercial banks toward reduction of debt and debt-service payments will be essential for the needed acceleration of the adjustment process. I support the proposed decisions.

The staff representative from the Western Hemisphere Department, commenting on the primary surplus and its analytical value, recalled that in the original program, the primary surplus target for 1990 had been 5.6 percent of GDP. In that program, which had been negotiated with the authorities in March, it had been assumed that the debt conversion at the beginning of the year would dampen the remonetization of the economy in 1990. In the event, demand for money had been stronger and had led, in turn, to a greater-than-expected appreciation of the exchange rate and lower-than-programmed revenues from taxes on external trade, which had been somewhat offset by a decline in the austral value of net imports of the public sector. All those factors had produced a lower-than-programmed primary surplus in GDP terms but the appreciation of the currency meant that fewer australs were required to purchase the same amount of foreign exchange. In U.S. dollar terms, the primary surplus target remained unchanged.

The primary surplus was considered to be a target, but the relevant performance criteria were the overall deficit of the combined public sector--including losses to the Central Bank--and the overall deficit of the nonfinancial public sector, the staff representative continued. The primary surplus was a useful concept because it showed the resources that were needed to purchase foreign exchange to meet the objectives for debt-service payments and reserve accumulation. Owing to shortfalls, particularly in the third quarter, the primary surplus was much lower than originally targeted and was expected to average only 3 percent of GDP for the year. As the medium-term scenario indicated, in coming years a higher primary surplus would be needed if the adjustment effort was to be sustained.

As to the effect of privatization on the primary surplus and the treatment of the sale of assets in the budget, it should be noted that although the program for 1990 envisaged a substantial sale of assets--some $600 million, including privatizations--a substantial increase in international reserves had also been targeted, the staff representative commented. In that light, the sale of assets could be viewed as an exchange of fixed assets for international reserves.

The medium-term scenario indicated a need for exceptional financing only through 1993 because it was assumed that by the end of 1993, there would be a comprehensive settlement of Argentina's debt through the sale of assets, enhancements from various sources, and the use of reserves to reduce the stock of debt, the staff representative remarked. Consequently, beyond 1993 no financing gaps were projected for the balance of payments. Moreover, the financing gaps through 1993 were much smaller than in the earlier worst-case scenario, which had assumed that unpaid interest was financed through arrears and that there was no privatization program to help reduce the stock of debt. The staff would be meeting with the authorities in the coming week to begin preliminary discussions on the budget as well as the course of action for 1991 and the medium term.

Fiscal policy was a key, but not the only, anchor of the adjustment program, the staff representative observed. Credit policy was also an important control on nominal variables in the economy in that the Central Bank had stopped extending credit to a number of sectors and discounts were being collected. In that connection, Decree 435, which had been issued on September 1, had transferred effective control of public enterprises to the Ministry of the Economy. A unit had been set up in the Ministry to monitor carefully the operations of the enterprises. In the case of the largest enterprise, the state oil company, operations were being monitored on a daily basis, including the payment of taxes, which had previously been withheld by the company and used as a source of financing. The state oil company had been current on tax payments for the past three months, and the amount of payments was substantial when compared with payments prior to September 1990. Monthly budgeting procedures were also being followed, including expenditure plans tailored to each enterprise. Overall, there was much tighter control over enterprise operations.

Wage policy had been a major source of deviations from the program toward the end of the second quarter of 1990 and particularly in the third quarter, the staff representative observed. The pace of wage increases had since slowed considerably. In October and November, wage settlements had been forward looking, and the guidelines had been adhered to in the public sector. The reorganization of the ministerial departments had begun in the second quarter, and a number of secretarial positions had already been eliminated. In the period ahead, a number of temporary positions would be terminated and thereafter, some permanent positions would be eliminated. The policy would be implemented over a period of a year and would be supported by World Bank financing to settle contracts with those employees that are dismissed.

Similarly, the reform of the social security system and provincial government finances had begun but would take some time and would be financed in part by sectoral loans from the World Bank, the staff representative explained. The proposal for the reform of the social security system, which aimed at making it more actuarially sound, was being reviewed prior to its submission to Congress and was expected to be approved in a few months. In the meantime, benefits would be set in accordance with the system's projected income.

It was true that some 58 percent of central government revenues were earmarked for the provinces, the staff representative commented. Prior to 1988 a similar amount had been transferred to the provinces, but in an ad hoc fashion, and the authorities' intention was to regularize such transfers so as to make them less subject to political factors. As revenues improved, spending programs would be transferred to the provinces, particularly those relating to health, education, and road maintenance to prevent a rise in overall spending.

On other points, following the sharp demonetization in the first two months of the year and the subsequent remonetization to the levels reached around the middle of the year, no further growth in money demand was expected under the revised program, the staff representative explained. The change in the economic growth forecast for the period ahead was not meant to be more pessimistic, but only more cautious and the government revenue projections had been raised accordingly. In that connection, the staff agreed with Mr. Al-Jasser that it was important to strengthen tax administration. The tax reform was currently in place, and the rate for the value-added tax, which was at the center of the tax system, had been raised. The tax authorities had hired a large number of new inspectors, mostly recent university graduates, who had begun to enforce compliance, particularly with respect to the extension of the value-added tax to services.

A good deal of the fiscal adjustment so far in 1990 was on the expenditure side, the staff representative observed. Further reductions in spending were always possible, particularly with respect to investment, as the process of privatization continued and investment outlays shifted from the public to the private sector. In the event, no change was expected in the investment level, but rather a shift in the sources of financing from the public to the private sector in the years ahead.

As to the effect of exchange rate movements on the trade accounts, the trade surplus had in fact increased substantially, in part because of the effect of the decline in incomes and output on imports, the staff representative from the Western Hemisphere Department remarked. Exports had also performed well, and the coming harvest was expected to result in no change in agricultural export volumes. Moreover, exports of industrial manufactured goods had not declined. In recent months industrial activity had picked up considerably, and notwithstanding the increase in domestic demand, there had been no slowdown in industrial exports, which were no longer being subsidized.

The Deputy Director of the Exchange and Trade Relations Department, commenting on the prospects for the Fund's involvement in Argentina in 1991 and beyond, said that consistent with the medium-term scenario of the balance of payments, which postulated debt reduction, a reduced need for exceptional financing, and increased enhancements in the period 1991-93, the staff would be working with the authorities to develop a comprehensive medium-term program that could be supported by an arrangement with the Fund. Of course, the Fund's continued support was conditional on the authorities' success in stabilizing the fiscal position sufficiently to sustain the recent rapid decline in inflation and increased price stability. In those circumstances, the conditions might be established to support an arrangement that aimed at deepening structural reform within a medium-term framework so as to help mobilize the enhancement resources that would be required to refinance the remaining debt to a sustainable level.

On another point, the real appreciation of the exchange rate was largely attributable to monetary tightening and clearly imposed considerable pressure on the manufacturing sector to effect cost containment and discipline, the Deputy Director from the Exchange and Trade Relations Department remarked. In their discussions with the staff, the authorities had emphasized that that outcome was welcome.

Mr. Al-Jasser asked whether the real appreciation was expected to have any impact on trade flows and whether it was having any negative impact on inflationary expectations.

The staff representative from the Western Hemisphere Department observed that inflationary expectations were mainly being affected by the implementation of fiscal and credit policies. The outflows of private capital in the third quarter, for example, were related primarily to the substantial weakening of the fiscal stance. Thus, the appreciation of the currency since September reflected the effect of the fiscal adjustment that had been reinitiated in that month, together with a very tight credit policy.

Mr. Dawson said that he still had fundamental concerns about the staff's focus on the primary surplus, and not only as it related to Argentina. In a number of countries, the primary surplus was clearly being viewed as a "take-it or leave-it" factor in negotiations with external creditors. In fact, it was being used as a ceiling for external debt payments. In the case of Argentina, he was not satisfied that enough attention was being paid to the composition of revenues and expenditures. The basic level of the primary surplus had been revised downward by 25-30 percent, which implied a downward revision in the ceiling on external payments. More thought should be given to the use of the primary surplus as an indicator, particularly as it figured in negotiations with creditors, and the Fund should avoid the perception that it was taking sides in the negotiation process.

The Chairman remarked that Mr. Dawson was correct in calling the Board's attention to the need to avoid a misinterpretation on the part of negotiators of the key indicators of fiscal policy in Fund-supported programs. The Fund had to explain clearly to all parties its views on a member's budgetary target to ensure that it was not seen to be taking a position on debt negotiations.

Mr. Goos said that the design of the Argentine program created a linkage with debt negotiations in that under the program, the authorities could not buy more foreign exchange for debt-servicing and reserve accumulation than was covered by the primary surplus. He had some doubts as to whether the reserve buildup had to be limited to the primary surplus. He, of course, shared the concern that intervention in the market might give rise to excessive liquidity if the public failed to accept central bank paper owing to its previous bad experience with such paper. He wondered whether the staff or the authorities had considered the issuance of special paper with sufficiently attractive features to be accepted by the market. If, for example, the Central Bank issued dollar-denominated paper for open market operations, it could introduce an additional element of discipline with respect to exchange rate policy as well as monetary and fiscal policies.

On a related point, he was not sure that the authorities should aim at such a high reserve target, Mr. Goos commented. There was a certain trade-off between reaching a relatively high reserve target in the short run and the time required to restore overall viability. The external financial constraint could be expected to ease over time to the extent that relations with external creditors were normalized. Of course, if the reserve objective was bolstered by sufficiently credible financial policies, the time span could be shorter rather than longer. In making those points he fully shared Mr. Dawson's concern that the Fund and the authorities should accord utmost importance to Argentina's quick normalization of relations with commercial bank creditors. He was also concerned that the medium-term scenario assumed that Argentina would continue to make only partial payments to the banks not only in 1990-91 but for several years to come.

The staff representative from the Western Hemisphere Department explained that the Government had placed some dollar-denominated paper--the BONEX 1989 series--as a means to convert time deposits and other government bonds in January 1990. Because of country risk, such paper could only be placed at a steep discount--about 50 percent--which implied a substantial debt service on the bonds. In the staff's view, it would be preferable instead to increase the fiscal effort to mop up liquidity and to recover rediscounts, to avoid the cost involved in open market operations. The Central Bank had followed that course with respect to advances made to provincial banks in the past.

Compared with monthly imports, reserves were somewhat high, the staff representative from the Western Hemisphere Department remarked. But debt obligations also had to be taken into account when setting the reserve target. Moreover, some reactivation of the economy was expected, and the current level of imports, which was the lowest in ten years, would increase over time.

The Deputy Director from the Exchange and Trade Relations Department, commenting on the primary fiscal surplus as an indicator of a country's capacity to raise public sector resources for debt service, observed that Argentina presented an extreme case because of the very limited scope for issuing paper domestically. The use of the primary surplus to define public resources for payments abroad also gave rise to difficult issues of burden sharing, including whether it was necessary to devote a significant share of the surplus to acquire foreign exchange for a buildup of reserves or whether a larger share should be used for current interest payments or other payments. Those issues would have to be resolved on a case-by-case basis, and the approach might shift over time in line with a different judgment on burden sharing.

Mr. Clark recalled that the staff had indicated that in the future the primary balance would have to be higher than that for 1990. In view of the program modifications owing to policy slippages in 1990 and the fact that interest rates were higher than the growth rate of the economy, and thus interest costs were increasing faster than the primary surplus, he wondered what were the prospects that the authorities would be able to introduce the policy commitments needed to achieve the primary balance required to meet Argentina's debt service obligations.

The staff representative from the Western Hemisphere Department remarked that although the program had been revised several times and the fiscal targets were not being met, the overall deficit had declined from 20 percent of GDP in 1989 to 3 percent of GDP in 1990, and the primary surplus, which had registered a deficit of almost 1 percent of GDP in 1989, had turned positive and would reach nearly 3 percent of GDP in 1990. Although the results had to be interpreted with caution, there had been an improvement in the fiscal performance, and although not enough, the trend was positive.

Mr. Al-Jasser said that he wondered whether, in determining the appropriate level of reserves for heavily indebted countries, the staff had contemplated the use of a different ratio than reserves to imports; for example, reserves to imports plus debt payments or reserves to payments, including services.

The staff representative from the Western Hemisphere Department remarked that the appropriateness of the ratio had to be considered for each individual case. For Argentina, the current level of reserves was explained in part by the authorities' heavy emphasis on maintaining a high coverage ratio of reserves to the monetary base to prevent sudden movement of short-term private capital.

Mr. Dawson observed that the improvement in the overall operational balance of the public sector was to a considerable degree a result of the debt conversion scheme of 1990, which had involved the forced conversion of bonds. Thus, the improvement was not totally the result of improved performance.

The staff representative from the Western Hemisphere Department remarked that, as he had earlier mentioned, the swing in the overall deficit had to be viewed cautiously. A substantial portion of the deficit incurred in 1989 was due to quasifiscal losses of the Central Bank related to the high interest rates that had been offered to depositors to stem capital flight. In any event, there had been a major improvement in the overall balance as well as in the nonfinancial public sector.

Mr. Yamazaki made the following statement:

> The case of Argentina has certainly tested our judgment most severely. Looking at the history of arrangements for Argentina, it is clear that program reviews have always forced the Board into a corner to make a difficult decision. The Board's response to performance under the current stand-by arrangement is reminiscent of its response to performance under the previous stand-by arrangement with Argentina, which was approved in 1987. The track record under the current arrangement so far is an exact repetition of the stop-and-go record under the previous arrangement. Such repeated failures seriously undermine the confidence of the international financial community in the authorities' willingness to adjust the economy. In particular, the repeated failure in negotiations between the authorities and creditor banks sends a completely wrong signal to the banks and should be avoided by all means. At the same time, it is most regrettable that each time the Board gives positive support to Argentina by making difficult decisions, the authorities' response falls short of expectations.
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> I would like to stress that the lessons of the past should be strictly applied to this review. In particular, the lesson to be drawn from the previous stand-by arrangement is that, after a history of slippage, approval of the program review should be based both on stiffer prior actions by the authorities and on better expectations that such actions will lead to more intensified adjustment efforts.
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> Since I share the fundamental concerns expressed by other speakers, I will refrain from going into the details of Argentina's economic performance. The progress made so far in areas such as the increase in public prices, including energy prices, the extension of the value-added tax to services, and the increase in its rate are encouraging prior actions. The news that

the President will sign a decree in the coming week to eliminate up to 120,000 government jobs is a sign of the authorities' strong determination to adjust.

I welcome these prior actions. However, it is apparent the revised program has been substantially weakened in key areas. It is most regrettable that the program target for the combined public sector deficit has been weakened by about 1 percentage point of GDP compared with the May program target. I also share the strong reservations of other Directors about the substantial weakening of the December performance criteria. All in all, I have strong hesitations in approving this review in the light of past experience.

As to the staff's medium-term scenario, the weakened projections for Argentina's external position in the foreseeable future are cause for great concern. The current scenario projects constant financing gaps of the magnitude of about $3 billion each year between 1991 and 1996. Moreover, those financing gaps were not explicitly projected in the scenario that was provided at the time of the last review. It seems that the deterioration was mainly due to the sharp weakening of the current account. I would be interested to hear from the staff the reason for such a significant deterioration in the external balance.

In view of the weakened external performance projection, I can only express my deep concern about Argentina's capacity to repay the Fund. The prolonged negotiations between the authorities and the private banks on future debt operations are yet another source of concern with respect to financing assurances. Although I recognize the unfavorable factors mentioned above, consideration should be given to the fact that the Fund's support for Argentina's adjustment is needed to avoid the disintegration of the progress achieved so far. Thus, the Board is forced by economic realities to recognize that the cost of nonapproval outweighs the disadvantages of approval of the review. To avoid further repetition of stop-and-go adjustment, the authorities must recognize the need for a more intensified medium-term adjustment program supported by the extended Fund facility and commit themselves to its strict implementation. In view of Argentina's projected weak external position, I would urge the authorities to take further steps.

With these considerations in mind, my authorities, after painful and lengthy consideration, have come to the conclusion that the current review should be completed as proposed by the staff. I can therefore go along with the proposed decisions.

Mr. Obame remarked that further clarifications on two issues relating to the revised program would be appreciated. There was no doubt that the bulk of adjustment in the authorities' program lay on the fiscal side. In that regard, and after the financial slippages that had occurred in July/August, an important policy package had been adopted in early September to bolster revenues and reduce expenditure so as to strengthen the financial position of the public sector. He noted in particular the measures related to the establishment of a firmer timetable for the reduction of public sector employment and to the sharp adjustments in public sector prices as well as those limiting salary increases for all public sector employees. Although those measures were courageous and comprehensive, he wondered whether a primary surplus of the public sector on the order of 3 percent of GDP for 1990, although lower than envisaged in May, was still a somewhat ambitious target. That point was all the more relevant when considered against the staff's statement that "the targeted surplus should be seen in the light of seasonal influences that normally increase expenditure and reduce revenue in the fourth quarter." It should be recalled that the fiscal primary surplus had been only 1.4 percent of GDP in the third quarter. Taking into account seasonal factors and the fact that some of the recently adopted revenue-raising measures would take time to yield their full impact, he wondered whether the sale of assets and the operating surpluses of the public enterprises would be sufficient to achieve the 3 percent target.

It was clear that the program's objectives with regard to the achievement of low inflation and the stabilization of public finances required adherence to a strict wage policy, Mr. Obame continued. In that context, the measures taken, particularly those related to the suspension of automatic clauses in wage contracts and the setting of nominal increases in the public sector wage bill for the last three months of 1990, in line with targeted rates of inflation, were indeed steps in the right direction. However, it should be emphasized that while those measures could achieve positive results, it was unlikely that they could solve the deep-seated rigidities of the wage structure in Argentina. He was therefore pleased to note that the Government was undertaking a comprehensive review of salary scales with a view to achieving a greater differentiation of pay in favor of better-qualified and better-performing personnel. As that review process could be time consuming and subject to possible social and legal risks, he would appreciate further information from the staff on its status. In particular, had any timetable been set for its completion; were some elements of the authorities' plan for a new wage structure already known; and, if so, what obstacles, if any, lay ahead?

In view of the authorities' commitment to maintain the momentum of adjustment, his chair had no difficulty in supporting the proposed decisions, Mr. Obame concluded.

Mr. Wright said that the main thrust of his remarks was very much in line with those of other speakers, particularly Mr. Filosa and Mr. Cirelli, with respect to commending the positive measures that the Argentine authorities had taken, the progress that had been made, and the considerable disappointment at the slippages. More generally, he observed that the revised program was weaker than that approved in May, which had accommodated slippages from the original program. In his view, the Board could not continue to waive performance criteria indefinitely; instead, any future program must address those problems, and the authorities must establish a worthwhile track record. Moreover, the authorities' performance under the arrangement should condition the Fund's attitude toward potential access under any future arrangement, as was consistent with the conditionality attached to the use of Fund resources. He could support the proposed decision on the basis of the efforts that the authorities had made and their commitment to avoid further slippages during the remainder of the program period.

Three points should be emphasized, Mr. Wright considered. The first concerned fiscal policy. He remained uneasy about the extent to which revenue problems reflected difficulties in tax administration or, alternatively, the constraints of the revenue-sharing arrangements with the provinces. He had the impression that revenue sharing was having a damaging effect on central government finances. In that regard, he noted that the reduced expenditure arising from reduced transfers to the provinces did not come close to compensating for the fall in revenue.

The second point, also on fiscal policy, was that although the expected privatization of three railway lines would result in considerable savings of the railway system as a whole, the system remained largely exempted from the requirement that public enterprises should achieve a surplus on their operations exclusive of debt service, Mr. Wright continued. The background paper revealed that the state railway company continued to enjoy substantial transfers from the Central Government to cover losses. He wondered why the railway system continued to be exempted.

As to monetary policy, the high and volatile levels of interest rates over the past two years called into question the quality of the commercial banks' portfolios and perhaps even their viability, Mr. Wright commented. He wondered whether there was an incipient financial crisis within the Argentine financial system or whether such a crisis might already have emerged. He noted from the staff report that financial institutions in liquidation accounted for 50 percent of central bank claims on the financial system, and that bankruptcy proceedings were to be initiated for financial institutions which failed to settle their debts. He wondered what impact those developments were having on the financial system.

He shared the concerns that other Directors had expressed about the high level of the real exchange rate, Mr. Wright remarked. In the future, the authorities either must be able to achieve a greater adjustment than they had managed so far--including a significant reduction in wages--or face a severe loss of competitiveness. Alternatively, a further depreciation of the austral would risk setting off an inflationary spiral once again. Those considerations should figure largely in the authorities' thinking.

Some Directors had questioned whether the authorities' reserve target was too high, Mr. Wright recalled. He understood from the staff report that there had been a large drop in reserves--on the order of $600 million--between June and September. Thus, there appeared to be a short-run problem as well as a long-run problem. He would be grateful for the staff's comments on that point.

On debt management, he agreed that the best policy was the gradual reduction of commercial bank debt through debt-equity swaps associated with privatization and, in the longer term, with phased debt-reduction operations, Mr. Wright said. The accumulation of sufficient enhancements to undertake meaningful debt reduction would be a long-term process. That would give the Fund and the World Bank an opportunity to monitor the adjustment process in Argentina and give the process a chance to take hold. He very much agreed with other speakers that the authorities must keep the lines of communication with the commercial banks open. He welcomed their intention to make partial interest payments on commercial bank debt as well as the suggestions made earlier that those payments were likely to be increased to the extent feasible.

Mrs. Sirivedhin made the following statement:

> The Argentine economy has experienced almost anything but stability in the recent past. For many years, Argentina has been attempting painfully to solve the problems of grave economic distortions in resource allocation, wide internal and external financial gaps, and a deterioration in the standard of living. Only recently have those efforts begun to show some results. It is encouraging that following the corrective measures taken by the authorities in the first quarter of 1990, performance criteria for end-June 1990 with respect to the Central Bank's net domestic assets and the target for net international reserves were observed with a large margin. Inflation has been brought down drastically. The confidence of domestic as well as international economic agents in the economy is improving as reflected, inter alia, in the substantial general holdings of austral-denominated deposits and in the external direct financing of privatization. These developments confirm that adjustment measures aimed at allowing the economy to work under the market mechanism lead to a more efficient allocation of resources, reduce distortion, and lay the foundation for economic agents to move toward improving efficiency and the standard of living.
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> It is unfortunate to note, however, that in the third quarter of 1990, the economy again witnessed the consequences of policy slippages. It is particularly regrettable that half of the

performance criteria for end-September 1990 were missed by a wide margin. The fiscal situation weakened considerably in July and August, partly owing to continued delays in extending the coverage of the value-added tax to services and in putting into effect measures to improve tax administration. Efforts to bring the public enterprises under the full control of the Ministry of Economy were impeded by administrative problems. At the same time, inflation continued to be high and the process of remonetization came to a halt. External arrears on debt, other than medium- and long-term commercial debt, increased by over $100 million, instead of declining as programmed.

On the external program, I welcome the authorities' plan to suspend export promotion schemes and to reduce export taxes on agriculture products because the very existence of such taxes runs counter to a program specifically designed for export promotion. I am encouraged by the fact that the authorities have made partial interest payments to commercial banks on medium- and long-term debt since June 1990. As reserves at the end of 1990 are expected to cover almost six months of imports, I wonder whether the authorities are considering to increase their payments.

As to the revised program, the objectives for the remainder of the year are to bring inflation to a low level and to assure a satisfactory balance of payments. I agree with the authorities and the staff on the importance of public sector policies to avoid a resurgence of inflation, and on the choice of fiscal policy as the cornerstone of the program. Argentina's experience in the third quarter of 1990 shows that the fiscal component of the program is a major determinant of the success of the whole stabilization strategy. After all, slack fiscal discipline, together with a somewhat loose monetary stance, had allowed the resumption of high inflation and less than satisfactory performance. Therefore, it is clear that stronger efforts are needed to tighten fiscal expenditure and to improve revenue. To this end, I welcome the authorities' most recent measures in both areas.

At the same time, I wish to call the authorities' attention to the risk that the implementation of the revised program might be obstructed not only by the strong complementarity between the various measures, but also by the need to establish confidence in all sectors of the economy. No doubt the planned reduction of the fiscal deficit is necessary. Nevertheless, I have some concerns that fighting inflation through fiscal retrenchment could result in economic contraction and penalize the poor.

The recent increase in fuel prices will certainly yield a large dividend to the Treasury, but it will also put inflationary pressures on the economy through increased production costs. In addition, the rationalization measures outlined in the revised program to reduce expenditure on public sector employment are somewhat ambitious and will certainly increase unemployment. Since the employees who are dismissed are usually the less skilled, the program may ultimately increase the number of the poor. Therefore, it is crucial for the Government to continue implementing a social program to support the unemployed through, for example, retraining, and to help the poorest segment of the population. In that connection, I am pleased to hear that the World Bank is involved in revamping the social security system.

I note with satisfaction that substantial progress has been achieved in the implementation of the privatization program. I also welcome the authorities' intention to broaden its scope to include the electric company, railways lines, petrochemical industrial complexes, the National Port Administration, and the postal service. However, drawing from the experience of other countries, the process of privatization requires administrative preparation and careful planning as well as substantial financing. In view of the limited availability of domestic financing and somewhat reluctant external funding, the modalities of privatization have to be designed so as to ensure efficiency and productivity gains. The privatization program also has to be monitored very closely. Moreover, this process usually cannot be completed quickly. Consequently, the projected resources owing to the privatization program--some $1 billion by early 1991--appear to be somewhat on the high side.

For a country with a long addiction to wage indexing, the repeated slippages in respect of the Government's wage bill is understandable. I agree with the staff that attempting to raise real wages through catch-up pay awards would jeopardize recent gains on the inflation front. Special wage increases for certain groups such as defense personnel are indeed worrisome because of their possible effects on other groups of public employees. At the same time, I recognize that the Government does not have full control over the level and movement of wages in the private sector. Therefore, I urge the authorities to monitor the development of wage settlements and to ensure that they can be contained within the program targets. In this connection, I note with satisfaction that the Government has suspended the automatic indexation clause in wage contracts and intends to override provisions in current contracts that conflict with its wage norm. In this respect, the cooperation of workers and entrepreneurs will be crucial because the implementation of these policies are not exclusively under government control.

It is unfortunate that owing to economic circumstances, particularly after the forced conversion of domestic debt into dollar-denominated government bonds at the beginning of the year, the Central Bank has been left with only the legal reserve requirement as its key monetary tool. Nevertheless, I would like to emphasize that although the available monetary instruments are limited, monetary policy must be implemented so as to reinforce fiscal policy in achieving a reduction in inflation. So far this year, the Central Bank has lowered the legal reserve requirement in July and August and reversed it to the previous level in September. Adjustments to reserve requirements are not, however, well suited to the day-to-day implementation of monetary policy. Contrary to the objective of enhancing the efficiency of the banking sector, frequent changes in required reserves unnecessarily complicate banks' business calculations. In this respect, I am heartened by the authorities' intention not to change legal reserve requirements throughout the remainder of the program period and to continue to enforce strictly their observance.

Early this year, the authority allowed the market to determine interest rate levels. Since then, interest rates have declined dramatically. I note with satisfaction that despite the declining trend, the authorities have succeeded in maintaining positive real interest rates. It is indeed important to maintain positive real rates to stimulate private savings and drive the process of remonetization of the economy, especially in this period of financial uncertainty.

Based on these considerations, and particularly on the determination shown by the authorities to reinforce their adjustment effort, I support Argentina's request for a modification of its stand-by arrangement.

Mr. Moss made the following statement:

At the time when Argentina's request for a stand-by arrangement was approved, this chair maintained that economic realism forced it to recognize that the costs of nonapproval would outweigh the benefits of approval despite the program's serious drawbacks. Today I can only reiterate this view, while accepting the proposed waiver for nonobservance of a number of performance criteria for the third quarter of 1990 as well as the modification of performance criteria.

This does not mean, however, that our attitude is one of complacency. Far from that. When reviewing Argentina's experience since last May, it is clear that the program suffers not only from weaknesses but also from the authorities' lack of timely action to avoid further slippages. A comparison of the second and third quarters is altogether striking in this regard.

In the spring, the economy reacted favorably to the restrictive fiscal and credit policies adopted by the authorities in the first months of 1990. Inflation was lower than programmed in April, the exchange rate stabilized, and there were some signs of a moderate recovery in industrial output. Fiscal policy was on target, but mainly owing to some temporary favorable revenue developments, which offset the slippages in wage policy. These slippages, together with the fact that inflation failed to decline further after April, should have acted as an early warning to the authorities that a further tightening of credit and fiscal policies was appropriate. Instead, no action was taken during the summer, and both inflation and the fiscal position worsened again. New interest payments arrears occurred, and the austral depreciated further, although not in real terms. It was only in September that the Government responded to these setbacks with a deepening of the adjustment effort. This might still have been a timely reaction for a normal case of economic adjustment, but in view of Argentina's deep-seated problems as well as its long track record of failed adjustment, the country can ill-afford losing precious time to correct slippages.

Ex ante actions rather than ex post reactions are needed to address the failures to meet the program's performance criteria. Even slight deviations with respect to one target should be avoided in the future, especially when they pertain to fiscal policy. As the staff appraisal notes, the success of the program hinges on the capacity of the authorities to strengthen tax administration, to exercise effective control over the public enterprises and the social security system, to limit the demands on the Treasury from the provincial governments, and to adhere to the forward-looking wage policy that has been set for public employees. In most of these areas, however, concrete action has yet to substantiate the Government's good intentions, and I would therefore urge the authorities to act expeditiously. All the more so since the measures taken in the area of the value-added tax--one of the few concrete steps taken so far--will not raise much net revenue as they will be offset in 1991 by lower export tax receipts.

As Appendix IV of the background paper points out, the float of the exchange rate as of December 18, 1989 represented a significant departure from the approaches to exchange rate policy of the previous decade in Argentina. The reason for this drastic turnaround was the inability to support the stable rate with sufficiently tight fiscal policies. I would caution the authorities, however, that a floating rate can imply even worse results when the appropriate fiscal policy stance is found to be lacking.

Indeed, following the fiscal measures taken at the beginning of September, the austral has been appreciating. This upward movement can only be reined in by central bank interventions backed by public sector financial surpluses. If the latter are insufficient, two things can happen. Either the Central Bank continues buying foreign exchange even though purchases are not backed by a lasting increase in money demand, and then the rapid monetary expansion will feed onto wage and price increases. As the staff notes, this policy has so far not been pursued by the monetary authorities. Alternatively, the Central Bank refrains from intervening, with the consequence that the currency becomes overvalued until the market perceives the fiscal policy slippages. A steep depreciation will then occur, fueling once more the deeply entrenched inflationary psychology as well as creating such a degree of exchange rate volatility that all other efforts to open up the economy will be wiped out.

With this latter point especially in mind, I would be interested to hear the staff's views on Argentina's experience with a floating exchange rate under the stand-by arrangement. In particular, the authorities contend that allowing the exchange rate to reflect market conditions will result in price and exchange rate stability when persevering with the adjustment process. Could this not be achieved sooner with a more stable regime, in view of Argentina's previous experience and assuming the authorities' fiscal policy stance to be credible? Is appreciation of the austral by almost two thirds in real terms between March and September rational and advisable at a time when private capital outflows evidence a lack of confidence? Is the staff satisfied with the authorities' explanations for maintaining a high level of reserves when the exchange rate is floating? Finally, what will be the effect on the trade account of opening up the economy to foreign competition when bouts of substantial overvaluation are still to occur?

Because Argentina's economic program is subject to considerable risk, every effort should be made to avoid slippages, not only in fiscal policy but also in wage policy, where more needs to be done. Granted, wage policy efforts have been sizable and real wage levels are low, but the situation is so serious that extreme care has to be taken not to give in to attempts to increase real wages on the basis of historical comparisons. The only comparison that counts for the moment is the program target, and in that respect, the wage bill still exceeds the targeted 2.9 percent of GDP.

As to the medium term, I would appreciate the staff's comments on whether the growth estimate needed to be revised downward for the whole of the medium term, solely on the basis of a longer response lag for the economy to structural changes. Also, I wonder whether the assumptions on the external environment have significantly changed since the Gulf crisis.

There was little in the staff report on the private sector in Argentina, which is undoubtedly the core element for a resumption of growth on a sustained basis in any country. Today's discussion was, after all, also an Article IV consultation, dealing not exclusively with debt problems. If the background paper proves me wrong, I would have liked to consult it somewhat earlier than less than 48 hours before the meeting, and in that respect, I associate myself with Mr. Dawson's remarks. With these comments, I wish to express the hope that the Argentine authorities will succeed in keeping the adjustment program on track as well as in reducing their external debt in order to pave the way for a successful growing-out-of-debt strategy along the lines of the second medium-term scenario.

Mr. Spencer made the following statement:

It is evident from the staff report that Argentina remains in a difficult and fragile situation. It is unfortunate that, once again, Argentina is requesting a waiver for the nonobservance of performance criteria. The evident lack of commitment to a consistent policy strategy can only erode the credibility of the overall economic program, making it increasingly difficult to break down Argentina's entrenched inflationary psychology. Furthermore, if Fund conditionality is not preserved in such circumstances, there is a grave risk that incentives for firm corrective policies will be undermined--both in Argentina and in other countries making use of Fund resources.

Nevertheless, as discussed at the time of the first review in May, setbacks will be inevitable in countries which are attempting to overcome protracted economic problems. In such cases, it makes no sense for the Fund to penalize temporary reversals to the extent that an ongoing adjustment program may be put at risk. The staff is clearly of the view that the Argentine authorities have restored sufficient policy momentum for the program to achieve ongoing improvements in economic performance. Moreover, the modification of the stand-by arrangement to exclude the September purchase represents a clear element of conditionality. On balance, and notwithstanding some real doubts about the prospects for consistent implementation of the program, there is sufficient ground for this chair to support the modified arrangement and the proposed decisions.

As to specific aspects of the revised program, the key elements are clearly those policies aimed at achieving nominal stability in the economy--namely, a sustained reduction in inflation. Policies aimed at improving economic efficiency by freeing up the price mechanism will inevitably be swamped by major price distortions so long as hyperinflation is allowed to persist.

The disinflation effort clearly starts with fiscal policy and the primary surplus target. As discussed at the May review, the main weaknesses of the fiscal strategy have centered on the actual collection of government revenues and the containment of the public sector wage bill. New moves since September to tighten policies in these areas are encouraging, but experience suggests that revenues and the fiscal outturn will remain vulnerable.

The setting of indicative fiscal targets for major components of government revenue is a useful device for focusing attention on some of these key policy outcomes. Future trends in real public sector wages and employment levels will also be important sign-posts for success in controlling the public finances. Certainly these indicators will be examined closely in the third review in January.

The other main contributor to the disinflation effort is monetary policy. As discussed at the recent Board seminar on exchange rate policy, monetary policy and exchange rate policy must be seen as part and parcel of each other. Furthermore, it was agreed that each country review should consider what was the best exchange rate/monetary policy approach to meet the particular characteristics and objectives of the country. It was acknowl-edged, in particular, that policies would need to be modified to meet the different emphases that might be placed on financial stability versus external adjustment objectives. My concern with respect to the staff report on Argentina is that the trade-off between these objectives is hardly acknowledged and is certainly not discussed.

The approach to monetary policy adopted in the program seems to be based on a stable money base, with injections through reserves accumulation being limited to the extent of withdrawals through the primary fiscal surplus. It may be that such an approach will provide the monetary anchor that is intended while at the same time remaining consistent with the external balance objectives. But in fact, there is no guarantee at all that this policy approach will perform any better in this regard than the exchange rate peg adopted in late 1989. What will happen, for example, if the proposed monetary prescription leads to a massive real appreciation of the exchange rate and a collapse of the traded goods sector? Presumably, the monetary rule would be modified to rebalance the two objectives in the light of the various monetary indicators--M1, M2, interest and exchange rates, asset prices--and their relationships with both the external accounts and inflation.

It would certainly seem appropriate to make use of any historical relationships of this sort to set up indicative targets to help keep monetary and exchange rate policy in line with the ultimate inflation and external balance objectives of the program. Of course, it is likely that compromises will have to be made between the two objectives, but it is better that the potential conflicts be identified and discussed before, rather than after, the fact. Failure to do so will simply increase the risks inherent in an already vulnerable program.

My final comment again relates to the mix of policies and the real exchange rate, but from a different perspective. Many country cases have shown that, under a float, a tight disinflationary monetary policy will inevitably put upward pressure on the real exchange rate. In Argentina, such pressure has been evident since early this year, and it will no doubt be necessary to accept more pressure if inflation is to be brought down to levels prevailing in the G-10 countries. The amount of exchange rate pressure, however, will depend critically on the mix of policies and, in particular, on the strength of policies aimed at spreading the burden of adjustment toward the nontraded, or nonexposed, sectors. In this regard, the further removal of protection, real wage restraint, and public sector rationalization--including privatization--can all play a major role in reducing the costs of disinflation, thereby increasing the likelihood of the program's success.

In conclusion, I would strongly urge the Argentine authorities to follow through with their intended program in a methodical and consistent manner. In view of the poor track record to date, it is clear that a sustained period of improved performance will be required to establish policy credibility both in the financial markets and, more important, within the domestic community.

Mr. Clark made the following statement:

This chair can support the proposed decisions, although admittedly, with considerable reservations for reasons that other Directors have detailed. It is disappointing that the Board has again been requested to approve further modifications to Argentina's stand-by arrangement, mainly as a result of policy slippages.

This chair shares the concern that there be no further policy slippages and urges the authorities to move ahead with their policy program, particularly in the areas of tax administration and the enforcement of tax collection. This is essential to reverse the economic deterioration in the country and provide the basis for sustained growth. Moreover, the firm adherence to agreed policies under the current program and further progress on structural reforms are regarded by this chair as a prerequisite to a follow-up program.

The revised program calls for a primary surplus of 4.2 percent of GDP in the fourth quarter, bringing the surplus for the year as a whole to 3 percent of GDP. This would, of course, be a significant improvement over a primary deficit of 0.5 percent of GDP in 1989. However, it represents a scaling back from the 4 percent surplus envisaged in May, and an even greater scaling back from the 6.1 percent primary surplus initially projected under the program.

The current program sets performance criteria only through the end of 1990, although it is expected that Argentina will seek a follow-up program. Moreover, the authorities will soon--if they are not already--be preparing the 1991 budget, and therefore, will be considering the appropriate size of primary surplus.

Against this background of policy slippage and the need to build confidence and credibility, I would like to pose a question to the staff concerning the size of financial adjustment required for the coming year. Obviously, a wide range of factors will need to be taken into account in determining the appropriate size of fiscal correction. However, three come to mind, and I would appreciate the staff's assessment of the importance of these considerations as well as some idea of the size of primary surplus, as a percentage of GDP, that the authorities should be aiming at in 1991 to meet the goals of a low level of inflation, a resumption of growth, and a satisfactory balance of payments.

First, given the objective of reducing inflation, Argentina's sources of noninflationary financing are severely constrained. Its ability to finance government deficits externally is extremely limited, and owing to the debt conversion operation conducted early this year, it cannot borrow on the domestic market for the time being. Thus, it must live within its means, undertake overdue fiscal reforms, and privatize loss-making public enterprises.

Second, the tightening of financial policy in Argentina has led to high interest rates, and recently, to an appreciation of the exchange rate. A large primary surplus in 1991 would allow more scope for an easing of credit conditions without jeopardizing the inflation target. In addition, such a policy could help foster a recovery in private sector activity.

Third, the initial primary surplus target of 6 percent of GDP set for 1990 allowed for substantial, although not full, payment of interest on debt to commercial banks. In the latest staff report, it is noted that the authorities have indicated that they would consider increasing the size of interest payments to banks, as the fiscal adjustment is consolidated and the level of international reserves becomes more adequate. In our view, the authorities should be aiming at increased payments in setting fiscal policy for 1991. An increase in the current minimal interest payments now being made to banks could improve relations with the banks and result in a better negotiating climate.

I wonder whether the staff or Mr. Zoccali could indicate the status of the draft legislation to reform the charter of the Central Bank and how soon the legislation might be passed. This reform, which would make the Central Bank more independent, was included in the staff report on the request for the stand-by arrangement a year ago as part of broader financial reforms that the authorities planned to undertake.

Mr. Goos said that after checking his remarks on the occasion of the first review of Argentina's stand-by arrangement, he found that almost everything he had said then was still valid, particularly with respect to the repeated program slippages and their possible adverse effect on the confidence and credibility of the authorities' adjustment strategy. The fact that the Board was considering the second substantial program revision within a period of six months evoked sobering and worrisome memories of Argentina's history of weak program implementation and unsustained adjustment efforts.

Another major concern in his earlier statement related to the Fund's financing assurances policy, Mr. Goos recalled. He continued to hold the view that the Board was overstretching its current guidelines in the case of Argentina to the extent that those guidelines stipulated that the balance of payments gap needed to be closed within a reasonable period of time. He wondered how long it would be before Argentina's program was fully financed.

Two specific points were related to those concerns, Mr. Goos continued. With respect to program implementation slippages, the discussion on statistical issues in Appendix III of the background paper was striking. According to the staff paper, the statistical data and information in Argentina was apparently so deficient that it was difficult to evaluate economic policies and monitor developments, particularly in the fiscal sector. He wondered how, after so many years of Fund involvement in

Argentina, including the provision of technical assistance, such deficiencies could still persist and why they had not been mentioned in the main body of the staff report. Those questions were all the more pressing because the statistical weaknesses were probably not unrelated to the poor program implementation in the past. In any event, the rectification of statistical problems should be subject to prior action under any successor arrangement with the Fund.

He wished to associate himself with Mr. Dawson's views on the relevance of the concept of the primary surplus, Mr. Goos said. That was a point he himself had repeatedly made in the Board, and he had repeatedly expressed the wish that more focus be placed on the public sector borrowing requirement, which, after all, was strategic to stabilize an economy. In that regard, the reference in the staff report to quasifiscal losses that would arise from increases in interest rates sounded euphemistic. If interest rates increased, there would be a real increase in expenditures, which would place a real burden on the budget.

In his statement Mr. Zoccali had put forward a worrisome assessment, namely, that "until the fiscal adjustment is consolidated, spurts of price, exchange, and financial instability may be rekindled in the future," Mr. Goos observed. He was not sure how that assessment related to the limited scope for domestic financing of the public sector borrowing requirement and, in that context, to the slow pace of remonetization. In his view, those factors should instead strengthen fiscal discipline and thereby assist in the maintenance of price, exchange rates, and financial stability.

The staff representative from the Western Hemisphere Department, commenting on whether the performance criteria placed emphasis on the public sector borrowing requirement or on the primary surplus, remarked that the performance criteria in the fiscal area were the overall deficit of the combined nonfinancial public sector and central bank losses. A waiver for nonobservance of those performance criteria was being requested for end-September.

Mr. Thorláksson remarked that the Nordic countries very much regretted that Argentina had failed to meet the targets set in the spring. However, following the most recent policy slippages, the authorities had introduced new measures, and the initial results had indeed been encouraging. As the budget had often been the weak point in Argentine programs, he was pleased to note that a substantial improvement was aimed for in the budget balance for the fourth quarter. The decisive implementation of declared policy intentions, for instance, with respect to public sector salaries, was called for. Tangible progress in fiscal policy was paramount also for credibility reasons, as such progress would in due course be instrumental in resolving the problem of capital flight, which had been a major factor in Argentine economic development.

With regard to the ambitious privatization plans, it was of the utmost importance that the authorities remain undeterred by any difficulties that might emerge during the privatization process, Mr. Thorláksson continued. The measures that had already been taken, and the plans that had been announced, indicated the Government's willingness to reform the economy.

Nonetheless, performance in the period April-September had been weak, Mr. Thorláksson observed. That clearly gave rise to serious concerns about the future prospects of the adjustment process and the credibility of Argentina's economic policies. In fact, his authorities found a continuation of the original program highly questionable, in view of the weak economic results and unrealized commitments. In view of the most recent adjustment effort and because conditionality was being maintained in relative terms through a reduction in access, his authorities could, although with great hesitation, accept the staff's proposals.

Mr. Hogeweg said that the case of Argentina presented a long succession of good intentions, strong measures, slippages, new good intentions, and so forth. In that way, Argentina continued to struggle with its legacy of severe imbalances, its need for a fundamental structural overhaul of its economy, and its debt burden. The international financial community, both private and official, including the Fund, had to find a way to deal with Argentina. With each slippage and new try, the Argentine authorities lost more credibility.

The measures recently taken were in the right direction and deserved the Fund's support, Mr. Hogeweg considered. It was not clear from the staff report, however, what distinguished the latest attempt from previous ones, so as to assure the Board that it would be sustained. Argentina would have been in a very different situation if all the benefits of previous strong measures had been fully realized and had reinforced each other, without slippages in between.

The solution to keep the current program nominally alive was similar to the previous one, Mr. Hogeweg observed. It was somewhat comforting that the proposed waivers served to enable Argentina to make the purchase relating to end-June, when most performance criteria were still on track, and that a further purchase was being dropped. He hoped that Argentina lived up to the responsibility it took upon itself in requesting such treatment. Likewise, he hoped that no other country would wish to emulate Argentina's track record.

He had great admiration for the large scale and so far successful privatization program in Argentina, Mr. Hogeweg said. He expected the program to contribute significantly to greater economic efficiency and to a leaner, more manageable Government. Moreover, those gains would be lasting. The pace of further privatization might slow down, but policy slippages would not easily reverse the process. At the same time, the debt-equity schemes linked to privatization would contribute to lowering the debt overhang. Such debt reduction made all the difference in the two medium-term scenarios. He missed in those projections the possible interrelationship between debt-equity swaps and other capital inflows for which they might in part substitute.

The negotiations with the commercial banks were central to Argentina's prospects, Mr. Hogeweg considered. The negotiations should provide the financing assurances that the Fund needed to be able to continue to assist Argentina, while the Fund's support of Argentina's program was crucial to the process of normalizing relations between Argentina and its creditors.

The medium-term scenarios suggested that a phased approach to debt reduction, financed by debt-equity swaps and $3 billion in enhancement resources, could eliminate the need for exceptional financing by 1996, when external debt as a percentage of GDP would have been halved to 32 percent, Mr. Hogeweg remarked. He assumed that that figure would serve as the yardstick to judge a future agreement between Argentina and its commercial bank creditors as well as the release of set-asides for that purpose. Again, Argentina needed a very different track record to be able to accumulate sufficient enhancement resources. Waivers on the scale requested by Argentina were not the means to accomplish that objective.

With hesitation, he could go along with the proposed decisions, Mr. Hogeweg commented. In view of Argentina's prolonged use of Fund resources, access in future arrangements, if truly deserved, should be set at a level that allowed for a gradual decline in the Fund's exposure.

Mr. Allouba remarked that he understood the skepticism of some Directors regarding the usefulness of the concept of the primary fiscal balance, but he continued to believe that that concept provided an additional perspective on the underlying fiscal adjustment. He did not see it as a substitute, in terms of presentation, to the aggregate fiscal position but rather as a useful complement. He understood, however, that the concept of primary balance had been used by the staff in an ad hoc manner depending on how it viewed a particular economy. While not necessarily advocating a uniform presentation of the concept in Fund documents, he questioned the usefulness of a completely ad hoc approach.

On more specific issues, the alternative balance of payments scenarios in Table 11 showed, among other things, projected reserve levels with and without debt reduction, Mr. Allouba observed. According to his calculations, reserves would be about $500 million lower if debt reduction was assumed. He wondered whether that figure represented the assumed share of Argentina in the needed enhancement resources. He also wondered to what extent the monetary and price implications of debt-equity swaps had been taken into account in the projections. Were those operations strictly privatization schemes with a minimal inflationary impact because they involved the sale of the Government's stake in domestic enterprises, or did the program of debt-equity swaps to include the sale of nongovernment-owned enterprises, which would have an inflationary impact unless higher domestic monetary emissions were sterilized?

According to reports of data that had been released by the Argentine authorities a few days earlier, the trade balance through October 1990 was significantly larger than estimated in the staff papers, Mr. Allouba commented. For 1990 as a whole, those reports projected a trade surplus of $7.5 billion, or $1.2 billion higher than the staff's revised projections. He wondered whether the staff could confirm those reports and comment on the implications for the balance of payments targets for 1990. He supported the proposed decisions.

Mr. Dai said that he joined other speakers in supporting the proposed decisions. Argentina's economic performance in the second quarter had been generally satisfactory and, except for a small deviation with respect to the target for the nonfinancial public sector deficit, other performance criteria had been observed for end-June. A great deal of progress had also been made in structural reform. However, in the third quarter, a number of problems had been encountered in implementing fiscal policies and, although the external objectives of the program had been achieved, there had been deviations with respect to other performance criteria. As he was in broad agreement with the staff's analysis and recommendations, he wished to make only a few brief comments.

Fiscal policy remained crucial to the success of the revised program, which aimed at bringing inflation down to a low level, assuring a satisfactory balance of payments, and resuming the growth of output, Mr. Dai observed. He was pleased to note that the authorities had taken timely and effective measures to strengthen the fiscal position in early September after its weakening in the third quarter. It was also encouraging that the implementation of those measures had yielded positive results. In October tax revenue had improved significantly and inflation had fallen to its lowest monthly rate in nearly a year. He encouraged the authorities to continue their efforts to implement the relevant policy measures, such as enhancing tax administration and exercising effective control over public enterprises and the social security system. In his view, the Fund's technical assistance in monitoring and controlling the filing and payment of the value-added tax would also help the authorities' fiscal position.

Regarding monetary policy, he welcomed the measures taken by the authorities to maintain a tightened monetary stance, Mr. Dai commented. As indicated in the memorandum on economic policy, to facilitate the development of an efficient capital market capable of channeling domestic savings toward the financing of productive activities, the authorities would continue to promote the market determination of interest rates. He believed that structural reform of the financial system would promote efficiency in the allocation of financial resources.

In concluding, he wished to emphasize that Argentina's economy still faced difficulties, and although there had been policy slippages in the third quarter, the authorities had taken measures to re-establish the momentum of adjustment, Mr. Dai remarked. They had also shown their strong determination to take any additional measures necessary for the success of the revised program. In his view, the authorities deserved the Fund's financial support. He could therefore endorse the modification requested by the authorities.

The staff representative from the Western Hemisphere Department said that the seasonal influences that tended to reduce the primary surplus were expected to be largely offset by the sale of government assets. In the staff's view, the fiscal target should not be considered to be ambitious. As to the burden-sharing arrangements with the provinces, a safeguard against an increase in overall spending provided for the transfer of spending programs to the provinces if the level of central government transfers to the provinces exceeded the level of the past three years.

It was true that in the third quarter there had been a reserve loss, the staff representative continued. The margin that had been built up through June with respect to the target for international reserves had been dissipated largely because central bank purchases of foreign exchange had ceased and the fiscal effort had weakened. There had, however, been no reserve loss in terms of a reduction in gross reserves; rather, the central bank purchases that had been envisaged in the program had not been made.

Fuel prices had been increased in September as a means to sharply reduce the overall financing needs of the public sector, the staff representative observed. Moreover, the increase aimed at facilitating the privatization of oil reserves by raising domestic prices to international levels.

The staff agreed with Mr. Goos that there was considerable room for improving the statistical coverage, the staff representative commented. There had been a substantial improvement over the past year, and the posting of a Fund resident representative had been helpful in that regard.

The major distinction between the revised program and the previous program was the Government's decision to expand the privatization effort which meant that it was putting up assets of significant value for sale to achieve, among other purposes, substantial debt reduction, the staff representative explained. As a result, the need for enhancements was expected to be reduced, and there would be no need for exceptional financing beyond 1993. It was assumed that $400 million of Argentina's own resources would be used for debt reduction in 1992 and $500 million in 1993. Those amounts were over and above the reserve buildup in both of those years. The debt-equity transactions related exclusively to the means of payment for privatized public enterprises, and were not expected to have any monetary impact.

The projected trade balances had been discussed with the authorities and were based on recent data, the staff representative remarked. The staff would, of course, look into any discrepancies between its own projections and those in the article mentioned by Mr. Allouba.

On other points, the proposed charter for the Central Bank had been approved by the Executive Board and had been presented to Congress for review by interested committees, the staff representative commented. The proposed charter was also being reviewed by the private sector at large for comments and suggestions. As Mr. Spencer had noted with respect to the exchange rate, the Central Bank would purchases australes only to the extent that they were brought into the public sector through the generation of surpluses. In the authorities' view, setting the exchange rate and trying to defend it would be more arbitrary than letting the market determine its level. As to public enterprises, it was true that the railroads had the largest financing needs, which were met through transfers from the Treasury. At the same time, the level of transfers had declined substantially as some lines were sold to the private sector. The three lines being sold to the private sector implied a reduction of 15,000 railroad workers out of a total of 85,000. It should be noted, however, that the wages of railroad employees had not been adjusted to the same extent as those of other public sector employees.

The number of commercial banks in Argentina was large, but not as large as a few years earlier, the staff representative from the Western Hemisphere Department remarked. There had already been substantial streamlining, mergers, and liquidations of commercial banks. There had also been serious concern that following the debt conversion operations, commercial banks would face substantial problems and that some large banks might fail. In the event, that outcome was avoided for three main reasons: exemptions had been allowed that diluted the effect of the conversion; there had been substantial retrenchment in the commercial banks as the size of the work force as well as other expenses had declined; and, the substantial fiscal adjustment in the second quarter and again in the past two months had helped inspire some confidence in the system, which in turn had led to reflows of private capital and the injection of liquidity into the system.

Mr. Zoccali said that the comprehensive comments of Directors would be conveyed to his Argentine authorities. In that connection, he noted that the authorities were keenly aware of Argentina's past record of performance. At the same time, they had made great efforts to accelerate the pace of reform, particularly since July 1989. Moreover, they shared Directors' concern about the sustainability of the adjustment effort and had shown their commitment to reform through the constant adaptation of program measures, as well as the implementation of additional measures as necessary to further consolidate the Argentine economy.

He was grateful to the staff for its responses and general observations, Mr. Zoccali continued. He himself would stress the continuity of the authorities' efforts, notwithstanding Argentina's past record. In his view, it was important to take into consideration not only the track record but also the starting point: Argentina had suffered two bouts of hyperinflation in the past 14 months; stagnation and output loss had been severe; and, the significant decline in real incomes had constrained the political room for maneuver. Nevertheless, the authorities believed that clear prior actions had been taken, as reflected and highlighted in the staff appraisal, with which they were in broad agreement. Those actions had been decisive both in respect of demand management as well as structural reform. Moreover, the structural reforms were unprecedented and exhibited heavy reliance on market-determined variables in the economy, with deregulation and the substantial redefinition of the role of the state in the Argentine economy.

As to the authorities' intentions with respect to medium-term adjustment, legislation to support their reform effort had been enacted, including the National Economic Emergency Law, which curtailed subsidies, and the National State Reform Law, which allowed for the redefinition of the role of the State, Mr. Zoccali observed. Future measures based upon that basic legislation would certainly facilitate agreement on adjustment measures to achieve the medium-term viability of the Argentine economy.

The challenge remained to reconcile adjustment goals with efficiency and growth considerations in the short run, Mr. Zoccali considered. Strengthened fiscal action continued to be viewed by the authorities as the core ingredient for restoring financial stability and for sustaining the improvement in the external accounts. Tight credit and money policy had been helpful in that regard, and the incipient remonetization process had increased the effectiveness of monetary policy. At the same time, the remonetization process, although significant, had not been sufficient to completely eliminate the domestic financing constraints. Thus, the possibilities for instability remained. Nonetheless, the objective of maintaining confidence in the economy required the further monetization of reserves through foreign exchange purchases, notwithstanding slippages in the fiscal area. In hindsight, that had been a positive feature in that it had checked the further appreciation of the austral, notwithstanding the fact that this latter development was also contributing to the decline in inflation.

Although primary surpluses had slipped somewhat in the third quarter, all other external disbursements had similarly declined, Mr. Zoccali commented. At the same time, the track record in terms of programmed payment commitments had been maintained. In the context of the current unrestricted foreign exchange market, the structure and size of the supply and demand for foreign exchange underscored the need to deepen the effort to restructure and deregulate markets. The instruments in that regard were certainly limited and there were political constraints. Within the enacted legislation, the authorities had accelerated the implementation of a far-reaching program of privatization, which envisaged the complete deregulation of the oil industry and the full pass-through of energy costs. They consider the continuation of the privatization effort as a key instrument to bring about efficiency gains in the economy and reduce the debt burden to more manageable levels.

The authorities had stressed their intention to continue a dialogue with external creditors on the basis of consistent actions, Mr. Zoccali emphasized. Sustainable interest payments were the key feature that they had stressed in their meeting with the banks. Payments had been made on a monthly basis, and the authorities intended to increase them in line with the primary fiscal surpluses as well as other financing flows that might become available. In that connection, the timely access to set-asides and other enhancements for debt and debt-service reduction also had a useful role to play in normalizing relations with commercial bank creditors as well as for restoring medium-term external viability. His authorities remained open to initiatives that might help to maintain the momentum of the negotiation process, and certainly would do their part to maintain the adjustment momentum.

On the central bank charter, the draft legislation was in fact in Congress and was being discussed at the same time in the relevant committees, Mr. Zoccali remarked. The Director of the Board of the Central Bank was already functioning as if many of the relevant features of the legislation had been enacted. In fact, credit growth had been constrained, subsidies had been eliminated, and rediscounts were being recouped. The intent was to achieve a monetary policy consistent with increasing primarily fiscal balances.

The Chairman made the following summing up:

In reviewing developments to date in Argentina's economic program, Executive Directors noted the problems that the Government has encountered in bringing down inflation and achieving a viable payments position, and they recalled the magnitude of that task. They underscored that weaknesses in the policy stance had contributed to these problems. Moreover, inflationary expectations remained strong, confidence was precarious, and the imbalances continued to be large. Directors were encouraged, however, by the Government's continued demonstration of a strong commitment to the achievement of economic stability and to structural reforms designed to improve the efficiency of the economy, reduce the size of the public sector, eliminate price controls, remove trade and exchange rate restrictions, and restore relations with external creditors.

Following the unfortunate policy slippages in the third quarter of 1990, the policy package introduced in September and October was seen by Directors as further evidence of the Government's commitment. They took note of the adjustment to public sector prices, including large increases in fuel prices;

the extension of the value-added tax to services and the raising of the rate to its legal maximum; the tightening of credit policy; and the slowdown in the pace of wage increases. Directors were of the view that these actions should be expected to lead to an improvement in the fiscal position and thus to a reduction of inflation and a strengthening of the external accounts.

Directors noted that while the initial results of the latest measures have been positive, it will be important to persevere in the implementation of the program. Fiscal restraint continued to be the cornerstone of Argentina's program; a reduction in the size of the government sector and a much stronger public sector savings performance were essential objectives, and Directors stressed that the primary budget surplus should be consistent with Argentina's programmed external debt obligations and targets for reserve accumulation.

Directors expressed satisfaction with the major reform of the tax system that had been enacted. They cautioned, however, that the reform needs to be complemented without delay with measures to strengthen tax administration. They noted that, often in the past, shortfalls in tax collections have been a major source of fiscal imbalances.

Directors observed that the attempt in the third quarter to raise real wages in the public sector, despite falling output and productivity, was a factor behind the acceleration of inflation, and stressed the need for tight adherence to the current forward-looking wage policy.

Directors welcomed the recent decision to raise legal reserve requirements to the pre-July 1990 level. They observed that fulfillment of the objective of reducing reserve requirements and interest rates depended on the evolution of the public finances.

Directors expressed satisfaction with the recently concluded sale of certain state enterprises and welcomed the broadening of the scope of the privatization program that had been announced. Directors expected that this program would result in efficiency gains for the whole economy and viewed the exchange of equity for existing external commercial bank claims on Argentina as an appropriate way to reduce Argentina's external debt. They expressed the hope that it would be possible to consider a comprehensive debt and debt-service reduction arrangement as enhancements for such operations become available and official reserves reach an adequate level. Directors supported the Government's efforts to restore relations with its commercial bank creditors through its regular partial payment of interest since June and were encouraged by the authorities' willingness to consider increasing the level of these payments.

While recognizing the progress that had been made to date in opening the economy to foreign competition, Directors felt that the timetable for reviewing the tariff code and eliminating remaining quantitative restrictions and specific tariffs should be accelerated. The shift in the composition of taxes toward domestic transactions also was seen as a positive step. At the same time, some Directors expressed concern regarding the rise in the real effective exchange rate of the austral in the course of 1990 and the attendant pressure on Argentina's competitive position.

Directors welcomed the continued policy of allowing unrestricted access to the foreign exchange market. They stressed the importance of the authorities' policy of backing purchases of foreign exchange with public sector surpluses, which added urgency to the achievement of a faster paced and more sizable adjustment as well as a further opening of foreign trade.

In approving the review and the modifications of the stand-by arrangement, many speakers noted their hesitations and stressed that Argentina's record of implementation in the remaining months of the program would very much color their attitude with regard to any possible follow-up arrangement next year.

It was agreed that the next Article IV consultation with Argentina would be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Stand-by Arrangement - Review and Modification

1. Argentina has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Argentina (EBS/89/199, Sup. 1) and paragraph 3 of the letter of May 10, 1990 from the Minister of Economy, in order to reach understandings regarding further measures to achieve the objectives of its program and the circumstances in which purchases may be resumed under the stand-by arrangement.

2. The letter, with annexed Memorandum on Economic Policy and tables attached thereto, dated November 9, 1990 from the Minister of Economy of Argentina shall be annexed to the stand-by arrangement, and the letters of October 12, 1989 and May 10, 1990--with the annexed Memoranda on Economic Policy and tables attached thereto--shall be read as modified and supplemented by

the letter of November 9, 1990 with annexed Memorandum on Economic Policy and tables attached thereto.

3. Accordingly, paragraphs 1 and 2(a) of the stand-by arrangement shall be amended to read as follows:

"1. For the period from November 10, 1989 to March 31, 1991 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 736 million, subject to paragraphs 2, 3, 4, 5, and 6 below without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 184 million until May 15, 1990, the equivalent of SDR 368 million until November 15, 1990, and the equivalent of SDR 552 million until February 15, 1991."

4. Moreover, Argentina will not make purchases under the stand-by arrangement for Argentina that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota:

(a) during any period in which the data at the end of the preceding calendar quarter indicate that

(i) the limit on the combined deficit of the nonfinancial public sector and the Central Bank specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(ii) the limit on the cash deficit of the nonfinancial public sector specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(iii) the limit on treasury outlays specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(iv) the targets for change in the net domestic assets of the Central Bank specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(v) the targets for change in net international reserves specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(vi) the limit on external arrears of the public sector as specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, or

(vii) the limit on the external debt of the public sector and the limit on net disbursements of short-term debt of the public sector specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990, are not observed or

(b) during any period after February 14, 1990, until the review contemplated in paragraph 26 of the Memorandum on Economic Policy annexed to the attached letter of November 9, 1990 has been completed and understandings on additional measures that may be needed to attain the program's objectives had been reached, or after such understandings have been reached, while they are not being observed.

5. The Fund decides that the review contemplated in paragraph 4(c) of the stand-by arrangement is completed and that, notwithstanding the nonobservance as of end-September 1990 of performance criteria set forth in paragraphs 4(a) (i), (ii), (iv), and (vi) of the arrangement, Argentina may proceed to make purchases under the arrangement.

Decision No. 9596-(90/166), adopted
November 28, 1990

Exchange System

Argentina continues to retain restrictions on payments and transfers for current international transactions, as described in EBS/90/191. In the circumstances of Argentina, the Fund grants approval, under Article VIII, Section 2(a), of the retention by Argentina of the restrictions evidenced by the external payments arrears, except those on payments of interest on medium- and long-term external public debt to commercial banks and on other debt subject to the commercial bank rescheduling, until December 31, 1990, or the completion by the Fund of the review pursuant to paragraph 4(b) of this decision, whichever is earlier.

Decision No. 9597-(90/166), adopted
November 28, 1990

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/165 (11/26/90) and EBM/90/166 (11/28/90).

2. PAYMENTS RESTRICTIONS FOR SECURITY REASONS - TEMPORARY EXEMPTION FROM PERFORMANCE CLAUSES

1. Notwithstanding performance clauses pertaining to the imposition or intensification of restrictions on the making of payments and transfers for current international transactions, and to external payments arrears, in stand-by, extended, or enhanced structural adjustment arrangements, and until further notice by the Fund, disbursements under such arrangements shall not be suspended because of restrictions and arrears on payments and transfers to the Government of Iraq or persons within the territories of Iraq and Kuwait.

2. This decision shall apply to disbursements made on or after August 2, 1990.

Decision No. 9598-(90/166), adopted
November 26, 1990

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/281, Supplement 1 (11/21/90) and EBAP/90/306 (11/26/90), by an Advisor to Executive Director as set forth in EBAP/90/306 (11/26/90), and by an Assistant to Executive Director as set forth in EBAP/90/305 (11/21/90) is approved.

APPROVED: September 12, 1991

LEO VAN HOUTVEN
Secretary