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THE WORLD BANK

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DEBT - Argentina  
1987-1990

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## OFFICE MEMORANDUM

DATE: July 18, 1990

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi *mm*

EXTENSION: 39378

SUBJECT: Argentina: Citibank

We understand that John Reed and/or Bill Rhodes will be calling you to talk about their recent visit to Brazil and Argentina. We have no specific information on the purpose of their call other than that they wish to brief you on their findings.

Background Notes

Argentina's new standby program with the IMF (approved early June) appears to be on track so far. Mr. Camdessus visited Buenos Aires earlier this month and publicly expressed strong support for the Government's economic program. We know that in private meetings he urged the Government to further strengthen the fiscal adjustment effort.

Partial voluntary interest payments to the commercial banks were started in June at a modest rate of US\$40 million per month. The banks are upset at the low level of these payments; most banks had expected at least US\$100 million (about one-third of the amounts actually falling due on average per month). The total amount of Argentina's arrears to the commercial banks accumulated since April 1988 is close to US\$6 billion.

The most pressing outstanding issue between Argentina and commercial bank creditors, however, at this time is Argentina's waiver request to ENTEL (Argentina's state-owned telecommunications company) creditors for the recently announced privatization deal. Under this deal Argentina will receive US\$214 million in cash and about US\$5 billion (face value) of commercial bank debt paper from the two successful bidders, i.e., Bell Atlantic and a consortium of Citibank, the Spanish telephone company Telefonica and a local Argentine company (Techint) in exchange for 60% of ENTEL's equity. We understand that Citi, one of the larger commercial bank creditors of ENTEL has not yet formally approved the waiver. This delay seems odd in light of the fact that Citi is also a member of a winning consortium in the privatization bidding. It is in our opinion very important for Argentina that the ENTEL deal (the first privatization of a large utility in Latin America since the debt crisis prepared with intensive Bank assistance) goes through and that Citi agrees to the waiver as soon as possible. Argentina is expected to announce the sale of 85% of the equity in Aerolineas Argentinas to a consortium led by Iberia shortly. The agreed sales price is US\$260 million (to be paid in installments) plus US\$2 billion (face value) in commercial bank debt paper.

The Bank has a major program of financial and technical assistance for Argentina and we expect to go forward with new loan proposals to the Board before the end of 1990 provided the macro economic situation continues to improve as now seems possible.

cc: Messrs. Husain (o/r), Choksi, Bery (o/r), Scherer, Moreau, Newfarmer



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 08-Jun-1990 05:18pm

TO: Koji Kashiwaya ( KOJI KASHIWAYA )

FROM: Dennis Flannery, CFSFA ( DENNIS FLANNERY )

EXT.: 80017

SUBJECT: Argentina

Pieter Bottelier, Richard Newfarmer and I attended yesterday's meeting between the Commercial Bank Working Group for Argentina and the Government debt negotiation team. The Fund and IADB were represented by Armando Linde and Cyro de Falco, respectively.

The Government team was led by Central Bank President Gonzalez Fraga and included a fairly large number of officials (including the Central Bank Representative from Geneva, by example). They brought along two partners from Cleary Gottlieb, which have now been engaged to represent them in the negotiations.

Bill Rhodes chaired the Committee for a brief period, but Rima Ayas ran the meeting (an indication of the level of seriousness with which the matter is viewed by Citibank?).

Mr. Gonzalez Fraga started the meeting by giving a pretty good presentation of the Government's economic program, progress to date, near-future expectations, privatization plans and recent economic indicators. He made the case for the Government's only paying \$40 million per month to the banks until the economic plan really takes root and bears fruit. He said that - until more cash was available for application to the external debt problem - the debt conversions associated with the Government's privatization program would be the principal means of debt reduction. He took pains to tell the banks that he personally sympathizes with their frustrations and that he does not expect them to accept the payment plan, but that he hopes they will understand the rationale.

The highlight of the meeting was the banks' insistence that the payment of \$40 million - received on the preceding day - was not sufficient to warrant a resumption of negotiations on a debt settlement for Argentina. It is not clear if they will stick to that position, or if they will be willing to move along with negotiations - even while receiving less-than-desired payments. The banks all expressed their satisfaction with the presence of Mr. Gonzalez Fraga in the economic team, and many of them mentioned how they understood the fragile nature of the economic program. Bank of Tokyo's representative put it very well when he

said that this may be the last chance Argentina has to reach an agreement with its bankers - meaning that if the economic plan collapses, many banks will reach a level of frustration which will lead them to simply walk away from the country and not entertain future proposals to deal with the debt.

Another issue which was aired was that of the privatization program and the poor fashion in which the ENTEL divestiture was being handled. The sentiment was expressed that - if the ENTEL deal is not viewed as a success - the entire privatization effort could be in jeopardy. The banks focused in on the very amateurish way in which the necessary waivers from ENTEL's current creditors have been requested. They made it clear that they would require a more professional handling of that matter if the waivers were to be forthcoming. We later learned that Cleary, Gottlieb are working on that matter and that they hope to have it under control shortly IF THE GOVERNMENT AND ENTEL CAN COORDINATE AND COOPERATE. This is a very important issue - and one in which the Bank can play a key role in resolving.

The banks put the Fund on the spot over their procedure of requiring meetings of the sort that we attended as a means of demonstrating "Progress" on their financing assurances question even when real progress is not being made. (They cited their annoyance at having to generate a gratuitous exchange of correspondence two weeks ago in order to satisfy the Fund's Board on the occasion of the last Argentine review meeting.) In this case it seems clear that no real progress will be possible until the economy of Argentina has recovered sufficiently for the Government to have surpluses available to make meaningful payments to the banks to clear up the arrears and to finance a debt reduction operation. Rima Ayas asked Armando Linde point-blank what they would say to their Board at the next review meeting to assure them on that point, as she felt certain that there would be no true progress in the debt talks by that point. Armando naturally had trouble with the question and - in response - mumbled something about progress on the privatization program sufficing for the time being insofar as it serves to reduce the debt.

CC: Moeen A. Qureshi  
CC: John D. Shilling

( MOEEN QURESHI )  
( JOHN D. SHILLING )

World Bank/International Finance Corporation  
OFFICE MEMORANDUM

DATE: 2-Jan-1989 02:09pm

TO: David R. Bock

( DAVID BOCK )

FROM: Moeen A. Qureshi, OPNSV

( MOEEN QURESHI )

EXT.: 73665

SUBJECT: RE: Argentina

David:

You should tell Bill that I shall be happy to jump in and support the commercial banks in their demand if they begin behaving responsibly and stop playing games. The recent "term sheet" was a scandal and as long as they do not adopt a serious and constructive attitude to the negotiations, it is hard for respectable people like us to appear to be merely debt collectors.



World Bank/International Finance Corporation  
OFFICE MEMORANDUM

DATE: 16-Dec-1988 01:23pm

TO: Moeen A. Qureshi

( MOEEN QURESHI )

FROM: David R. Bock, DFS

( DAVID BOCK )

EXT.: 72942

SUBJECT: Argentina

Bill Rhodes asked me to convey to you the importance that he attaches to further interest payments by the Argentines and his disappointment that --unlike the Fund--the Bank is not pressing the Argentines to make such payments. Bill says that cynicism among the banks run very deep and that he will not be able to get bank commitments unless there is a demonstrated seriousness of purpose by the Argentines in regularizing their relationships with the banks.

Any message you wish me to convey back to him?

CC: Pieter P. Bottelier

( PIETER P. BOTTELIER )

CC: Dennis Flannery

( DENNIS FLANNERY )

David  
You should tell Bill that I shall be happy to jump in  
& support the committed banks in their demand  
if they begin behaving responsibly and stop  
playing games. The recent "time sheet" was  
a scandal and as long as they ~~do~~ do  
not adopt a <sup>(+constructive)</sup> ~~serious~~ attitude <sup>to the negotiations</sup>, it is hard  
for respectable people like us to appear  
to be <sup>merely</sup> debt collectors.

DRB  
12/30

✓  
The World Bank/International Finance Corporation  
OFFICE MEMORANDUM

DATE: 9-Dec-1988 06:08pm

TO: Moeen A. Qureshi  
TO: Pieter P. Bottelier

( MOEEN QURESHI )  
( PIETER P. BOTTELIER )

FROM: David R. Bock, DFS

( DAVID BOCK )

EXT.: 72942

SUBJECT: Argentine Guarantee Request

I spoke to both Marx and Citibank about not sending a formal request for a guarantee at this stage. Marx was happy with this, since he did not want to do it anyway. Rema Ayas reluctantly agreed on the grounds that it would accomplish nothing positive and could produce a negative, formal response that would be more difficult to reverse later. I assured her that we would do our best not to let technical aspects of the design of a guarantee operation delay final agreement on the package. We agreed to stay in close touch without committing us in any way to discuss specific guarantee ideas.

I think we should continue to do our homework on guarantee possibilities, but we should not give any indication to the banks that we are doing so or indicate what sorts of things might eventually be acceptable. At least not for now.

CC: Dennis Flannery  
CC: RICHARD NEWFARMER

( DENNIS FLANNERY )  
( PAPER MAIL )

The World Bank/International Finance Corporation  
O F F I C E   M E M O R A N D U M

DATE: 21-Oct-1988 11:46

TO: See Distribution Below

FROM: Lina Escudero, EXTEU

( LINA ESCUDERO AT A1 AT PARIS )

EXT.: 4600

SUBJECT: ARGENTINA ADJUSTMENT LOAN PACKAGE - VISIT TO THE HAGUE

Hugh Blackman and I met yesterday with Mr. Peter Stek, Director of Foreign Financial Relations, Ministry of Finance and Mr. Ruud Tressers, Director, Multilateral Cooperation, Ministry for Foreign Affairs.

Mr. Stek put the proposed Argentina loan package as a top item for discussion on the agenda. From the discussion, it is clear that the proposed loan package is creating serious difficulties within the Dutch Government. Mr. Stek informed us that the Dutch Government would be asking for a postponement in the presentation of the loans scheduled to be put to the Board on Tuesday, October 25th and that, at a meeting of some of his European counterparts that he will chair the same day, he would be seeking their agreement to ask for yet another delay.

It is increasingly clear that he intends to send specific instructions to Mr. Arlman to voice objections, or at least strong reservations, on both the content and nature of the proposed package (especially in view of what he perceives as insufficient guarantees obtained by the Bank) as well as the process by which the loan package has been agreed with Argentina, particularly with the issue of perceived lack of collaboration with the IMF.

Olivier Lafourcade

DISTRIBUTION:

TO: MOEEN QURESHI

( MOEEN QURESHI @A1@VAX12 )

CC: MARIANNE HAUG

( MARIANNE HAUG @A1@VAX12 )

CC: PIETER P. BOTTELIER

( PIETER P. BOTTELIER @A1@VA

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( FRANCISCO AGUIRRE-SACASA @

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CC: ERNEST STERN

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( ERNEST STERN @A1@VAX12 )

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The World Bank/International Finance Corporation  
OFFICE MEMORANDUM

WBG ARCHIVES

DATE: 13-Oct-1988 06:53pm

TO: Moeen A. Qureshi  
TO: S. Shahid Husain  
TO: Pieter P. Bottelier

( MOEEN QURESHI )  
( S. SHAHID HUSAIN )  
( PIETER P. BOTTELIER )

FROM: Dennis Flannery, DFS

( DENNIS FLANNERY )

EXT.: 72657

SUBJECT: Argentina

STRICTLY CONFIDENTIAL

I spoke this afternoon with Daniel Marx who reported on the meetings with the banks in New York. They met with Chase, Chemical, Citibank, Manufacturers Hanover, and Morgan. They discussed five broad topics: Amount, Credit Enhancement, Menu, Down Payment and Escrow. The following are the salient comments:

Amount

John Reed said the amount provided by the commercial banks should cover needs through June, 1990. Bill Rhodes and the others (except Lew Preston) all said that the amount should only cover needs through the end of 1989. Preston had no comment on the amount.

Credit Enhancement

Preston and Susan Segal said that World Bank credit enhancement will be necessary to do a deal. The others did not seem to feel as strongly on that. Preston said cofinancing would be a minimum, while Segal said that a guarantee would be required.

Menu

Reed said that a Brazil style menu is needed; Preston mentioned the need for debt/equity conversions; and Boyle said that onlending would be needed.

Down Payment

Boyle said that more than \$200 million in down payment is needed to start the process; Reed, Shipley and Segal all said that \$100 million should suffice; while Preston felt that a lower amount could be acceptable.

Escrow Account

They all seemed to find the notion of an escrow arrangement during negotiations repugnant - characterizing it as extortionate. Preston, however, thought it

could be acceptable if it were not at the Fed (presumably, he would prefer MGT). Boyle was the most adamant in his opposition. Rhodes, Shipley and Segal all felt that payments should simply be made as progress is achieved. They said that specific amounts should be released as specific objectives are reached.

All of the banks said that they are concerned about erosion of the base.

Marx has returned to Buenos Aires, but he is hopeful that a meeting will be called for the later part of next week in New York. He said that he is looking to us to provide significant support throughout the entire negotiation.

Marx called me about a half hour after providing the above information to tell me that some of these details had been leaked and that he would like us to guard this information (especially the references to individuals and specific banks) as closely as possible.

CC: David R. Bock

( DAVID BOCK )



25000001  
Mr. QURESHI

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# ***Boards of Governors***

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MEMBERS OF THE PRESIDENT'S COUNCIL

For information.

Marianne Haug

September 27, 1988

LETTER OF DEVELOPMENT POLICY

Buenos Aires  
September 22, 1988

Mr. Barber B. Conable  
President  
The World Bank  
Washington, D.C. 20433

Dear Mr. Conable,

1. In early August, the Argentine Government announced an economic program designed to reduce inflation and thereby stimulate growth. Embracing both stabilization objectives and medium-term goals, the program is intended to curb inflation as well as to help reverse the secular deterioration in saving and investment that has occurred during the 1980s. Even though investment rates have improved in the last two years, the economy still has not been able to recover from the debt crisis and macroeconomic instability of the early 1980s. The substantial reversal in flows of net external resources after 1982 has implied a difficult and prolonged adjustment that must lead to a process of sustained economic growth.

2. The Government's short-term measures constitute a strong program of action that can lead the country away from endemic inflation and towards a more promising future. The short-term fiscal objective is to limit the public sector's financing needs as much as possible to amounts that can be borrowed from abroad, so that total financing is consistent with the monetary policy designed for stabilization. In order to place the economy on this development path, short-term measures are being complemented by structural reforms. In this respect, the Government is implementing an extensive reform program that leads to the integration of the Argentine economy with the rest of the world, the modernization of

the State and to a general deregulation of markets. With these objectives, the Government is moving in the direction of eliminating quantitative restrictions to imports, reforming the industrial promotion incentives and reforming the financial markets to improve the efficiency of private sector activity. Finally, we are committed to improving the efficiency of the public sector's own operations, particularly in public enterprises. Both the short-term actions and the structural reforms constitute necessary elements to secure sustained growth and macroeconomic stability of the Argentine economy.

#### Macroeconomic Goals

3. Early experience with the measures announced in August is encouraging. We expect that the rate of inflation will decrease substantially in coming months. We believe, however, that sustained progress toward our goals of permanently reduced inflation, reduced real interest rates, improved efficiency and increased investment will require additional measures as outlined here.

4. Achieving our near-term fiscal objective implies that the consolidated public sector deficit including the Central Bank's quasi-fiscal deficit will have to be reduced from 4.6 percent of GDP in 1988 to a maximum of 2.4 percent in 1989. Fiscal moderation is essential to attain our goals of a unified, market-determined exchange rate by the end of 1989.

5. Reducing the combined public sector deficit on a cash basis to 2.4 percent of GDP will require a substantial adjustment in the nonfinancial public sector because the quasi-fiscal deficit is determined largely by movements in external and internal interest rates, and is therefore basically outside the direct reach of policy instruments. As external interest rates have risen during 1988 and the Central Bank will absorb the new external debt of the public sector in 1988-89, the quasi-fiscal deficit will increase from 0.3 percent of GDP to 1.4 percent of GDP. This means that the non-financial public sector deficit will have to shrink by more than 3 percentage points of GDP -- from 4.3 percent to 1 percent -- to reach the objective of 2.4 percent of GDP.

6. To accomplish this goal, the Government intends to improve tax administration and collection as well as introduce a new tax reform aimed at broadening the tax base and improving its horizontal and vertical equity. This additional fiscal effort will yield gross additional public sector revenues equivalent to about 1.5 percent of GDP in 1989, of which, about 0.6 percent would be available to the Treasury after revenue sharing with the provinces. An additional 0.6 percent of GDP deficit reduction will be achieved through specific expenditure cuts, equivalent to about US\$500 million, by



national administration and public enterprises. These measures will reduce pressure on domestic financial markets and thus contribute to a reduction in real interest rates which in turn will reduce the quasi-fiscal deficit of the Central Bank.

7. The combined overall public sector deficit of 2.4 percent of GDP for 1989 is expected to be financed by the proceeds of public sector external borrowing equivalent to 1.4 percent of GDP. Given the expected remonetization of the economy in 1989, the projected level of domestic financing (not exceeding 1 percent of GDP) is consistent with the Government's near-term stabilization target of monthly inflation of less than 5 percent. It is also consistent with the objective of avoiding any further crowding out of the private sector. Nonetheless, prudent conduct of monetary policy is of fundamental importance for the success of the plan.

8. In spite of relatively favorable agricultural export prices and vigorous growth of both traditional and industrial exports expected to amount US\$10.2 billion in 1989, we project a modest increase in Argentina's current account deficit from US\$2.4 billion in 1988 to US\$2.6 billion in 1989. Substantial improvements in the country's trade balance of US\$750 million in 1989 -- a 27 percent increase over 1988 -- are more than offset by increases of US\$1 billion in interest payments mainly due to increased interest rates on foreign debt.

9. The Government has begun discussions with its external creditors and intends to have a complete external financing plan for 1988 and 1989 in place by the end of this year.

#### Public Sector Reform

10. Disequilibria in public finances have been a continuing feature of recent Argentine history. In 1975, the deficit reached 15.5 percent of GDP and remained between 10 and 15 percent for much of the remainder of the decade. Foreign borrowing, especially after 1979, financed most of these deficits. The 1982 crisis triggered an interruption in credit flows and caused a significant deterioration of public finance: sharp real devaluations and high international interest rates increased the domestic resources required to meet external interest payments. In 1983, just before the present Government took office, the fiscal deficit was the highest registered in the last 30 years, 16.1 percent of GDP.

11. The Government has been addressing the fiscal problem through across-the-board expenditure restraint, attempts to improve management of the public sector and concerted efforts in the four areas affecting the deficit: central government, relations with the provinces, public enterprises, and social security. The Government

began tax reform efforts in 1985 and an additional package was passed in January 1988. Expenditure measures have affected public sector wages and public investment. To reduce the deficit of the of public enterprises measures have been taken towards increasing tariffs, expenditure control, demonopolization and deregulation of selected public enterprise activities, together with the start of a program of privatization of public sector enterprises. The Government will not make funds available to the provinces beyond those foreseen in the co-participation law, nor will the Central Bank finance the provinces through extension of rediscounts to provincial banks. Transfer to public enterprises will be confined to the funds already earmarked for them. Similarly, the Social Security System will have no recourse to general Treasury revenues.

#### Federal Government

12. In order to facilitate an early agreement on priorities, the Government will submit the 1989 budget to Congress before December 31, 1988.

13. The Government regards restoration of its revenue base as one of the most urgent tasks it faces. Action will be taken both to reduce evasion and improve collection under the existing structure, to reduce leakage under the industrial promotion system and to broaden the tax base, while reducing distortions implicit in the present tax system and in the current system of industrial incentives. To these ends the Government will:

- Immediately move to strengthen the tax administration and audit capabilities of the DGI.
- Develop by December 31, 1988, a medium-term plan of action for the further development of the DGI.
- Request Congressional approval of legislation which increases penalties for tax evasion and which facilitates legal prosecution of tax evaders.
- Improve the auditing capabilities of both the DGI and the Secretariat of Industry to determine abuses under the existing industrial promotion system so that appropriate penalties can be imposed.
- Request passage of the Industrial Promotion Law currently before Congress.



14. These administrative and legislative measures will be accompanied by the development of proposals for tax reform to take effect next year, in part to replace revenue lost with exchange rate unification. The Government will begin immediately the study of a project of tax reform with the objective of increasing total revenues and enhancing the efficiency of the tax system. The project will define ways to increase the tax base. Particular attention will be devoted to a reform of the VAT and excise tax system. The project will be completed by the end of 1988, and will be the basis for legislation to be submitted to Congress by that date. Implementation of the reform will be sought starting July 1, 1989. The design of the tax reform as well as ways of improving tax administration will be elaborated by the Government in consultation with organizations representing the private sector.

#### Public Enterprises

15. The objectives of the Government's program continue to be increasing the quality of services supplied through public enterprises, while securing access to private resources to increase investment and contributing to the reduction of the overall fiscal deficit. To achieve these objectives, the National Government has reorganized the regulatory framework and decision-making structure of the public enterprises sector to clarify the financial relations of the sector to the National Government. Sectoral policies have been placed under the responsibility of the Ministry of Public Works (MOSP), and budgetary and financial control of the enterprises managed by the MOSP has been assumed by a holding agency of public enterprises, the Public Enterprises Board (DEP).

16. Increased accountability of public enterprises requires that they operate in a predictable environment with respect to their tariff levels. This is particularly important if the principles referred to above restricting their access to Treasury finance are to become well-established. Accordingly, at the end of the current policy on public utility rates and fuel prices, the Government will undertake adjustments to maintain prices in real terms. The goal would be to prevent an erosion in the real revenues of public utilities. We consider that in the electric power sector there is a need to improve working margins of federally owned utilities. It is also our intention to adjust relative prices of gas and diesel (gas-oil) to encourage utilization of the former.

17. We shall maintain our efforts to improve the financial planning and management of public enterprises by the following means:

- The DEP will require all enterprises within its charge to develop budgets and performance targets for 1989. The approved budgets and plans will be published by December 31, 1988.



- The DEP will continue its efforts to standardize accounting and information systems among enterprises, as well as improving long-term planning of investments and finances in a consistent fashion.

18. In order to improve operating efficiency and reduce working capital needs of public enterprises, the Government will direct immediate attention to procurement and inventory control practices. To this end, the Government, through the Ministry of Public Works, will develop by December 31, 1988, for enterprises reporting to it, guidelines to increase the competitiveness and transparency of the enterprise procurement process, guidelines on purchase programming and inventory control, and methods for monitoring compliance by public enterprises with the guidelines. These measures will be complemented by continuing reforms of the "Compre Nacional" policies that apply to public sector procurement, with a view to reducing cost and increasing the efficiency and competitiveness of the public enterprises and their suppliers.

19. The Government will give urgent attention to the restructuring of Ferrocarriles Argentinos and the development of an action plan to divide the current operation into specific lines of business (freight, inter-city passenger and suburban passenger). In addition, to ensure that oil exploration activities are protected from continuing fiscal pressure and are consistent with the Government's general policy of encouraging private sector participation, the Executive will sign the Petroplan Decree so that the program can start before the end of the year.

#### Financial Sector Policies

20. The financial public sector in Argentina has traditionally been characterized by the strong participation of the Central Bank in financial intermediation; substantial recourse to the banking system as a source of involuntary public sector deficit financing; and the existence of serious inefficiencies in the operation of certain national and provincial public banks.

21. Central Bank participation in financial intermediation has taken place both through overregulation of the sector and a substantial volume of Central Bank lending through rediscounts. To finance rediscounts and the deficit of the nonfinancial public sector, the Central Bank has imposed heavy reserve requirements and other forced investments on the financial system's deposits. When reserve requirements and forced investments have not been enough, the monetary base has been expanded. Moreover, losses on the lending operations of several public banks -- most prominently the National Mortgage Bank (BHN), the National Development Bank (BNADE) and certain provincial banks -- have eroded their financing base and these banks have therefore become excessively dependent on Central Bank credit.

22. In recent years these problems have resulted in large Central Bank losses (the quasi-fiscal deficit referred to earlier), adversely affecting interest rates and inflation. Financial intermediaries, in turn, have substantially reduced credit to the private sector and become inefficient. They have to charge large spreads to cover high operating costs and losses associated with reserve requirements and forced investments.

23. Particularly in the last two years, the Government has taken numerous measures to rationalize the financial public sector and to strengthen the financial system. These reforms include: (i) a restrictive policy on new Central Bank rediscounts (excluding rediscounts to BHN, the net cash flow of Central Bank rediscounts has been negative during January-August 1988); (ii) streamlined rediscount portfolio administration, including greater transparency (the 1988 rediscount budget has been sent to Congress together with the fiscal budget); (iii) a reduction in subsidies associated with Central Bank rediscounts; (iv) liberalization of interest rates; (v) improvement in regulations and supervision of financial institutions; (vi) deposit insurance for all small-sized deposits; (vii) liquidation of several insolvent intermediaries as well as privatization of others whose administration had been taken over by the Central Bank; and (viii) strong sanctions against overdrafts of the public banks.

24. The Government intends to continue its efforts by taking the following measures:

- Continuing the rationalization of Central Bank rediscounts, including improved accounting, transparency, and a negative cash flow;
- Gradually reducing reserve requirements and forced investments to facilitate access by the private sector to financial resources;
- Establishing a deposit insurance agency for the rehabilitation or liquidation of ailing financial intermediaries;
- Continuing to improve supervision and transparency in the financial system as well as firmly enforcing prudential regulations (particularly on provisions for potential loan losses);
- Restructuring major public banks -- especially BHN and BANADE -- to transform these institutions into self-sustaining financial intermediaries (discontinuing reliance on Central Bank rediscounts and gradually



reducing existing indebtedness with the Central Bank). The Central Bank will continue to restrict rediscounts to BHN only to finance BHN's lending commitments outstanding as of January 1988; a vigorous collection policy -- including automatic foreclosure of loans in arrears -- will be an important source of funds for BHN.

#### Trade Policy

25. Export expansion, efficient import substitution, increased international competitiveness, and overall investment growth in the productive sectors are key elements of the medium-term strategy. The country's poor export performance in the past, while partly caused by external conditions, has reflected a domestic economic policy environment not conducive to export activity. This environment in the past included overvalued and unstable exchange rates, heavy protection for domestic market production and sales, export taxes and other impediments to exports. Recently these policies have begun to change. Since 1985, the Government has pursued a policy to stimulate exports, principally through a high and stable exchange rate policy.

26. During 1987, the Government: (i) transformed the temporary admission regime for imported inputs for exports, extending it to almost all intermediate goods and making it automatic; (ii) removed export taxes for about 800 positions of the export nomenclature; (iii) introduced a general GATT-compatible scheme for indirect tax reimbursement for exports; (iv) improved credit risk assessment in export financing; (v) reduced the production coverage of quantitative import restrictions from 62 to 37 percent of manufacturing production; and (vi) undertook a program to simplify export and import procedures.

27. Since the beginning of 1988, the Government has taken other important steps: (i) transferred authority over iron and steel imports from the General Directorate of Military Industries to the Secretariat of Industry and Foreign Trade, which subsequently removed all quantitative import restrictions on iron and steel, thereby reducing the production coverage of quantitative restrictions to 32 percent; (ii) reduced the production coverage further to 30 percent by removing the import restrictions on agricultural machinery and tractors; (iii) removed all reference prices in line with the application of the GATT customs valuation code; (iv) extended the standard and the special temporary admissions regime to indirect exporters after first introducing a Domestic Letter of Credit; and (v) reduced import tariffs on iron and steel, petrochemicals, agro-chemicals, pulp and some paper products.

28. The Government recently has taken measures to: (i) reduce the production coverage for quantitative import restrictions to less than



18 percent of manufacturing output and to make importation of all other goods fully automatic; (ii) remove export taxes for about 400 positions of the export nomenclature; and (iii) remove tariff exemptions outside the temporary admissions regime. By October 21, 1988, the Government intends to reduce the average tariff rate to 30 percent (on a production-weighted basis) and the maximum tariff rate to 40 percent, thereby also reducing tariff dispersion. In addition, by April 30, 1989, the Government intends to: (i) start the process of transferring all export transactions to the free market exchange rate; (ii) reduce the production coverage of quantitative import restrictions further to 15 percent; (iii) remove a substantial number of export taxes; and (iv) remove export licenses that are neither required by law or international agreement, or not justified on grounds of health, quality control, or environmental protection.

29. Other new measures will include:

- simplification and liberalization of export procedures, especially those affecting small and medium-size firms; and
- development and implementation of a comprehensive international marketing strategy and improvement in the quality of government services for exporters, especially for small and medium-size enterprises.

#### Industrial Policy

30. The objective of the Government's industrial policy is to promote an internationally competitive industrial sector capable of realizing its full export potential. Efficient and competitive industry will increase Argentina's global market share and improve the population's standard of living. Achieving this goal requires that trade reform be complemented with a reform in industrial investment incentives to increase investment productivity. Implementation of macroeconomic and financial reforms is also necessary to mobilize financial resources to undertake the investment.

31. The present provincial and sectoral investment regimes entail a large fiscal cost -- nearly 3.5 percent of GDP -- and do not encourage the most efficient investment. In 1988, the Government sent to Congress a law that would unify the industrial promotion system by abolishing the special provincial and sector regimes.

32. As noted earlier, the Government will request a rapid passage of the above legislation through the Senate and undertake the related measures noted above to reduce the fiscal cost and tax abuses associated with the present incentive regime.

Conclusion

33. I believe you will agree this is an important agenda of measures. The Government fully intends to pursue these measures vigorously. However, our success depends on financial support from your organization. Two sectoral loans -- the Banking Sector Loan and the Trade Policy Loan -- have already been negotiated. In addition, several other investment loans are under preparation. I trust that this program and its implementation constitute an adequate basis for the materialization of these loans.

Sincerely,

Juan Sourrouille  
Minister of Economy

Berlin, 27 September 1988

H.E. Juan Vital Sourrouille  
Minister of Economy  
Buenos Aires, Argentina

Dear Minister Sourrouille,

Ref.: Macroeconomic Basis for Adjustment Lending

1. Following our extensive discussions of the last few weeks, I thought it useful to summarize the Bank's views and understandings of the Government's macroeconomic management and performance targets through the remainder of 1988 and 1989. As we agreed, disbursements under the Second Trade Policy Loan as well as the first Banking Sector Loan require that the macroeconomic environment be consistent with the objectives of the loans. This letter is intended to make more precise our understandings in this regard.
2. Broadly speaking, we would review the macroeconomic environment against two yardsticks: the general quantitative framework for the remainder of 1988 and for 1989 as discussed between us; and progress on the economic policies and measures included in the Letter of Development Policy (LDP) to Mr. Conable dated September 22, 1988. Our understandings in both these areas are elaborated below. Of course, disbursements under the above loans would also depend on satisfactory performance of the specific conditions negotiated under each loan. These conditions are summarized in Annex 1 and Annex 2 respectively, for convenience.
3. As we agreed, the first tranche of the Trade Policy Loan (\$150 million) would be available soon after Board approval and loan signing, once conditions of effectiveness have been complied with and satisfactory evidence of eligible imports has been received by the Bank. We foresee undertaking a macroeconomic assessment early in 1989 to serve as



the macroeconomic basis for release of the first tranche of the Banking Sector Loan (\$200 million) and the second tranche of the Trade Policy Loan (\$150 million). Release of the second tranche of the Banking Sector Loan would require a further macroeconomic assessment in mid-1989.

#### MACROECONOMIC ASSESSMENT IN EARLY 1989

4. The framework of our monitoring for the remainder of 1988 and 1989 will be the fiscal, monetary and balance of payments programs provided to us in the LDP. Within this general framework, the following items are of particular concern to us:

##### A. Fiscal Policy

Public Utility Pricing: Consistent with your policy as articulated in the LDP, and the goal of a slight surplus in the current account of the public enterprises in the fourth quarter of 1988, it is critical that public enterprise savings not be allowed to deteriorate. We would expect the real level of prices adjusted with reference to relevant costs to be maintained at the levels of August 1988.

Transfers to Provinces, Public Enterprises and the Social Security System: We understand that the Government will adhere strictly to its policies in these areas as indicated in para. 11 of the LDP.

##### B. Monetary and Exchange Rate Policies

We understand that the growth of monetary aggregates is planned to be consistent with a target rate of monthly inflation of less than 5 percent (para. 7 of the LDP), and with the Government's announced policy of containing the margin between the official and the free exchange rates to about 25 percent. Exchange rate policy would be conducted in accordance with the Government's stated goals and the objectives of the Trade Policy Loan, namely the maintenance of a competitive real exchange rate for exports.

Regarding rediscounts, we trust that the limitation agreed to under the Banking Sector Loan will be strictly observed. We understand that new rediscounts granted (other than to BHN) will be less than total recoveries (amortization and interest) of previously granted rediscounts (on a cash basis). Rediscounts to BHN will be limited to financing components outstanding in January 1988, provided BHN collection policies remain as agreed. Policies on reserve requirements and forced investments will also be as specified in agreements on the Banking Sector Loan.

### C. Inflation

The viability of the macroeconomic program depends crucially on achievement of your present inflation targets for the remainder of 1988. Accordingly, if monthly rates of inflation in the last quarter of the year make the fiscal, quasi-fiscal and monetary targets unattainable, the Government would consult the Bank in relation to required adjustments of the macroeconomic program. An agreement in this respect would be needed for the Bank to give further consideration to the release of the first tranche of the Banking Sector Loan and the second tranche of the Trade Policy Loan.

### D. Tax Administration and Tax Reform

We understand that the Government is fully committed to proceed vigorously with specific measures to improve tax administration and collection, as agreed. This equally applies to the preparation of new tax legislation aimed at broadening the tax base and increasing revenues to achieve the fiscal targets stated in the LDP (para. 14). From its side the World Bank, as agreed, will support both the administrative efforts and the preparation of new tax legislation through technical and financial assistance. Significant and rapid progress in these areas towards your stated goals is considered essential for the credibility and eventual success of the Government's development program as explained in the LDP. During the proposed macroeconomic assessments in early and mid-1989, we intend to pay careful attention to the progress made. We understand that you plan to submit new tax legislation as required to meet the LDP fiscal objectives for 1989, before the end of this year.

### MACROECONOMIC ASSESSMENT IN MID-1989

5. As noted above (para. 3), release of the second tranche of the Banking Sector Loan will entail a second macroeconomic assessment in mid-1989 in addition to performance under loan specific conditions. This second macro-economic management in 1989 should be guided by the objectives explained in paras. 3-9 of the LDP. The fiscal and quasi-fiscal deficits for the year should not exceed financial support available to the consolidated public sector from abroad (currently estimated at 1.4 percent of GDP), plus benefits from increased monetization which are not expected to exceed one percentage point of GDP. Given our present estimates of the likely outturn for 1988, compliance with these goals will entail additional fiscal measures as indicated in the LDP. Specifically, we would anticipate the following program of additional actions:

- (a) Reform of the VAT and excise tax systems, and improvements in tax administration. In this regard, the critical actions are:



- Performance against the agreed action plan developed for the DGI.
- Restoration of the rate of value-added tax to 18 percent effective January 1, 1989, or measures to provide equivalent increases in tax revenue as of that date. Such alternative measures should be discussed with the World Bank before enactment and should not be in lieu of increasing the base of the VAT or other additional taxes that may be needed to reach overall fiscal targets for 1989, as indicated in the LDP.
- Approval by Congress of the new tax legislation described in para. 14 of the LDP.

(b) Adjustments in the current revenues and current and capital expenditures of public enterprises, central administration and decentralized agencies to yield additional net savings of 0.6 percent of GDP in 1989 over levels shown in the 1989 fiscal program prepared in September.

6. During the first six months of 1989, we understand that the Government intends to maintain a competitive exchange rate for exports and to adhere to the announced policy of exchange rate unification starting in April 1989.

Additional Actions Under the Letter of Development Policy

7. The assessments in early and mid-1989, will also review progress on other items included in the LDP, as follows:

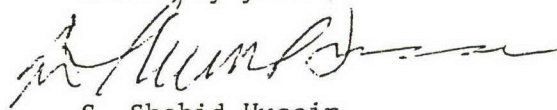
- Reasonable progress on the Government's external financing package for 1988/89.
- Signing of the Petroplan Decree and meaningful progress towards the implementation of a comprehensive restructuring plan for Ferrocarriles Argentinos, as indicated in para. 19.
- Passage of new Industrial Promotion Law: (para. 13 of the LDP).



- Development of guidelines on public enterprise procurement, programming and inventory control: (para. 18). An action plan to develop these guidelines would be prepared by DEP and reviewed by the Bank before their finalization.
- Preparation of Action Plans for the Restructuring of Banco Hipotecario and BANADE (para. 24).

I trust that this helps to clarify these matters.

Sincerely yours,



S. Shahid Husain  
Vice President  
Latin America and the Caribbean

Confirmed

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Juan Vital Sourrouille

Attachments: Annexes 1 and 2

Conditions of Loan Effectiveness and Second Tranche Release:  
Second Trade Policy Loan

Conditions of Loan Effectiveness

1. Reduction of Quantitative Restrictions to no more than eighteen percent of production coverage.
2. Reduction of tariffs to an average of 30% by production coverage, with a maximum rate of 40% subject to certain exceptions.
3. Automaticity of import licenses for an additional 2,000 tariff positions.
4. Satisfactory progress in audits by DGI of beneficiaries under industrial promotion system.

Conditions of Second Tranche Release

1. Reduced Production Coverage of QRS to no more than fifteen percent (and complied with reductions under loan effectiveness).
2. Antidumping measures must be consistent with overall trade liberalization parameters.
3. Production coverage of export taxes on industrial goods reduced to 7.5%.
4. Elimination of all export licenses except those required by law.
5. Development of an audit capability and action plan for SICE's audit of promoted industries.

Conditions of Loan Effectiveness and Second Tranche Release - Banking Sector  
Loan:

A. Conditions of Loan Effectiveness

1. Negative Cash Flow on Rediscounts of Central Bank (except for BHN), starting September 1988.
2. Rediscounts to BHN only to finance previous commitments, and provided BHN foreclosure policy remains as agreed.
3. Submission to Bank of Rediscount Budget for CY 1989 maintaining above policies.
4. Maintain Reserve Requirements at August 15, 1988 levels (3% maximum for time deposits).
5. Freeze stock of all forced investments at August 15, 1988 levels, plus:
  - interest accrued on this stock.
  - any reduction in amount of government bonds outstanding and interest thereon.
6. Finalization of action plans for restructuring of BHN, BANADE, satisfactory to Bank.
7. Circular from Central Bank authorizing consolidation of rediscounts against forced investments.
8. Submission of legislation to Congress Establishing Deposit Insurance Corporation.



B. Conditions of Second Tranche Release

1. Compliance with agreed programs on rediscounts, reserve requirements and forced investments.
2. Compliance with action plans of BHN, BANADE.
3. Compliance with program of consolidation of rediscounts against forced investments.

INTERNATIONAL MONETARY FUND

THE WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL FINANCE CORPORATION    INTERNATIONAL DEVELOPMENT ASSOCIATION  
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MULTILATERAL INVESTMENT GUARANTEE AGENCY

**Boards of Governors • 1988 Annual Meetings • Berlin(West)**

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September 25, 1988

REMARKS BY BARBER B. CONABLE  
AT THE ARGENTINE PRESS CONFERENCE

Ladies and Gentlemen of the Press.

Ten days ago, I travelled to Argentina. On that occasion, I held frank discussions with President Alfonsin and members of the economic team --including Minister Sourrouille-- on the state of the economy and on the Government's plan to put it on a sounder footing. We also discussed the possibility of Bank support for these efforts.

In the wake of my visit, Bank staff and government officials have continued to work on designing a program which will strengthen the country's finances, reduce inflation, streamline its public enterprises, improve Argentina's balance of payments and revive economic growth.

This afternoon, I am pleased to announce that we have reached agreement with the Authorities on such a program. I am also pleased to advise you that, in support of Argentina's program, I am prepared to recommend to our Executive Directors the approval of two sectoral adjustment loans totalling \$700 million. These fast disbursing loans will support reforms in the financial sector and in trade policy. They will also be linked to agreed macroeconomic stabilization measures. Both loans have been negotiated and will move promptly to our Board for consideration and approval.

In addition, we have agreed in principle on two investment loans totalling \$550 million for low cost housing and power development. These will bring total commitments under these four loans to \$1.25 billion.

Let me be blunt. Argentina faces tough problems and an uphill battle to escape the low growth/high debt/high inflation trap it is in. But I am convinced that the program the Government has designed is a major step in the right direction. If executed with perseverance and backed by the international financial community, it will enable the country to improve significantly its macroeconomic performance.

I am confident of the Government's commitment to this program. For this reason, I am recommending this package of loans to our Executive Directors. And on this basis, I call upon other members of the financial community to support Argentina's efforts.

Argentina:

Tramway:

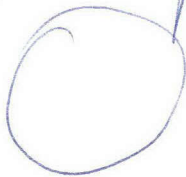
We want to look for avenues to extend the bridge

In contact with B13 -

They are raising substantial complications to using

the World Bank. They are interested in seeing how they can put 107F <sup>back</sup> into the Bridge.

Sting Programme - Earliest possible date of effectiveness in January 31 was pushing it





# OFFICE MEMORANDUM

DATE: September 2, 1988

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi

EXTENSION: 73665

SUBJECT: ARGENTINA: Proposed Strategy

As agreed yesterday, I attach a memorandum from Shahid Husain summarizing the results of his mission and the operational strategy proposed by him. The specific conditions of tranche release and their timing are presented in para. 17 of the memorandum and Annex II.

Attachment

SBery/db

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

# OFFICE MEMORANDUM

DATE: September 2, 1988

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

*P. Bottani  
for Mr. Husain*

EXTENSION: 39001

SUBJECT: ARGENTINA: Principal Findings and Proposed Strategy

## Introduction

1. The mission led by me had four goals:
  - (i) Assessment of the current economic situation and the package of measures announced in early August;
  - (ii) Development of an independent World Bank perspective on the structural factors underlying Argentina's public finance problems;
  - (iii) Renegotiation of the conditions of effectiveness of the Banking Sector Loan (Ln. 2923-AR); and
  - (iv) Negotiation of a second Trade Policy Loan.

As you know, these two loans have, as conditions of effectiveness (and second tranche release), certification that the macro policy environment is acceptable to the Bank.

2. Negotiations were successfully concluded on the two loans. The Bank's view of a medium-term agenda on the macroeconomy was articulated to the Government in the form of a Draft Letter of Development Policy which is attached as Annex I. Agreement was reached on all substantive issues in the Letter of Development Policy, but its finalization will depend on receipt and review of the Government's macroeconomic program for 1989, which was not yet available. As you will see, the LDP deliberately omits references to quarterly targets, to avoid any conflict with possible IMF conditionality.

3. This memorandum reports the salient points of our macroeconomic assessment and the main features of the LDP. It then proposes an operational strategy for the Bank, particularly with regard to the two policy-based loans.

## Economic Assessment

4. The main elements of the economic program announced in August were:



- Creation of a dual exchange rate for trade transactions, with the bulk of exports receiving a lower, government-set "commercial" rate, with imports being converted at a higher free market rate. The implicit export taxation is largely borne by the agricultural sector. Unification of the rate is promised for 1989.
- Imposition of a "voluntary" wage-price freeze, supported by frozen public utility prices and a frozen "commercial" exchange rate until end-September.
- Measures to consolidate debt of the Central Bank to commercial banks so as to reduce cash outflows from the Central Bank on payment of this debt.

5. The essence of the short-term program is to use the revenues from the implicit export tax, together with the build-up of reserves from funds attracted by the short-term exchange rate guarantee (and high nominal domestic interest rates), to make credible the Government's ability to defend its exchange rate and inflation goals. If the public perceives these goals to be credible, (with respect to wage negotiations, money demand and short-term capital movements), the Government hopes that its finances will benefit sufficiently from the reduction in inflation such that, together with the proceeds from the exchange rate differential, the consolidated public sector deficit would no longer be a major source of pressure on the domestic financial and monetary systems. Monetary growth would thereby be consistent with the inflation target of single-digit inflation in the last quarter of the year. The program hinges on the Government being able to "talk down" inflationary expectations on the basis of measures it has taken, and to benefit from the virtuous circle that the reverse Tanzi effect generates. There could be additional anti-inflationary benefits from increased money demand as well.

6. The mission examined the Government's fiscal and monetary program for the remainder of the year. Our conclusions are that the program is internally consistent but fragile and in need of supplementary policy action of a more durable and structural nature, particularly on the fiscal side. The Government takes the view that its program will succeed if it can keep the voluntary wage-price guidelines in force through the end of September, at which point inflationary expectations would moderate. Although major private industries have promised to limit price increases, labor unions may still insist on significant wage increases in September. Since labor suffered real wage losses in July and August, moderation in wage demands in September is not guaranteed. The opposition (Peronist) party, which is closely associated with the labor movement, is apparently not keen to be blamed for the failure of the program. If the wage-price situation were to come unstuck, so would other elements of the program.

7. The Government's most recent projections of the fiscal accounts and the evolution of the sources of monetary expansion imply that the overall public sector deficit will be about 6.2 percent of GDP in 1988 (Table 1). This presumes that the non-financial public sector deficit



Table 1: SUMMARY OF MAIN ELEMENTS OF MACROECONOMIC PROGRAM

(% of GDP)

|                                               | 1988 I | 1988 II | 1988 | 1989 I | 1989 II | 1989 |
|-----------------------------------------------|--------|---------|------|--------|---------|------|
| Nonfinancial Public Sector                    | -4.9   | -3.1    | -4.1 |        |         |      |
| Quasifiscal Deficit                           | -3.6   | -1.9    | -2.7 | -1.2   |         |      |
| Adj: Exchange Rate Gains                      |        |         | 0.6  | 1.3    | 0.6     | 0.9  |
| Combined Deficit                              | -8.5   | -5.0    | -6.2 |        |         |      |
| External Finance                              | 3.2    | 1.2     | 2.2  | 0.7    | 3.3     | 2.0  |
| Domestic Borrowing <u>a/</u>                  |        |         | 4.0  |        |         | 0.0  |
| Necessary Deficit Reduction in 1989 <u>b/</u> |        |         |      |        |         | 3.9  |

a/ Implicit borrowing; the table does not show borrowings by semester because the balance of payments may record flows in different periods than the fiscal accounts.

b/ Reduction in deficit relative to combined deficit in 1988. That is, this is the effort necessary to reduce the deficit over and above the anticipated 1989 exchange-rate gains.

will be 4.1 percent of GDP and the quasi-fiscal deficit will be about 2.1 percent of GDP, after taking into account the fiscal gains resulting from the dual exchange market (0.6 percent of GDP on an annual basis). As the table indicates, there is improvement in both the nonfinancial and quasi-fiscal deficits in the second semester as compared to the first, and the revenue gains from the dual exchange rate (entirely in the second semester) are additional to these gains.

### 1989 Prospects

8. The Government's balance of payments projections (Table 2) indicate that the current account deficit will be about \$2.4 billion in 1988 and about \$2.8 billion in 1989. These projections reflect reasonable expectations regarding export and import performance, as well as realistic expectations of rising world interest rates. The Government anticipates having access to net external financing totalling about US\$ 1.8 billion in 1988 and US\$ 1.9 billion in 1989 (2.2 percent of GDP and 2 percent of GDP, respectively). Our view, shared by the Government, is that at this juncture genuine stabilization requires that the public sector's net financing requirement not exceed what it can borrow from abroad. Given that available external financing in 1989 is unlikely to exceed 2 percent of GDP, and that the Government has committed itself to phase out the multiple exchange rate, it appears that a further adjustment of 3.9 percent of GDP will be required in 1989 over 1988 levels. On the optimistic assumption that the quasi-fiscal deficit will be held within 1 and 1.5 percent of GDP, the requisite adjustment in the non-financial public sector accounts will be on the order of 2 to 2.5 percent of GDP in comparison with 1988 performance. The Government's program for attaining these goals will be reviewed by the Bank in the next weeks (see below, para. 14).

### Structural Issues in Fiscal Management

9. While government expenditure policies have undoubtedly been responsible for much past fiscal excess, these have been compounded by fundamental weaknesses in the machinery of fiscal management. Apart from the Central Government's own finances, the Treasury and the Central Bank have been lenders of last resort to public sector banks, public enterprises, provincial governments, provincial banks and the social security system. Over the last year, the Central Government has taken significant measures to contain recourse to central finances from other parts of general government. Revenue-sharing with the provinces has been regularized through a so-called "co-participation" law; the Treasury has set limits on its transfers to public enterprises and to the social security system; and the Central Bank has imposed sanctions on overdraft and rediscount relationships between itself and public banks.

10. Based on my discussion with the President and the economic team, I believe that the Government is serious about enforcing these new rules, to the limits of its powers. There is need, however, for a continued program of structural measures on public finance, and it was the articulation of such measures that dominated our discussions with the Government on a proposed letter of development policy. We chose to concentrate on three areas: government revenue, public enterprise finances, and Central Bank intermediation operations.

Table 2: BALANCE OF PAYMENTS, 1988-1989

(US\$ Millions)

|                                        | 1988   | 1989   |
|----------------------------------------|--------|--------|
| 1. Exports-Goods                       | 8,855  | 10,240 |
| 2. Imports-Goods                       | -5,900 | -6,400 |
| 3. Balance of Trade                    | 2,955  | 3,840  |
| 4. Non-factor Services                 | -248   | -227   |
| 5. Financial Services                  | -5,089 | -6,390 |
| 6. Of which: Interest <u>a/</u>        | -4,655 | -5,986 |
| 7. Current Account                     | -2,383 | -2,777 |
| 8. Direct Foreign Investment           | 996    | 886    |
| 9. Net MLT Lending                     | 332    | -3     |
| 10. Multilateral                       | 381    | 1,049  |
| of which: IBRD                         | 331    | 999    |
| 11. Bilateral                          | 387    | 180    |
| 12. Commercial Banks                   | -56    | -555   |
| 13. Bonds                              | -380   | -677   |
| 14. Net Short-Term Capital             | -626   | 297    |
| 15. Capital Account (before financing) | 702    | 1,180  |
| 16. Chg in Net Reserves (-increase)    | -1,316 | -1,094 |
| 17. Change in Gross Reserves           | -343   | -334   |
| 18. Other Reserve Changes              | -973   | -760   |
| 19. Net Bonex                          | -330   | -415   |
| 20. IMF net credit                     | 5      | -239   |
| 21. Others                             | -65    | -106   |
| 22. Arrears (net change)               | -583   | 0      |
| 23. Financing Gap (=1. 7+19+20)        | 2,997  | 2,691  |

a/ Assumes LIBOR equal to 8 percent in 1988 and 9.5 percent in 1989.

Source: Central Bank of Argentina.



11. There has been serious erosion of the Government's revenue base over the medium-term, with a particularly sharp drop in the last two years. While some of the deterioration is due to higher inflation, structural factors are also responsible. These include very poor tax administration, a narrow tax base, and the corruption of even this narrow base by substantial tax concessions for industrial promotion. The program proposed in the draft LDP includes immediate measures to strengthen the tax administration and audit capabilities of the internal revenue service (DGI), with particular attention paid to tightening up tax fraud under the existing industrial promotion law. I have offered to assist these efforts with a small technical assistance loan, should this be needed. The Government will simultaneously exert effort to achieve Senate approval of a new (and considerably better) Industrial Promotion Law, while developing proposals for substantial reform of the indirect tax system (paras. 10 and 11 of draft LDP).

12. The agenda of actions to be taken in the public enterprise area is immense, and will need to be supported by a whole range of Bank interventions, such as the forthcoming power sector loan and a public enterprise restructuring loan currently under preparation. In the draft LDP (paras. 13-15) we have received a commitment from the Government that there would be no significant erosion in real tariff levels at the end of the current freeze. Specific goals in the power sector would be elaborated in negotiations of the power loan. We have also attached considerable weight to improvements in the systems of procurement, purchase and inventory management of the public enterprise sector, which are by all accounts a great source of inefficiency and waste. These objectives would be clarified and reinforced in discussions of the proposed public enterprise restructuring loan, to take place in mid-September.

13. Finally, with regard to the quasi-fiscal deficit, considerable action has already been taken by the Central Bank to reduce the net flow of rediscounts, other than those needed for export finance, as well as to capitalize interest on forced investments of commercial banks held with it. The revised effectiveness conditions of the Banking Sector Loan provide for continued strictness of rediscount policy, together with action to restructure the two public banks which have been the biggest source of leakage: the National Mortgage Bank (BHN) and the Industrial Development Bank (BANADE) (para. 21 of LDP).

#### Operational Strategy

14. A proposed sequencing of actions by the Bank on the two policy based loans, and their links with actions to be taken by the government, is indicated in Annex 2. The trigger for Board presentation of the Trade Policy Loan and the revised conditions of effectiveness of the Banking Sector Loan would be final agreement on the Letter of Development Policy. Such agreement awaits presentation to us by the Argentine authorities of their fiscal, monetary and balance of payments program for 1989, and discussion of this program with our staff. The program was not ready when we left Argentina. Bank staff will join the IMF mission currently in Argentina for discussion and assessment of the 1989 program in the week of September 12.



15. Assuming that satisfactory agreement on 1989 is reached in mid-September, I would propose Board presentation of the two policy-based loans, together with the Housing Sector Loan, in mid-october. Assuming further that all loan-specific actions on the Trade Policy Loan were also taken by the Government by that time, the first tranche of that loan (US\$150 million) would be available for immediate disbursement. By contrast, I do not see loan-specific conditions of effectiveness on the Banking Sector Loan being met before December 1988-January 1989. Release of these funds (US\$200 million) would, therefore, require further macroeconomic assessment in January. Progress on tax reform and administration, and on public utility pricing would, inter alia, form part of the macroeconomic assessment. If the Government were able to take the remaining actions on the Trade Policy Loan, its second tranche (US\$150 million) could also be drawn upon concurrent with the first tranche of the Banking Sector Loan. Finally, a further macroeconomic assessment at mid-year would be needed, prior to release of the second tranche of the Banking Sector Loan.

16. As noted already, our policy-based lending would be reinforced by investment lending in the power sector (including a small fast-disbursing component to assist in the completion of DEBA, a power station in the province of Buenos Aires), and for public enterprise reform. In addition, we would proceed toward a technical assistance loan for tax reform, should our dialogue with the Government suggest that such a loan could be useful in supporting their efforts.

17. The timeline and conditionality implied by the above strategy are summarized below, indicating the key preconditions for each major action on the two policy based loans:

|                     |                                                                                                                                       |
|---------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| Mid-October<br>1988 | <u>Board presentation of TPL; revised conditions of effectiveness of BSL; availability of first tranche of TPL (US\$150 million).</u> |
|                     | <u>Preconditions:</u>                                                                                                                 |
|                     | 1. Agreement with Government on its 1989 fiscal, monetary and balance of payments program.                                            |
|                     | 2. Signature of Letter of Development Policy on basis of above.                                                                       |
|                     | 3. Program of trade liberalization measures agreed under TPL.                                                                         |
| End-January<br>1989 | <u>Release of first tranche of BSL (US\$200 million); release of second tranche of TPL (US\$150 million).</u>                         |
|                     | <u>Preconditions:</u>                                                                                                                 |
|                     | A. ( <u>Macroeconomic</u> )                                                                                                           |
|                     | 1. Review by Bank of exchange rate, fiscal and domestic credit developments in 1988 and updated program for 1989.                     |

2. Submission of 1989 budget to Congress.
3. Progress in strengthening tax administration.
4. Submission to Congress of tax legislation to increase tax base, revenue and efficiency.
5. Adjustment of public utility prices to prevent erosion in real terms.

B. Principal Loan Specific Conditions - BSL

- Net flow of rediscounts equal to zero except for loans to Housing Bank which will be within agreed limits.
- Action plans for restructuring of BHN and BANADE.

C. Principal Loan Specific Condition - TPL

- Reduction in QRs to 15 percent production coverage
- Removal of export taxes.
- Removal of export licenses.

July 1989

Release of Second Tranche of BSL (US\$200 million)

Preconditions

A. (Macroeconomic)

1. Review of exchange rate, fiscal and domestic credit developments in first half of 1989 and program of second half.
2. Progress on public utility pricing.
3. Passage of tax reform.
4. Continuing action on tax enforcement and administration.

B. Principal Loan Specific Conditions - BSL

- Adherence to agreed rediscount and reserve requirement programs.
- Adherence to agreed action plans on BHN, BANADE.

Attachments

SBery/PBeckerman:ab/db



DRAFT  
LETTER OF DEVELOPMENT POLICY

August 30, 1988

Mr. Barber B. Conable  
President  
The World Bank  
Washington, D.C. 20433

Dear Mr. Conable,

1. In early August, the Argentine Government announced an economic program designed to reduce inflation and thereby stimulate growth. Embracing both stabilization objectives and medium-term goals, the program is intended to curb inflation as well as to help reverse the secular deterioration in saving and investment that has occurred during the 1980s. Even though investment rates have improved in the last two years, the economy still has not been able to recover from the debt crisis and macroeconomic instability of the early 1980s. The substantial reversal in flows of net external resources after 1982 has implied a difficult and prolonged adjustment.

2. Early experience with the measures announced in August is encouraging. We are optimistic that the rate of inflation will decrease substantially in coming months. We believe, however, that sustained progress toward our goals of permanently reduced inflation, reduced real interest rates, improved efficiency and increased investment will require additional measures as outlined here.

3. Our strategy is to limit the public sector's financing needs to amounts that can be borrowed from abroad, thereby easing pressure on domestic financial markets. At the same time, we are moving in the direction of trade liberalization, industrial incentive reform and financial market reform to improve the efficiency of private sector activity. Finally, we are committed to improving the efficiency of the public sector's own operations, particularly in public enterprises.

Macroeconomic Goals

4. Our principal medium-term objective in fiscal policy is to reduce the combined deficit of the nonfinancial public sector and the quasi-fiscal deficit of the Central Bank to levels compatible with available foreign finance. This fiscal posture would reduce upward pressure on real interest rates and avoid crowding out of private investment. Monetization of any



unborrowed portion would also be avoided. Fiscal moderation will also be essential to attain our goals of a unified, market-determined exchange rate in 1989. The Government intends to reduce the combined cash deficit of the nonfinancial public sector and the effective cash deficit of the Central Bank from about 6.2 percent of GDP in 1988 to 2.0-2.5 percent of GDP in 1989. The main effects of the program will be felt early next year.

5. Prudent conduct of monetary policy is of fundamental importance for the success of the plan. The monetary program for the rest of 1988 is built around the conservative assumption that the demand for money will not increase in real terms for the rest of the year. In addition, the external sector is expected to turn from a strong source of monetary expansion to one of absorption. Credit to the public sector is also expected to decline substantially, reflecting the lighter amortization schedule after September 1988 of the nonfinancial public sector and the expected improvement of the quasi-fiscal deficit, as well as a reduction in nominal interest rates. Growth in Central Bank credit to the public sector would be consistent with the Government's target of single-digit monthly inflation.

6. The Government projects a current account deficit in its balance of payments of US\$2.4 billion in 1988 and US\$2.8 billion in 1989. In addition, the Government wishes to increase its reserves by US\$1.3 billion and US\$1.1 billion in these two years, implying net financing requirements of US\$3.7 and US\$3.9 billion. Approximately US\$1 billion of these requirements are anticipated to be financed each year through foreign direct investment, leaving a manageable financing gap on the assumption that the commercial banks will refinance at least half the interest payments due to them. The Government has begun discussions with its external creditors and intends to have an external financing program in place by the end of the year.

#### Public Sector Reform

7. Disequilibria in public finances have been a continuing feature of recent Argentine history. In 1975, the deficit reached 15.5 percent of GDP and remained between 10 and 15 percent for much of the remainder of the decade. Foreign borrowing, especially after 1979, financed most of these deficits. The 1982 crisis triggered an interruption in credit flows and caused a significant deterioration of public finance: sharp real devaluations and high international interest rates increased the domestic resources required to meet external interest payments. In 1983, just before the present Government took office, the fiscal deficit was the highest registered in the last 30 years, 16.1 percent of GDP.

8. The Government has been addressing the fiscal problem through across-the-board wage and expenditure restraint, attempts to improve management of the public sector and concerted efforts in the four areas affecting the deficit: central government, relations with the provinces, public enterprises, and social security. The Government began tax reform efforts in 1985 and an additional package was passed in January 1988. Expenditure measures have included restraint on public sector wages, reduced public investment, and reduction of deficits of public enterprises through increases in tariffs, expenditure control, demonopolization and deregulation of selected public enterprise activities, together with the



start of a program of privatization of public sector enterprises. The Government will not make funds available to the provinces beyond those foreseen in the co-participation law, nor will the Central Bank finance the provinces through extension of rediscounts to provincial banks. Transfer to public enterprises will be confined to the funds already earmarked for them. Similarly, the Social Security System will have no recourse to general Treasury revenues.

#### Federal Government

9. In order to facilitate orderly and early agreement on priorities, the Government will submit the 1989 budget to Congress before December 31, 1988.

10. The Government regards restoration of its revenue base as one of the most urgent tasks it faces. Action will be taken both to reduce evasion and improve collection under the existing structure, to reduce leakage under the industrial promotion system and to broaden the tax base, while reducing distortions implicit in the present tax system and in the current system of industrial incentives. To these ends the Government will:

- Immediately move to strengthen the tax administration and audit capabilities of the DGI.
- Develop by December 31, 1988, a medium-term plan of action for the further development of the DGI.
- Press for Congressional approval of legislation which increases penalties for tax evasion and which facilitates legal prosecution of tax evaders.
- Improve the auditing capabilities of both the DGI and the Secretariat of Industry to determine abuses under the existing industrial promotion system (including Tierra del Fuego) so that appropriate penalties can be imposed.
- Use its best efforts to ensure passage of the Industrial Promotion Law currently before Congress.
- Take measures to limit the availability of tax incentives for industrial activities in Tierra del Fuego.

11. These administrative and legislative measures will be accompanied by the development of proposals for tax reform to take effect next year, in part to replace revenue lost with exchange rate unification. The Government will begin immediately the study of a project of tax reform with the objective of increasing total revenues and enhancing the efficiency of the tax system. The project will analyze ways to increase the tax base, including possible extension of taxation to agriculture. Particular attention will be devoted to a reform of the VAT and excise tax system. The project will be completed by the end of 1988, and will be the



basis for legislation to be submitted to Congress by that date. Implementation of the reform will be sought starting July 1, 1989. The design of the tax reform as well as ways of improving tax administration will be elaborated by the Government in consultation with organizations representing the private sector.

#### Public Enterprises

12. The objectives of the Government's program continue to be increasing the quality of services supplied through public enterprises, while securing access to private resources to increase investment and contributing to the reduction of the overall fiscal deficit. To achieve these objectives, the Federal Government has reorganized the regulatory framework and decision-making structure of the public enterprises sector to clarify the financial relations of the sector to the Federal Government. Sectoral policies have been placed under the responsibility of the Ministry of Public Works (MOSP), and budgetary and financial control of the enterprises managed by MOSP has been assumed by a holding agency of public enterprises, the Public Enterprises Board (DEP).

13. Increased accountability of public enterprises requires that they operate in a predictable environment with respect to their tariff levels. This is particularly important if the principles referred to above restricting their access to Treasury finance are to become well-established. Accordingly, at the end of the current freeze on public utility rates and fuel prices, the Government will undertake adjustments to maintain prices in real terms. The goal would be to prevent an erosion in the real revenues of public utilities. We recognize that in the electric power sector there is a need to improve working margins of federally owned utilities. It is also our intention to adjust relative prices of gas and diesel (gas-oil) to encourage utilization of the former.

14. We shall maintain our efforts to improve the financial planning and management of public enterprises by the following means:

- The DEP will require all enterprises within its charge to develop budgets and performance targets for 1989. The approved budgets and plans will be published by December 31, 1988.
- The DEP will continue its efforts to standardize accounting and information systems among enterprises, as well as improving long-term planning of investments and finances in a consistent fashion.

15. In order to improve operating efficiency and reduce working capital needs of public enterprises, the Government will direct immediate attention to procurement and inventory control practices. To this end, the Government, through the Ministry of Public Works, will develop by December 31, 1988, for enterprises reporting to it, guidelines to increase the competitiveness and transparency of the enterprise procurement process, guidelines on purchase programming and inventory control, and methods for



monitoring compliance by public enterprises with the guidelines. These measures will be complemented by continuing reforms of the "Compre Nacional" policies that apply to public sector procurement, with a view to reducing cost and increasing the efficiency and competitiveness of the public enterprises and their suppliers.

16. The Government will give urgent attention to the restructuring of Ferrocarriles Argentinos and the development of an action plan to divide the current operation into specific lines of business (freight, inter-city passenger and suburban passenger). In addition, to ensure that oil exploration activities are protected from continuing fiscal pressure and are consistent with the Government's general policy of encouraging private sector participation, the Executive will sign the Petroplan Decree immediately so that the program can start before the end of the year.

#### Financial Sector Policies

17. The financial public sector in Argentina has traditionally been characterized by the strong participation of the Central Bank in financial intermediation; substantial recourse to the banking system as a source of involuntary public sector deficit financing; and the existence of serious inefficiencies in the operation of certain national and provincial public banks.

18. Central Bank participation in financial intermediation has taken place both through overregulation of the sector and a substantial volume of Central Bank lending through rediscounts. To finance rediscounts and the deficit of the nonfinancial public sector, the Central Bank has imposed heavy reserve requirements and other forced investments on the financial system's deposits. When reserve requirements and forced investments have not been enough, the monetary base has been expanded. Moreover, losses on the lending operations of several public banks--most prominently the National Mortgage Bank (BHN), the National Development Bank (BANADE) and certain provincial banks--have eroded their financing base and these banks have therefore become excessively dependent on Central Bank credit.

19. In recent years these problems have resulted in large Central Bank losses (the quasi-fiscal deficit referred to earlier), adversely affecting interest rates and inflation. Financial intermediaries, in turn, have substantially reduced credit to the private sector and become inefficient. They have to charge large spreads to cover high operating costs and losses associated with reserve requirements and forced investments.

20. Particularly in the last two years, the Government has taken numerous measures to rationalize the financial public sector and to strengthen the financial system. These reforms include: (i) a restrictive policy on new Central Bank rediscounts (excluding rediscounts to BHN, the net cash flow of Central Bank rediscounts has been negative during January-August 1988); (ii) streamlined rediscount portfolio administration, including greater transparency (the 1988 rediscount budget has been sent to Congress together with the fiscal budget); (iii) a reduction in subsidies associated with Central Bank rediscounts; (iv) liberalization of interest



rates; (v) improvement in prudential regulations and supervision of financial institutions; (vi) deposit insurance for all small-sized deposits; (vii) liquidation of several insolvent intermediaries as well as privatization of others whose administration had been taken over by the Central Bank; and (viii) strong sanctions against overdrafts of the public banks.

21. The Government intends to continue its efforts by taking the following measures:

- Continuing the rationalization of Central Bank rediscounts, including improved accounting, transparency, and a negative cash flow;
- Gradually reducing reserve requirements and forced investments to facilitate access by the private sector to financial resources;
- Establishing a deposit insurance agency for the rehabilitation or liquidation of ailing financial intermediaries;
- Continuing to improve supervision and transparency in the financial system as well as firmly enforcing prudential regulations (particularly on provisions for potential loan losses);
- Restructuring major public banks--especially BHN and BANADE--to transform these institutions into self-sustaining financial intermediaries (discontinuing reliance on Central Bank rediscounts and gradually reducing existing indebtedness with the Central Bank). The Central Bank will continue to restrict rediscounts to BHN only to finance BHN's lending commitments outstanding as of January 1988; a vigorous collection policy--including automatic foreclosure of loans in arrears--will be an important source of funds for BHN.

#### Trade Policy

22. Export expansion, efficient import substitution, increased international competitiveness, and overall investment growth in the productive sectors are key elements of the medium-term strategy. The country's poor export performance in the past, while partly caused by external conditions, has reflected a domestic economic policy environment not conducive to export activity. This environment in the past included overvalued and unstable exchange rates, heavy protection for domestic market production and sales, export taxes and other impediments to exports. Recently these policies have begun to change. Since 1985, the Government has pursued a policy to stimulate exports, principally through a flexible and realistic exchange rate policy.

23. During 1987, the Government: (i) transformed the temporary admission regime for exports, extending it to almost all intermediate goods and making it automatic; (ii) removed export taxes for about 800 positions of the export nomenclature; (iii) introduced a general GATT-compatible scheme



for indirect tax reimbursement for exports; (iv) improved credit risk assessment in export financing; (v) reduced the production coverage of quantitative import restrictions from 62 to 37 percent of manufacturing production; and (vi) undertook a program to simplify export and import procedures.

24. Since the beginning of 1988, the Government has taken other important steps: (i) transferred authority over iron and steel imports from the General Directorate of Military Industries to the Secretariat of Industry and Foreign Trade, which subsequently removed all quantitative import restrictions on iron and steel, thereby reducing the production coverage of quantitative restrictions to 32 percent; (ii) reduced the production coverage further to 30 percent by removing the import restrictions on agricultural machinery and tractors; (iii) removed all reference prices in line with the application of the GATT customs valuation code; (iv) extended the standard and the special temporary admissions regime to indirect exporters after first introducing a Domestic Letter of Credit; and (v) reduced import tariffs on iron and steel, petrochemicals, agrochemicals, pulp and some paper products. The liberalization of iron and steel imports in particular constitutes an important breakthrough for Argentina.

25. By September 21, 1988, the Government intends to: (i) reduce the production coverage for quantitative import restrictions to less than 18 percent of manufacturing output and to make importation of all other goods fully automatic; (ii) reduce the average tariff rate to 30 percent (on a production-weighted basis) and the maximum tariff rate to 40 percent, thereby also reducing tariff dispersion; (iii) remove export taxes for about 400 positions of the export nomenclature; and (iv) remove tariff exemptions outside the temporary admissions regime. In addition, by April 30, 1989, the Government intends to: (i) start the process of transferring all export transactions to the free market exchange rate; (ii) reduce the production coverage of quantitative import restrictions further to 15 percent; (iii) remove a substantial number of export taxes; and (iv) remove export licenses that are neither required by law or international agreement, or not justified on grounds of health, quality control, or environmental protection.

26. Other new measures will include:

- simplification and liberalization of export procedures, especially those affecting small and medium-size firms; and
- development and implementation of a comprehensive international marketing strategy and improvement in the quality of government services for exporters, especially for small and medium-size enterprises.

#### Industrial Policy

27. The objective of the Government's industrial policy is to promote an internationally competitive industrial sector capable of realizing its full export potential. Efficient and competitive industry will increase Argentina's global market share and improve the population's standard of living. Achieving this goal requires that trade reform be complemented

with a reform in industrial investment incentives to increase investment productivity. Implementation of macroeconomic and financial reforms is also necessary to mobilize financial resources to undertake the investment.

28. The present provincial and sectoral investment regimes entail a large fiscal cost--nearly 3.5 percent of GDP--and do not encourage the most efficient investment. In late 1987 and early 1988, the Government worked with Congress to enact a law that would unify the industrial promotion system by abolishing the special provincial and sector regimes.

29. As noted earlier, the Government intends to use its best efforts to ensure a rapid passage of the above legislation through the Senate and to undertake related measures noted above to reduce the fiscal cost and tax abuses associated with the present incentive regime.

#### Conclusion

30. In view of the limited time remaining for this Government, with elections due in mid-1989, I believe you will agree this is an impressive agenda of reform. The Government fully intends to pursue these measures vigorously. However, our success depends on financial support from your organization. Two adjustment loans--the Banking Sector Loan and the Trade Policy Loan--have already been negotiated. In addition, several other investment loans are under preparation. I trust you will find this program and its implementation a suitable basis for the approval of these loans.

Sincerely,

Juan Sourrouille  
Minister of Economy



ARGENTINA  
MACROECONOMIC CONDITIONS OF ADJUSTMENT LENDING: SUMMARY

Action on Loans

Policy Measures

I. Presentation of Trade Policy Loan (TPL) and modified conditions of effectiveness of Banking Sector Loan (BSL) to Board October 1988

Agreement on Letter of Development Policy (to be finalized after the 1989 fiscal and monetary programs are agreed with IBRD).

II. Disbursement of 1st Tranche of TPL

Loan Specific Conditions

October - December 1988

1. Reduction of QRs to 18% in production coverage;
2. Reduction of tariffs to average of 30% by production coverage, and a range of 0-40%;
3. Automaticity of import licenses for an additional 2,000 tariff positions; and
4. Satisfactory progress in audit of industrial firms enjoying tax concessions.

We expect all these conditions to be fulfilled by Board presentation in October. Therefore, 1st tranche of \$150 million will be available for disbursement before December 31, 1988.

III. Effectiveness and Disbursement of 1st Tranche of BSL

End-January 1989

- A. Satisfactory progress in implementation of macro-economic plan through January 1989, including:
1. Satisfactory management of exchange rate, fiscal accounts and domestic credit to the public sector;
  2. Submission of 1989 budget to Congress;
  3. Progress in strengthening tax office (DGI) to the satisfaction of the Bank;
  4. Submission to Congress of legislation to increase tax base to increase revenue and efficiency; and
  5. Adjustment of public utility prices.

Action on Loans

Policy Measures

IV. Second Tranche of TPL January-February 1989

B. Loan Specific Conditions:

1. Net flow of rediscounts=0 (except BHN);
2. No further increase in forced investments; and
3. Action plans for the restructuring of BHN and BANADE.

V. Second Tranche BSL July 1989

A. Macroeconomics - same as 1st tranche of BSL (or macroeconomic evaluation valid when specific loan conditions are met).

B. Loan Specific Conditions

A. Macroeconomic Program:

1. Satisfactory management of exchange rate, fiscal, credit policies as per agreed program;
2. Progress on public utility pricing; and
3. Implementation of tax reform.

B. Loan Specific conditions

LA4CO  
9/1/88



THE WORLD BANK

August 31, 1988

Mr. Conable:

Mr. Husain has come back with this draft Letter of Development Policy. This is in preparation for the meeting tomorrow.

MOEEN A. QURESHI  
Senior Vice President, Operations

DRAFT  
LETTER OF DEVELOPMENT POLICY

August 30, 1988

Mr. Barber B. Conable  
President  
The World Bank  
Washington, D.C. 20433

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2. Early experience with the measures announced in August is encouraging. We are optimistic that the rate of inflation will decrease substantially in coming months. We believe, however, that sustained progress toward our goals of permanently reduced inflation, reduced real interest rates, improved efficiency and increased investment will require additional measures as outlined here.

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Macroeconomic Goals

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start of a program of privatization of public sector enterprises. The Government will not make funds available to the provinces beyond those foreseen in the co-participation law, nor will the Central Bank finance the provinces through extension of rediscounts to provincial banks. Transfer to public enterprises will be confined to the funds already earmarked for them. Similarly, the Social Security System will have no recourse to general Treasury revenues.

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#### Financial Sector Policies

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18. Central Bank participation in financial intermediation has taken place both through overregulation of the sector and a substantial volume of Central Bank lending through rediscounts. To finance rediscounts and the deficit of the nonfinancial public sector, the Central Bank has imposed heavy reserve requirements and other forced investments on the financial system's deposits. When reserve requirements and forced investments have not been enough, the monetary base has been expanded. Moreover, losses on the lending operations of several public banks -- most prominently the National Mortgage Bank (BHN), the National Development Bank (BANADE) and certain provincial banks -- have eroded their financing base and these banks have therefore become excessively dependent on Central Bank credit.

19. In recent years these problems have resulted in large Central Bank losses (the quasi-fiscal deficit referred to earlier), adversely affecting interest rates and inflation. Financial intermediaries, in turn, have substantially reduced credit to the private sector and become inefficient. They have to charge large spreads to cover high operating costs and losses associated with reserve requirements and forced investments.

20. Particularly in the last two years, the Government has taken numerous measures to rationalize the financial public sector and to strengthen the financial system. These reforms include: (i) a restrictive policy on new Central Bank rediscounts (excluding rediscounts to BHN, the net cash flow of Central Bank rediscounts has been negative during January-August 1988); (ii) streamlined rediscount portfolio administration, including greater transparency (the 1988 rediscount budget has been sent to Congress together with the fiscal budget); (iii) a reduction in subsidies associated with Central Bank rediscounts; (iv) liberalization of interest



rates; (v) improvement in prudential regulations and supervision of financial institutions; (vi) deposit insurance for all small-sized deposits; (vii) liquidation of several insolvent intermediaries as well as privatization of others whose administration had been taken over by the Central Bank; and (viii) strong sanctions against overdrafts of the public banks.

21. The Government intends to continue its efforts by taking the following measures:

- Continuing the rationalization of Central Bank rediscounts, including improved accounting, transparency, and a negative cash flow;
- Gradually reducing reserve requirements and forced investments to facilitate access by the private sector to financial resources;
- Establishing a deposit insurance agency for the rehabilitation or liquidation of ailing financial intermediaries;
- Continuing to improve supervision and transparency in the financial system as well as firmly enforcing prudential regulations (particularly on provisions for potential loan losses);
- Restructuring major public banks -- especially BHN and BANADE -- to transform these institutions into self-sustaining financial intermediaries (discontinuing reliance on Central Bank rediscounts and gradually reducing existing indebtedness with the Central Bank). The Central Bank will continue to restrict rediscounts to BHN only to finance BHN's lending commitments outstanding as of January 1988; a vigorous collection policy -- including automatic foreclosure of loans in arrears -- will be an important source of funds for BHN.

#### Trade Policy

22. Export expansion, efficient import substitution, increased international competitiveness, and overall investment growth in the productive sectors are key elements of the medium-term strategy. The country's poor export performance in the past, while partly caused by external conditions, has reflected a domestic economic policy environment not conducive to export activity. This environment in the past included overvalued and unstable exchange rates, heavy protection for domestic market production and sales, export taxes and other impediments to exports. Recently these policies have begun to change. Since 1985, the Government has pursued a policy to stimulate exports, principally through flexible and realistic exchange rate policy.

23. During 1987, the Government: (i) transformed the temporary admission regime for exports, extending it to almost all intermediate goods and making it automatic; (ii) removed export taxes for about 800 positions of the export nomenclature; (iii) introduced a general GATT-compatible scheme

for indirect tax reimbursement for exports; (iv) improved credit risk assessment in export financing; (v) reduced the production coverage of quantitative import restrictions from 62 to 37 percent of manufacturing production; and (vi) undertook a program to simplify export and import procedures.

24. Since the beginning of 1988, the Government has taken other important steps. It: (i) transferred authority over iron and steel imports from the General Directorate of Military Industries to the Secretariat of Industry and Foreign Trade, which subsequently removed all quantitative import restrictions on iron and steel, thereby reducing the production coverage of quantitative restrictions to 32 percent; (ii) reduced the production coverage further to 30 percent by removing the import restrictions on agricultural machinery and tractors; (iii) removed all reference prices in line with the application of the GATT customs valuation code; (iv) extended the standard and the special temporary admissions regime to indirect exporters after first introducing a Domestic Letter of Credit; and (v) reduced import tariffs on iron and steel, petrochemicals, agro-chemicals, pulp and some paper products. The liberalization of iron and steel imports in particular constitutes an important breakthrough for Argentina.

25. By September 21, 1988, the Government intends to: (i) reduce the production coverage for quantitative import restrictions to less than 18 percent of manufacturing output and to make importation of all other goods fully automatic; (ii) reduce the average tariff rate to 30 percent (on a production-weighted basis) and the maximum tariff rate to 40 percent, thereby also reducing tariff dispersion; (iii) remove export taxes for about 400 positions of the export nomenclature; and (iv) remove tariff exemptions outside the temporary admissions regime. In addition, by April 30, 1989, the Government intends to: (i) start the process of transferring all export transactions to the free market exchange rate; (ii) reduce the production coverage of quantitative import restrictions further to 15 percent; (iii) remove a substantial number of export taxes; and (iv) remove export licenses that are neither required by law or international agreement, or not justified on grounds of health, quality control, or environmental protection.

26. Other new measures will include:

- (i) simplification and liberalization of export procedures, especially those affecting small and medium-size firms, and
- (ii) development and implementation of a comprehensive international marketing strategy and improvement in the quality of government services for exporters, especially for small and medium-size enterprises.

#### Industrial Policy

27. The objective of the Government's industrial policy is to promote an internationally competitive industrial sector capable of realizing its full export potential. Efficient and competitive industry will increase Argentina's global market share and improve the population's standard of living. Achieving this goal requires that trade reform be complemented



with a reform in industrial investment incentives to increase investment productivity. Implementation of macroeconomic and financial reforms is also necessary to mobilize financial resources to undertake the investment.

28. The present provincial and sectoral investment regimes entail a large fiscal cost -- nearly 3.5 percent of GDP -- and do not encourage the most efficient investment. In late 1987 and early 1988, the Government worked with Congress to enact a law that would unify the industrial promotion system by abolishing the special provincial and sector regimes.

29. As noted earlier, the Government intends to use its best efforts to ensure a rapid passage of the above legislation through the Senate and to undertake related measures noted above to reduce the fiscal cost and tax abuses associated with the present incentive regime.

#### Conclusion

30. In view of the limited time remaining for this Government, with elections due in mid-1989, I believe you will agree this is an impressive agenda of reform. The Government fully intends to pursue these measures vigorously. However, our success depends on financial support from your organization. Two adjustment loans -- the Banking Sector Loan and the Trade Policy Loan -- have already been negotiated. In addition, several other investment loans are under preparation. I trust you will find this program and its implementation a suitable basis for the approval of these loans.

Sincerely,

Juan Sourrouille  
Minister of Economy

**The World Bank**

Washington, D.C. 20433  
U.S.A.

MOEEN A. QURESHI  
Senior Vice President, Operations

August 17, 1988

Mr. Scott

David Malpass called me this morning and said the Treasury was close to completing the Bridge loan arrangements but felt very strongly about the need to have some statement from the World Bank which indicated the World Bank's expectations regarding disbursements under the World Bank loans. I went over the reasons why this was not feasible and if we did give a statement, it would not be very meaningful because it would be very qualified.

He said to me that it was both David Mulford's and his view that a statement, however qualified, would still be very useful and necessary. I responded that we probably could make a statement along the following lines:

"If all of the conditions required for disbursement of funds were met, and all the necessary documents were submitted to the Bank by a certain date, then disbursements could take place within a certain period."

David said even such a statement as that would be very desirable. I suggested to him that he should work this out with Mr. Scott.

cc: Mr. Tyler



August 17, 1988

cc: Mr. Vegui

To: Mr. Qureshi

(through Mr. Rainer Steckhan, Acting RVP)

re: ARGENTINA - Bridge Loan

1. This note is to report to you some conversations that I have had during the course of this week with US Treasury officials, namely Messrs. Juba and McCoy.
2. They have called periodically, wanting more specific information on effectiveness dates, negotiation outcomes, etc. I have gone through the arguments - not wanting to prejudge the outcome of the mission, the delicate nature of the discussions, the many uncertainties, etc. - as to why no great details are, or could be, available at this point. I have also indicated that they should probably not expect any news until after the mission returns at the end of next week. In sum, while I have tried to appear cooperative, the actual information that I have given them is quite limited.
3. Perhaps as a result of this failure to provide more concrete information, Mr. McCoy told me that either Mr. Mulford or Mr. Malpass would telephone Mr. Husain in Buenos Aires. I of course alerted Mr. Husain, and he has indicated a reluctance to talk to the US Treasury at this point, indicating again that there would be no news until the return of the mission.
4. At the staff level, i.e., Mr. McCoy, of the US Treasury there appears to be a great deal of cynicism as to the role of the US bridge loan and as to the adequacy of Argentine economic program. My reading is that at his, and Juba's, level there is no real expectation that the Bank will certify the meeting of the effectiveness conditions for the two loans.

  
W. Tyler

cc: Messrs. Husain (o/r), Bottelier (o/r), Bery (o/r), Moreau, Rowat  
Ms. Jones-Carroll

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1. The central issue is not the Bridge loan - we are not sure that the Bridge loan will go through. Incidentally, the Bridge loan has an explicit condition that its proceeds cannot be used to pay arrears to commercial banks (although of course money is fungible).

2. We have been pushing the Argentiniains to undertake a stabilization cum structural adjustment program since the beginning of this year. It was always understood that the stabilization program would be the front end of the medium-term program. The Argentiniains have not moved because the conditions established by the Fund were, in our view, too stringent, e.g. the reduction of the budget deficit to 2%, which we thought was not deliverable. At long last, the Argentiniains have now moved. They have asked us to make the Banking Loan effective because, in their view, the recent measures will de facto if not de jure meet all the conditions of the Banking Sector Loan. In addition, we have been waiting with the Trade Policy Loan for some time in the hope that the Argentiniains would undertake the Macro Policy Program which would provide the underpinnings for the trade policy reforms. They have now asked us to proceed with the Trade Policy Reform Loan because they have taken (or propose to take) all the measures that we had asked them to do in the trade policy field. There was also an industrial policy component in this loan. The status of that is unclear. They have asked us to move with this loan quickly. We would have had to do that as soon as the Argentiniains moved on the stabilization program.

3. It is the Argentinians who are seeking the Bridge loan. The US and the BIS are not at all keen to provide the Bridge loan. The Argentinians maintain (quite rightly) that they are afraid to go ahead with the trade and exchange liberalization measures, and with the movement of industrial products to the free market rate without the backing of additional liquidity. Hence their pressure for a Bridge loan. The US believes that the Bridge loan cannot be made available until either the Bank or the Fund is able to provide some "conditionality" and resources to back the Bridge loan. The US has not established any deadline by which we must complete our negotiations with the Argentinians. They have merely said that they cannot allow any drawings unless and until either a Fund or Bank program is in place. The Argentinians are the ones who are clamoring to get additional liquid funds in order to ensure that, with the implementation of liberalization, the free market rate does not get out of hand.

4. As far as the Fund is concerned, it has expressed public approval of the Argentine program and has stated that the program provides a basis for formulating a standby arrangement. It has made a similar statement to the BIS. Unfortunately, because of a history of past tensions and conflicts between the Fund and the Argentinians, the Fund has said that it has "lost credibility" vis-a-vis its principal shareholders in its dealings with Argentina and that therefore it would like to wait to see a fuller implementation of the program before it decides to present its standby arrangement to the Board. They intend to provide us with a letter of intent for the standby by around the middle of September.

8.12.88



**The World Bank**

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION

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*Bock*  
*Mr. Qureshi*

August 12, 1988

TO: Messrs. Shahid Husain  
Pieter Bottelier

Argentina

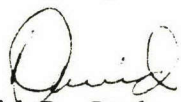
Attached is a memorandum we have prepared for your consideration as we begin to work with the Government in meeting the commercial bank problem. Given how rapidly events are moving, this note provides a reasonably up to date assessment of the attitudes of the commercial banking community as well as a good rundown on the realistic options available to the Government.

We would like to discuss the information set forth in this paper with whomever you see fit. We (either Dennis or I) are prepared to travel to Buenos Aires to convey some of the key points to the Government, provided this makes sense in terms of the overall dialogue.

From what we understand, there is a high likelihood that the Government is laboring under certain misapprehensions as they prepare to deal with the banks. It would be most unfortunate if that circumstance affects adversely the progress of their negotiations.

We would like to discuss all of this with you on Monday. We will try to call you and would appreciate your doing the same.

Sincerely

  
David R. Bock

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ARGENTINA - EXTERNAL DEBT STRATEGY OPTIONS

1. This note reviews the current situation in respect of Argentina's commercial bank debt and analyzes possible debt strategy alternatives. The first part of this note analyzes the structure of Argentina's external liabilities at end-1987 (in particular its commercial bank debt) and its debt service obligations during the 1988-95 period. The second part presents an analysis of possible debt strategy options.

A. BACKGROUND

2. Argentina's external debt has grown rapidly during the past decade: from \$12.5 billion in 1978 to \$56.2 billion at end-1987. During the first part of this period (1978-81), an overvalued exchange rate coupled with open financial markets led to a sharp increase in external debt. A substantial portion of the external financing inflows during this period was not used for productive purposes and much of the present debt now serviced by the public sector has a counterpart in private assets held abroad. The situation was complicated further beginning in 1982 by the assumption of most of the private external debt by the public sector. It is estimated that between 1982 to 1987, approximately \$7.0 billion was transferred from the private to the public sector. Moreover, only a fraction of Argentina's external debt is matched by corresponding domestic productive assets.

3. Argentina's external debt of \$56.2 billion is equal to about 82% of current GDP compared with 28% in 1978, and 75% in 1985. Interest payments have been running around \$4-5 billion p.a. in recent years, and accounted for 6.0% of current GDP and 50% of export earnings in 1987. In order to close its capital account in 1988-89, it is estimated that Argentina will need about \$1.5 to 2 billion additional new money from commercial banks. This estimation assumes gross disbursements from the IMF of \$1.3 billion in 1988 and \$1.2 billion under a new standby in 1989. It also assumes World bank gross disbursements of \$900 million per year during 1988-89, based upon lending under several sector adjustment loans in addition to a pipeline of project loans.

B. STRUCTURE OF EXTERNAL DEBT

4. Total external debt for Argentina as of end-1987 is estimated at \$56.2 billion, out of which about \$2 billion represents the appreciation of non-dollar obligations. Table 1 sets forth a breakdown of total debt by main categories.

Table 1  
Argentina: External Debt by Major Category  
(December 1987)

|                                | <u>US\$ Million</u> |
|--------------------------------|---------------------|
| Total External Debt            | 56,230              |
| Medium and Long Term Debt      | 49,084              |
| Public and Publicly Guaranteed | <u>45,634</u>       |
| Official                       | 9,223               |
| Bonds                          | 3,839               |
| Supplier and Other Credits     | 1,587               |
| Commercial Banks               | <u>30,985</u>       |
| New Money Loans under          |                     |
| Refinancing Agreements         | <u>8,000</u>        |
| 1983                           | 1,700               |
| 1985                           | 4,500               |
| 1987                           | 1,800 <u>a/</u>     |
| Private Debt Assumed by        |                     |
| National Govts. (1982-87)      | 7,000               |
| Other Public Sector Debt       | 15,985              |
| Private Non-Guaranteed         | <u>3,450</u>        |
| Commercial Banks               | 1,000               |
| Official                       | 550                 |
| Suppliers and Other Credits    | 1,900               |
| Short-Term Debt                | 3,200               |
| IMF Credits                    | 3,946               |

a/ The total facility is for \$1.95 billion, of which \$150 million is to be disbursed in 1988.

Source: DFS Estimates

Based on the above table, public and publicly guaranteed debt (including short-term debt and IMF credits) account for about 94% of Argentina's external liabilities. Short-term debt, owed mainly to commercial banks, of \$3.2 billion represents certain short-term trade and money-market lines which run until mid-1989. External government bonds, which totalled \$3.8 billion at December 1987, include approximately \$1.6 billion of Bonex obligations. It is anticipated that these government external bonds will be fully serviced.



5. The debt is held by five main groups of foreign creditors. Of this amount, almost 63% is owed to commercial banks, 6.0% to multilateral institutions, 11.0% to bilaterals, 7.0% to the IMF, and 7.0% in Government-guaranteed bonds. Table 2 below sets forth the composition of Argentina's total external debt by group of creditors.

Table 2  
Argentina: External Debt by Creditor  
(December 1987)

|                                      | <u>US\$ Million</u> |
|--------------------------------------|---------------------|
| <u>Total Debt</u>                    | <u>56,230</u>       |
| Commercial Banks                     | <u>35,185</u>       |
| Short-Term                           | 3,200               |
| Medium-Term                          | 31,985              |
| Suppliers and Other Non-Bank Credits | 3,487               |
| Official                             | <u>9,773</u>        |
| IBRD                                 | 1,619               |
| IDB                                  | 1,767               |
| Bilateral                            | <u>6,387</u>        |
| Bilateral (Direct)                   | 830                 |
| Paris Club (1982-85 Refinancing)     | 2,810               |
| Paris Club (1986 and Beyond)         | 2,747               |
| Bondholders                          | 3,839               |
| IMF                                  | 3,946               |

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Source: DFS Estimates

6. Commercial bank claims on Argentina reached \$35.2 billion at December 1987. Of this amount, \$34.2 billion represented public or publicly guaranteed debt and about \$1.0 billion of private nonguaranteed debt. As such, private commercial banks hold about 63% of Argentina's external liabilities. U.S. banks are the largest group of commercial bank creditors, and represent almost one-third of total commercial bank debt. The next largest groups in order of size are the Japanese, U.K. and German commercial banks. Altogether, U.S., Japanese, U.K. and German banks hold about 70.0% of total private commercial bank debt. Table 3 depicts the composition of commercial bank debt by nationality of bank.

Table 3

Argentina: Composition of Commercial Bank Debt

(December 1987)

|                     | <u>US\$ Million</u> | <u>%</u>    |
|---------------------|---------------------|-------------|
| United States       | 10,200              | 29.0        |
| United Kingdom      | 5,100               | 14.5        |
| Japan               | 5,500               | 15.6        |
| France              | 2,100               | 5.9         |
| Germany             | 4,000               | 11.3        |
| Switzerland         | 1,400               | 4.0         |
| Canada              | 1,600               | 4.6         |
| Italy               | 1,100               | 3.2         |
| All Other Countries | <u>4,185</u>        | <u>11.9</u> |
| Total               | 35,185              | 100.0       |

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Source: DFS Estimates

7. There are approximately 370 private commercial banks with loans to Argentina. However, around 60% of the commercial bank debt is concentrated in about 50 to 60 banks. Table 4 sets forth 22 commercial banks with the largest Argentine exposure. These 22 banks in aggregate represent approximately 40% of total Argentine commercial bank exposure.



Table 4

Argentine Exposure of Major Commercial Banks

| <u>United States</u>           | <u>US\$ Million</u> |
|--------------------------------|---------------------|
| Manufacturers Hanover          | 1,460               |
| Citibank                       | 1,400               |
| Chase Manhattan                | 960                 |
| Morgan Guaranty                | 876                 |
| Bank of America                | 730                 |
| Chemical                       | 430                 |
| Continental Illinois           | 380                 |
| Bank of Boston                 | 370                 |
| <u>United Kingdom</u>          |                     |
| Midland                        | 840                 |
| Lloyds                         | 630                 |
| Barclays                       | 570                 |
| National Westminster           | 380                 |
| <u>Japan</u>                   |                     |
| Bank of Tokyo                  | 800                 |
| Sumitomo                       | 380                 |
| Long-Term Credit Bank          | 380                 |
| Dai-ichi-Kangyo                | 370                 |
| <u>France</u>                  |                     |
| Credit Lyonnais                | 590                 |
| Societe General                | 360                 |
| <u>Canada</u>                  |                     |
| Royal Bank of Canada           | 365                 |
| Bank of Montreal               | 315                 |
| <u>Germany and Switzerland</u> |                     |
| WLB                            | 360                 |
| Swiss Bank Corporation         | 360                 |

Source: DFS Estimates

C. RECENT DEBT RESCHEDULINGS

8. Since 1982, Argentina has had a number of reschedulings and new money arrangements including three with the commercial banking community, in 1982, 1985 and 1987. The most recent (August 1987) had three main components:

- (i) a restructuring of \$30.2 billion of commercial bank debt to a new schedule extending to 2006;
- (ii) maintenance of short-term trade and money-market lines until mid-1989; and

- (iii) new money facilities aggregating \$1.95 billion and consisting of \$1.55 billion of term credits and \$0.4 billion of trade credit deposits.

9. The 1987 financial package also included "exit" bonds which were envisaged to provide a fresh approach to help resolve the debt problem. However, acceptance of this approach by commercial banks was low in large part because commercial banks generally viewed the pricing as financially unattractive.

10. In addition to the 1987 agreement with commercial banks, Argentina and the Paris Club creditors agreed to a rescheduling of the bilateral debt of \$1 billion in May 1987.

#### **D. ALTERNATIVE DEBT STRATEGIES**

11. In addition to uncertain economic prospects over the medium-term, Argentina is currently faced with a precarious near-term economic situation. Inflation is currently running at an annual rate of about 600 percent and output is declining. The fiscal deficit is thought to be running at about 7 percent of GDP as against a budget figure of 4.9 percent for the year. The Government still has no credible stabilization plan or a secure medium term program of external finance.

12. The IMF and the Government are currently negotiating a new stand-by arrangement to last until end-1989. However, in view of Argentina's track record of repeated non-compliance (of the 20 quarters of IMF programs since 1983, the country met only 3 without waivers), the existence of an IMF stand-by may not be sufficient to provide domestic and foreign investors the confidence necessary to stabilize the economy, or to secure a conventional external financing program especially over the medium-term.

13. The medium term picture, as perceived by external creditors, is further complicated by the political uncertainties associated with the upcoming presidential election in May 1989 and the re-emergence of populism as a significant factor. The electoral politics are extremely likely to politicize the debt issue and relations with foreign creditors. This will limit the capacity of the current Government to enact new reforms or to undertake serious stabilization measures.

14. Recent improvements in agricultural commodity prices as a result of the North American drought have had a favorable impact on Argentina's trade balance. Net financing requirements from commercial bank sources may range from \$1.5 to \$2 billion in 1988-89, depending on the extent of the improvement in the terms of trade of the country and the extent to which the Government is able to mobilize those resources for debt service.



15. In the light of these considerations, there are essentially two options open to the creditor banks with regard to closing the financing gaps:

(i) to permit the country to slide into a protracted arrears situation; or

(ii) to assemble a new money package to cover the financing requirements to the end of 1989;

A third option involving a comprehensive medium term restructuring (that may include elements of debt relief and interest capitalization) does not appear to be viable at this time due to the considerable uncertainties associated with the medium term picture (see further below).

#### Protracted Arrears/Moratorium

16. As of March 25, 1988 Argentina suspended interest payments to its bank creditors and since then, while some payments have been made intermittently, arrears on interest payments in the amount of about \$ 900 million have accumulated. Of this amount about \$250 million are now over 90 days due. In the absence of a commercial bank financing package, the likelihood of the country sliding into a protracted arrears situation would increase considerably.

17. From the country's standpoint, a protracted arrears situation may provide one way for meeting the financing requirements over the next 18 month period. As far as the banks are concerned, a protracted arrears situation may become imminent if adequate support for a new money package is not forthcoming. A number of commercial banks, particularly the non-U.S. banks, are vehemently opposed to the new money approach. These banks feel that Argentina is not capable of servicing its contractual debt in either the near or the medium term, and hence are simply not prepared to throw good money after bad. The willingness of these banks to endure a protracted arrears situation is also encouraged by several market driven factors. Existing Argentine debt is selling at only 25% to 30% of face value in the secondary market; most banks (except for the Japanese and major U.S. money center banks) have established loan-loss reserves of 40% or more; under current regulations in certain jurisdictions mandatory provisioning against new money loans (which is as high as 40% in Canada) is required; and stock market analysts tend to rate every bank in inverse proportion to the size of its LDC portfolio.

18. The first result of such an arrears situation would be for the banks to put Argentina loans on non-accrual status. This process has already started: a number of banks have reclassified a portion of their Argentine portfolio. The income account effects, particularly the impact on reported earnings, resulting from a re-classification would probably be moderate (around a 6 to 10% decline in reported earnings per share) for almost all banks except Manufacturers Hanover. This view is supported by a recent research report by a major U.S. investment house which quantified the change in reported earning resulting from putting Argentina loans on a non-accrual basis. The results of this analysis are summarized in the table below for six major U.S. banks.

Table 5

Earnings Impact of Argentina Interest Arrears  
(US\$ million)

|                       | Estimated<br>1988<br>Earnings<br>per Share | Impact <u>a/</u><br>of<br>Argentina<br>Interest | Potential<br>Revision | %<br>Change |
|-----------------------|--------------------------------------------|-------------------------------------------------|-----------------------|-------------|
| Manufacturers Hanover | 6.50                                       | 1.20                                            | 5.30                  | -18.5%      |
| J. P. Morgan          | 5.15                                       | 0.28                                            | 4.87                  | -5.4%       |
| Chase Manhattan       | 5.90                                       | 0.64                                            | 5.26                  | -10.8%      |
| Citicorp              | 4.15                                       | 0.24                                            | 3.91                  | -5.8%       |
| Bank of America       | 2.75                                       | 0.20                                            | 2.55                  | -7.3%       |
| Chemical Bank         | 7.00                                       | 0.40                                            | 6.60                  | -5.7%       |

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a/ Estimates based on placing entire portfolio on non-accrual status.

19. The next step in an arrears situation would be to have Argentine loans downgraded to value impaired status. The U.S. regulatory agencies (ICERC) would most likely take such action at a meeting in early 1989. This would mandate statutory ATRR provisioning by banks against their Argentine claims. Similar action would probably be taken by regulatory authorities in other creditor countries. These potential actions of regulators would have obvious income and balance sheet effects.

20. Table 6 below sets forth the Argentine portfolios and total equity for the 22 commercial banks with the largest Argentine exposures. As can be seen in the table, the ratio of Argentine exposure to equity is dangerously high (i.e. over 50%) for only one bank, Manufacturers Hanover. For several U.S. money center banks - Chase, Bank of America and Continental Illinois - that have ratios around 25%, an arrears situation with a value impaired classification could result in higher funding costs that would lower overall bank profitability. This however assumes that the protracted arrears situation in Argentina is contained and there are no systemic effects.



Table 6

Argentine Loans/Equity Ratios for Major Commercial Banks  
(US\$ million)

|                       | <u>Argentine<br/>Portfolio</u> | <u>Total<br/>Equity</u> | <u>Percent<br/>Arg. Port.<br/>of Equity</u> |
|-----------------------|--------------------------------|-------------------------|---------------------------------------------|
| Manufacturers Hanover | 1460                           | 2704                    | 54.0                                        |
| Citibank              | 1400                           | 8810                    | 15.9                                        |
| Chase Manhattan       | 960                            | 3852                    | 24.9                                        |
| Morgan Guaranty       | 876                            | 5036                    | 17.4                                        |
| Bank of America       | 730                            | 3259                    | 22.4                                        |
| Chemical              | 430                            | 3003                    | 14.3                                        |
| Continental Illinois  | 380                            | 1364                    | 27.9                                        |
| Bank of Boston        | 370                            | 1749                    | 21.2                                        |
| Midland               | 840                            | 4877                    | 17.2                                        |
| Lloyds                | 630                            | 4513                    | 14.0                                        |
| Barclays              | 570                            | 7767                    | 7.3                                         |
| National Westminster  | 380                            | 9236                    | 4.1                                         |
| Bank of Tokyo         | 800                            | 4265                    | 18.9                                        |
| Sumitomo              | 380                            | 5634                    | 6.7                                         |
| Long-Term Credit Bank | 380                            | 3284                    | 12.8                                        |
| Dai-Ichi-Kangyo       | 370                            | 4844                    | 7.6                                         |
| Credit Lyonnais       | 590                            | 4601                    | 12.8                                        |
| Societe General       | 360                            | 4109                    | 8.8                                         |
| Royal Bank of Canada  | 365                            | 2466                    | 14.8                                        |
| Bank of Montreal      | 315                            | 2627                    | 12.0                                        |
| WLB                   | 360                            | 2568                    | 14.0                                        |
| Swiss Bank Corp.      | 360                            | 6739                    | 5.3                                         |

21. Annex 1 analyzes the potential income account effects of an arrears situation and compares it with the income account effects of a new money operation for a selected group of U.S., European, Japanese and Canadian banks. The analysis shows that Japanese and well reserved European and Canadian banks would be better off, in terms of reported earnings, under the arrears option. On the other hand, U.S. money center banks sustain a significant adverse earnings effect from an arrears situation, with the largest impact falling on Manufacturers Hanover. The conclusion to be drawn by an examination of Table 6 and Annex 1 is that, with the possible exception of Manufacturers Hanover, the commercial banks could weather the adverse financial consequences of a protracted arrears situation.

22. However, a protracted Argentine arrears situation could nonetheless have systemic implications. Argentina is one of the five<sup>1</sup> major debtor countries that collectively pose a considerable problem for the international financial system. An Argentine arrears situation could have spillover effects on the other debtor countries. At a time when international financial markets were both fragile and volatile, an Argentine protracted arrears situation that led to a value impaired downgrading could represent a serious shock to the markets. Moreover, commercial banks currently are increasingly focussed on expanding their lending and other merchant banking activities in the industrial countries where deregulation is opening new opportunities and on meeting capital adequacy requirements that take effect in 1992. A protracted Argentine arrears situation could represent a serious impediment to these efforts for several U.S. money center banks, and put these banks at a competitive disadvantage vis-a-vis some larger European and Japanese banks. Hence, any assessment of the banks' ability to withstand the consequences of a long period of arrears should be made by taking into consideration the potential of a further deterioration of the debt situation and the systemic risk such a deterioration poses for the world's financial markets.

23. The arrears option may have negative consequences for the country. First, as the Brazilian experience in respect of its moratorium on interest payments in 1987 has illustrated, protracted arrears would adversely affect external resource flows to the country. Not only would the medium and long term flows from foreign investors and official bilateral and multilateral sources be affected, but also there is likely to be an immediate adverse impact on short term trade credit and interbank lines (the country's short term debt as of end-1987 was \$3.2 billion equal to about 10% of total commercial bank debt). As a consequence, the country's ability to carry out normal trade activities may be hampered, which in turn may affect economic stability and growth and further undermine investor confidence.

24. Second, a protracted arrears situation would almost certainly lead to a downgrading of Argentine debt to value impaired status by the U.S. regulatory authorities. This may be a situation that the country might strive hard to avoid because once the loans have been downgraded, restoring their status may be quite difficult. Downgrading of loans may also seriously disrupt lending relationships of commercial banks with the country; restoring these relationships may also involve an arduous and prolonged process.

25. From the perspective of the Bank also, a protracted arrears situation could potentially have consequences that may go beyond the simple Bank client relations. A protracted arrears situation coupled with poor economic performance may lead to a drastic curtailment of the Bank's direct lending to Argentina. These potential consequences of protracted arrears would be viewed with a considerable degree of alarm by

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<sup>1</sup>/ The other four major debtor countries are Brazil, Mexico, Venezuela and Philippines.



the Bank since the negative transfers from the Bank to Argentina implicit in such a situation could lead to a potential default by the country on its debt to the Bank. The Bank must also carefully evaluate the Argentine situation for spillover and contagion potential and should cautiously consider the possible implications for its entire loan portfolio.

26. Due to the potential systemic implications of an Argentine arrears situation, it would be in the interest to the parties involved, particularly the creditor governments, to take timely steps directed at preventing the drift towards protracted arrears. Argentina is currently negotiating a \$500 million bridge loan from the U.S. Treasury. The loan is to be linked to the Bank's policy based loans, namely the Financial and Trade sector loans. If the bridge loan is obtained, the proceeds would be used to clear part of the backlog of interest arrears. The banks would then have a 90-day "window of opportunity" to assemble a new money package.

#### Conventional Restructuring with a 1988-89 New Money Facility

27. Under this option, creditor banks would use the window of opportunity to quickly put together a concerted lending package to cover the net financing requirements for 1988-89. By the end of 1989, the new Argentine government would be in place and the direction of its policies would become clearer.

28. Argentina's 1988-89 new money requirement from commercial banks may be in the range of \$1.5 to 2 billion. However, recent increases in agricultural commodity prices are perceived as having a beneficial effect in raising Argentina's export receipts and thereby in lowering the financing gap. The Government is likely to contend, however, that due to the domestic transfer problem, increases in export revenues cannot be fully captured, and hence the financing gap is not likely to be significantly different from previous estimates. The seasonality of export receipts is also a factor in the Government's inability to resume full payments in the near term; the Government must conserve its current favorable reserves position for the leaner period commencing in October. Hence, although commodity price developments have improved the near term cash flow position, they have complicated the negotiations by raising bank expectations with regard to: (a) payments being made in the near term; and (b) a potential reduction in the 1988-89 financing gap.

29. The conventional new money approach is likely to be supported by the group of banks with large exposures and a long-term business interest in Argentina. Only a few banks fall in this category. Citibank, with its large overall LDC exposure, is apprehensive of the consequences of a possible debt relief contagion that could result from a deteriorating Argentine situation, and therefore has a vital interest in supporting a new money approach. Of the other U.S. money center banks, Manufacturers Hanover, the most exposed bank with respect to its equity base, strongly supports the Citibank position. The banks favoring the new money approach do so in the belief that they are buying time in the hope that Argentina's economic and financial position will at least stabilize and that they remain "cash positive" as compared with total arrears. They



also feel that a new money approach is preferable from a political strategic standpoint since it may be more difficult for a populist new government, if elected to power, to declare a moratorium on debt than to continue one. Several other U.S. money center banks including Bank of America, Chemical and Continental Illinois are, on the one hand, anxious to avoid the adverse income and balance sheet effects of a protracted arrears situation, but insistent on some element of official comfort being incorporated into the new money package. These banks can be considered to have a focus with respect to a new money approach in part (in large part, to be sure) identical with Citibank and Manufacturers Hanover.

30. Many of the remaining banks, however, appear disinclined to support the new money approach. These banks generally perceive Argentina as incapable of servicing its existing debt in either the near or the medium term. Regulatory requirements in certain jurisdictions that mandate immediate provisioning against concerted new lending (which are as high as 40% in Canada), and the increasingly stringent overall regulatory environment due to the progressive adoption of worldwide standards in portfolio grading and provisioning are some of the reasons for the banks' recalcitrance. Moreover, the spectre of moratorium raised by the re-emergence of populism in the political arena makes bankers more reluctant to throw good money after bad. At the same time, many of these banks are now more adequately provisioned to face an arrears situation that could potentially lead to a downgrading of their Argentine assets and are hence under considerably less pressure to participate in concerted lending than previous years.

31. Banks have indicated that putting together of a new money package for 1988-89 without official comfort is going to be extremely difficult. Banks argue that the concerted lending process in general is under extreme pressure due to a variety of reasons including: (i) increasing skepticism about viability of debt increasing strategies due to policy slippages in the past, domestic political difficulties and unforeseen adverse developments in the international environment; (ii) more stringent regulatory constraints; (iii) increased levels of loan loss provisions; and (iv) mounting evidence that bank stock prices are increasingly influenced by balance sheet rather than net income considerations. In Argentina, the situation is made even more complex by the bleak medium term outlook, tenuous macroeconomic framework, political uncertainties, and a strong anti-foreign creditor sentiment. Moreover, since a portion of Argentina's external debt is comprised of private sector debt assumed by the government during the early eighties that is not matched by equivalent productive assets, there is a growing public sentiment in Argentina against full contractual servicing of this debt.

32. With regard to the Bank's direct lending program in Argentina, there are several issues pertaining to the appropriate intervention and the nature and level of conditionality. These are, however, not considered in this paper. With regard to extension of comfort to facilitate a new money package, the options could obviously range from Brazil-type cross-disbursement linkages between commercial bank new money loans and new and approved Bank adjustment and non-adjustment loans (with optional cross default clauses), to extension of guarantees on commercial bank new money loans and involvement in direct participation B-loans.



33. At a minimum, banks are likely to insist upon Brazil-type, or even more extensive, linkages with Bank loans. It is worth bearing in mind, however, that at this stage Bank involvement in Argentina appears inherently riskier than in the case of Brazil and that the Bank's lending pipeline/program is less well-developed than in Brazil. Linkages to new loans which are yet to be approved (particularly those to adjustment loans involving macro conditionality) will naturally complicate the Bank's flexibility. Linkages a la Brazil in these circumstances will raise even more sharply questions of leverage and long-term conditionality.

34. With regard to extension of guarantees, the stance has to be even more restrictive than Brazil. First, even if the country were to undertake a well designed economic program, there would be little assurance with regard to the implementation of policy reforms under the program. The existence of an appropriate macroeconomic policy framework is an essential prerequisite for the extension of guarantees and other forms of credit support by the Bank. The banks know this and will regard--perversely--a guarantee as both necessary (to shift risk) and foolish. Second, there are considerable uncertainties with regard to the country's ability to meet its external financing obligations over the medium term. Finally, time is of essence in assembling a new money package. Consideration of guarantees and other forms of credit enhancement support by the Bank could complicate and lengthen the negotiations.

35. A direct participation B-loan with full sharing provisions would have serious risk implications for the Bank and should be out of the question under the present circumstances in Argentina.

#### Comprehensive Medium Term Restructuring

36. A comprehensive medium term restructuring does not appear to be a viable option at the present time for a number of reasons. First, many banks (particularly the critically exposed banks) like to believe that debt increasing strategies can still work in Argentina and hence, according to them, the country is not yet a suitable candidate for debt relief. Their concerns with regard to granting interest concessions include the following: (a) the potential for setting a precedent for other debtor countries; (b) moral hazard implicit in rewarding poor performance with debt relief; and (c) the uncertainty regarding the asset quality of residual claims. With regard to interest capitalization, their concerns center around the potential for automaticity, loss of control and the moral hazard issue.

37. Second, even if the present government were to embrace a comprehensive medium term program of structural reform at this time, the current political uncertainty in Argentina would undermine the credibility of such a program. In the wake of the considerable uncertainties associated with the continuation of policy changes after a possible change in administration in 1989 the creditor banks are not likely to extend concessions at this time.

38. Finally, there is no support for debt relief strategies from the creditor governments and official institutions at the present time. The likelihood of a shift in this stance in the near term is small.

Attachment



ANNEX 1

POSSIBLE IMPACT OF ARREARS VERSUS NEW MONEY  
ON THE INCOME STATEMENTS OF SELECTED COMMERCIAL BANKS

1. This annex assesses the impact on the post-tax earnings of eight banks of the choice between arrears and new money with respect to Argentine commercial bank debt over the period 1988-1990. The impact of the New Money option is calculated in two ways: (i) by assuming that loans to Argentina contain no risk beyond that implied in the contractual rate of interest; and (ii) by adjusting projected earnings by an appropriate risk premium.<sup>1/</sup> The income impact of the Arrears option is calculated by assuming that no interest income is received on existing debt while Argentina is in arrears. Reserves established in both the Arrears and New Money options are subtracted from income. Full tax deductibility of reserves is assumed in most cases as indicated on page 5A. Some banks, however, may not have sufficient tax cover to take advantage of the tax deductibility of reserves.

2. The basic conclusion of this analysis is that Japanese banks and well-reserved European and Canadian banks would show better income statements under the Arrears option. On the other hand, U.S. Money Centers and, perhaps, less well-reserved European banks show better income statements under the New Money option. The benefit of the New Money option on income statements may be offset to some extent by the increased riskiness of bank balance sheets under the New Money option.

3. The results of the analysis are summarized in Table 1 of this annex. The column labeled "NM1" shows the income impact of the New Money option where the rate of return on Argentine debt is calculated without adjusting the contractual rate of interest for the riskiness of loans to Argentina. The column labeled "NM2" shows the income impact of the same new money operation where the rate of return on Argentine debt is calculated after taking into account the appropriate risk premium. The last column labelled "Arrears" shows the impact on post-tax income of the Arrears option.

4. If NM1 is compared to the Arrears option, six of the eight banks are better off lending new money. The only two banks that are better off under the Arrears option are the Royal Bank of Canada and WLB. These banks are better off due to the assumption that they must establish reserves equal to their existing level of reserves against new

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<sup>1/</sup> This risk premium is calculated by using the individual commercial bank's present level of reserves as an indicator of the perceived risk of lending to Argentina. The risk premium is calculated according to the formula:  $rc * (-1 + 1 / (1 - r_l))$  where  $r_l$  = reserve level as a percent of Argentine exposure and  $rc$  = the contractual rate of interest.

money lent to Argentina. Under the Arrears option, on the other hand, it is assumed that they would not need to add to their reserves due to the adequacy of their existing reserves. It is assumed that the Royal Bank of Canada has existing reserves of 40% and that WLB has reserves of 50% against Argentine debt.

5. It should be noted, however, that NM1 overstates the benefit of the New Money option to bank income statements since it does not take into account the perceived riskiness of increasing a bank's Argentine exposure. This becomes apparent when NM2 is compared with the Arrears option. When this comparison is made the three U.S. Money Centers remain better-off under the New Money Option. This result is due to the heavy provisioning that is assumed to be required by U.S. banking regulators in the Arrears option. But, the British bank, Midland, and the French bank, Credit Lyonnais, are now marginally better off under the Arrears option. This result is heavily dependent on the assumption that under the Arrears option Midland and Credit Lyonnais increase their reserves from 30% and 35% of Argentine exposure respectively to 40% of their Argentine exposure. If the level of required reserves under the Arrears option is increased slightly for these two banks the New Money option becomes more attractive than arrears even when the risk premia are taken into account (NM2). When the risk premia are taken into account, the Japanese bank (the Bank of Tokyo) appears substantially better off if it chooses the Arrears option. The German and Canadian banks (WLB and the Royal Bank of Canada) remain better off under the Arrears option when the risk premia are taken into account.

6. In addition to the income effects noted above the New Money option could worsen bank balance sheets by increasing LDC assets as a percentage of total assets. In the cases where the income statement is better under the New Money option, this benefit may be offset by the balance sheet impact implied in lending new money to Argentina.

7. Note that this analysis is entirely dependent upon the assumptions stated on pages 4A through 7A of this annex.

JHay/NPaul:gm



TABLE 1 : IMPACT ON TOTAL POST-TAX INCOME (1988-1990)

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|                      | NM1 | NM2  | ARREARS |
|----------------------|-----|------|---------|
| MANUFACTURES HANOVER | 14  | -172 | -723    |
| CITI                 | 14  | -165 | -693    |
| CHASE MANHATTAN      | 9   | -113 | -361    |
| MIDLAND              | -1  | -99  | -55     |
| BANK OF TOKYO        | 6   | -94  | 0       |
| CREDIT LYONNAIS      | -2  | -69  | -20     |
| ROYAL BANK OF CANADA | -2  | -43  | 0       |
| WLB                  | -3  | -42  | 0       |

TABLE 2 : ASSUMPTIONS AND COMPUTATIONS (all figures in millions)

|    |                                                 |
|----|-------------------------------------------------|
| a) | \$35,000 = TOTAL ARGENTINE COMMERCIAL BANK DEBT |
| b) | \$750 = 1988 NEW MONEY REQUIREMENT              |
|    | \$750 = 1989 NEW MONEY REQUIREMENT              |
| c) | NO FREE RIDERS                                  |
| d) | 34.00% = EFFECTIVE TAX RATE                     |

|      |                   |       |                         |                     |                            |                                  |                                   |
|------|-------------------|-------|-------------------------|---------------------|----------------------------|----------------------------------|-----------------------------------|
| e)   | INTEREST RATES:   |       |                         |                     |                            |                                  | Discount<br>Rate                  |
|      | Argentine<br>Debt | LIBOR | Spread<br>Over<br>Libor | Cost<br>of<br>Funds | Spread<br>Over<br>of Funds | Secondary<br>CostMarket<br>Price | Implied by<br>Secondary<br>Market |
| 1988 | 9.31%             | 8.50% | 0.81%                   | 8.83%               | 0.48%                      | 29                               | 32.10%                            |
| 1989 | 8.91%             | 8.10% | 0.81%                   | 8.43%               | 0.48%                      | 29                               | 30.72%                            |
| 1990 | 8.91%             | 8.10% | 0.81%                   | 8.43%               | 0.48%                      | 29                               | 30.72%                            |

|                |         |       |       |         |               |                    |                 |       |     |
|----------------|---------|-------|-------|---------|---------------|--------------------|-----------------|-------|-----|
|                | Mnfctrs |       |       |         |               |                    |                 |       |     |
|                | Hnvr    | Citi  | B/A   | Midland | Bank<br>Tokyo | Credit<br>Lyonnais | Royal<br>Canada | Bnk   | WLB |
| Risk<br>Premia | 2.63%   | 3.10% | 2.33% | 3.99%   | 1.03%         | 5.01%              | 6.21%           | 9.31% |     |

## f) Reserve Levels

|                                           |         |        |        |         |               |                    |                 |        |     |
|-------------------------------------------|---------|--------|--------|---------|---------------|--------------------|-----------------|--------|-----|
|                                           | Mnfctrs |        |        |         |               |                    |                 |        |     |
|                                           | Hnvr    | Citi   | B/A    | Midland | Bank<br>Tokyo | Credit<br>Lyonnais | Royal<br>Canada | Bnk    | WLB |
| % of Exposure<br>Reserve Level<br>in 1987 | 22.00%  | 25.00% | 20.00% | 30.00%  | 10.00%        | 35.00%             | 40.00%          | 50.00% |     |
|                                           | 321     | 350    | 146    | 252     | 80            | 207                | 146             | 180    |     |
| New Reserves                              |         |        |        |         |               |                    |                 |        |     |
| New Money                                 | 1988    | 0      | 0      | 0       | 5             | 2                  | 4               | 3      | 4   |
| Option                                    | 1989    | 0      | 0      | 0       | 5             | 2                  | 4               | 3      | 4   |
|                                           | 1990    | 0      | 0      | 0       | 0             | 0                  | 0               | 0      | 0   |
| New Reserves                              |         |        |        |         |               |                    |                 |        |     |
| Arrears                                   |         |        |        |         |               |                    |                 |        |     |
| Option                                    | 1988    | 365    | 350    | 183     | 84            | 0                  | 30              | 0      | 0   |
|                                           | 1989    | 365    | 350    | 183     | 0             | 0                  | 0               | 0      | 0   |
|                                           | 1990    | 365    | 350    | 183     | 0             | 0                  | 0               | 0      | 0   |



TABLE 2 - CONTINUED

## g) Tax Benefits of Reserves:

|           |      | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-----------|------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
| New Money | 1988 | 0               | 0    | 0   | 2       | 0                | 2                  | 1                     | 1   |
| Option    | 1989 | 0               | 0    | 0   | 2       | 0                | 2                  | 1                     | 1   |
|           | 1990 | 0               | 0    | 0   | 0       | 0                | 0                  | 0                     | 0   |
| Arrears   | 1988 | 124             | 119  | 62  | 29      | 0                | 10                 | 0                     | 0   |
| Option    | 1989 | 124             | 119  | 62  | 0       | 0                | 0                  | 0                     | 0   |
|           | 1990 | 124             | 119  | 62  | 0       | 0                | 0                  | 0                     | 0   |

## h) New Money Obligations Using 1987 Base

|  |      | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|--|------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
|  | 1988 | 31              | 30   | 16  | 18      | 17               | 13                 | 8                     | 8   |
|  | 1989 | 31              | 30   | 16  | 18      | 17               | 13                 | 8                     | 8   |
|  | 1990 | 0               | 0    | 0   | 0       | 0                | 0                  | 0                     | 0   |

Argentine Exposure of Major Commercial Banks  
New Money Option

|  |      | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|--|------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
|  | 1987 | 1460            | 1400 | 730 | 840     | 800              | 590                | 365                   | 360 |
|  | 1988 | 1491            | 1430 | 746 | 858     | 817              | 603                | 373                   | 368 |
|  | 1989 | 1523            | 1460 | 761 | 876     | 834              | 615                | 381                   | 375 |
|  | 1990 | 1523            | 1460 | 761 | 876     | 834              | 615                | 381                   | 375 |

## Before Tax Income-New Money option

|       |      | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|------|-----------------|------|-----|---------|---------------|--------------------|-----------------------|-----|
|       | 1988 | 7               | 7    | 4   | -1      | 2             | -2                 | -1                    | -2  |
|       | 1989 | 7               | 7    | 4   | -1      | 2             | -1                 | -1                    | -2  |
|       | 1990 | 7               | 7    | 4   | 4       | 4             | 3                  | 2                     | 2   |
| Total |      | 22              | 21   | 11  | 2       | 9             | 0                  | -1                    | -2  |

TABLE 2 - CONTINUED

## Post-Tax Income-New Money Option

|       | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
| 1988  | 5               | 5    | 2   | -2      | 1                | -2                 | -2                    | -2  |
| 1989  | 5               | 5    | 2   | -2      | 2                | -2                 | -2                    | -2  |
| 1990  | 5               | 5    | 2   | 3       | 3                | 2                  | 1                     | 1   |
| Total | 14              | 14   | 7   | -1      | 6                | -2                 | -2                    | -3  |

## Before Tax Income-New Money option (Using Risk Premia)

|       | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
| 1988  | -32             | -38  | -14 | -30     | -5               | -27                | -21                   | -32 |
| 1989  | -33             | -38  | -14 | -31     | -5               | -28                | -22                   | -33 |
| 1990  | -33             | -38  | -14 | -31     | -5               | -28                | -22                   | -33 |
| Total | -97             | -114 | -42 | -92     | -14              | -83                | -65                   | -99 |

## Post-Tax Income-New Money Option (Using Risk Premia)

|       | Mnfctrs<br>Hnvr | Citi | B/A | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|-----------------|------|-----|---------|------------------|--------------------|-----------------------|-----|
| 1988  | -21             | -25  | -9  | -20     | -3               | -18                | -14                   | -21 |
| 1989  | -22             | -25  | -9  | -20     | -3               | -18                | -14                   | -22 |
| 1990  | -22             | -25  | -9  | -20     | -3               | -18                | -14                   | -22 |
| Total | -64             | -75  | -28 | -60     | -9               | -55                | -43                   | -65 |

## Before Tax Income-Arrears Option

|       | Mnfctrs<br>Hnvr | Citi  | B/A  | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|-----------------|-------|------|---------|------------------|--------------------|-----------------------|-----|
| 1988  | -365            | -350  | -183 | -84     | 0                | -30                | 0                     | 0   |
| 1989  | -365            | -350  | -183 | 0       | 0                | 0                  | 0                     | 0   |
| 1990  | -365            | -350  | -183 | 0       | 0                | 0                  | 0                     | 0   |
| Total | -1095           | -1050 | -548 | -84     | 0                | -30                | 0                     | 0   |



TABLE 2 - CONTINUED

## Post-Tax Income-Arrears Option

|       | Mnfctrs<br>Hnvr | Citi | B/A  | Midland | Bank of<br>Tokyo | Credit<br>Lyonnais | Royal Bnk<br>of Canad | WLB |
|-------|-----------------|------|------|---------|------------------|--------------------|-----------------------|-----|
| 1988  | -241            | -231 | -120 | -55     | 0                | -20                | 0                     | 0   |
| 1989  | -241            | -231 | -120 | 0       | 0                | 0                  | 0                     | 0   |
| 1990  | -241            | -231 | -120 | 0       | 0                | 0                  | 0                     | 0   |
| Total | -723            | -693 | -361 | -55     | 0                | -20                | 0                     | 0   |

August 11, 1988

To: Mr. Qureshi

Re.: ARGENTINA - Bridge Loan Materials  
Note for US Treasury

The Treasury has come back with a number of comments that I have discussed with Messrs. Juba and McCoy during the course of the day. With your signature on the attached letter, I am hopeful that we can put the matter to rest.

I would be happy to explain this to you over the phone.

W. Tyler

P.S. I should also  
brief you on a  
related document, also  
requested by the US  
Treasury.



RECEIVED

88 AUG 11 PM 5:48

OFFICE OF THE  
SVPOP

**The World Bank**  
Washington, D.C. 20433  
U.S.A.

MOEEN A. QURESHI  
Senior Vice President, Operations

August 11, 1988

Dear David:

Attached, per your request, is a note describing  
the World Bank's upcoming sector adjustment lending operations  
to Argentina.

Sincerely,

*Moeen*

Mr. David R. Malpass  
Deputy Assistant Secretary  
United States Treasury  
Washington, D.C.

Attachment



**The World Bank**  
Washington, D.C. 20433  
U.S.A.

MOEEN A. QURESHI  
Senior Vice President, Operations

August 11, 1988

Dear David:

Attached, per your request, is a note describing  
the World Bank's upcoming sector adjustment lending operations  
to Argentina.

Sincerely,

Mr. David R. Malpass  
Deputy Assistant Secretary  
United States Treasury  
Washington, D.C.

Attachment

cc: Mr. Camarasa

cc: Messrs. Husain (o/r), Steckhan (Acting LACVP); Bottelier (LA4DR-o/r);  
Bery (o/r), Moreau, Newfarmer (o/r) (LA4CO)

## NOTE ON ARGENTINA

1. This is to advise you of the status of certain policy-based World Bank loans for the benefit of Argentina. It should be noted that World Bank adjustment loans are generally subject to certain conditions which differ from conditions required under investment loans. These include the following:

(a) a letter of development policy from the government is usually required, which addresses the macroeconomic environment as well as the sector policies intended to be pursued by the government;

(b) a set of sector-specific conditions which are expected to be met in the course of loan implementation; and

(c) specific conditions which must be met before the loan agreement becomes effective, and before release of any second tranche of the loan. (A Bank loan does not become effective upon signature, but after submission to the Bank of satisfactory evidence concerning the validity of the loan agreement under (in this case) Argentine law, and concerning the fulfillment of additional conditions of effectiveness which may be specified in the loan agreement.)

2. It should also be noted that any disbursements under these policy-based loans are contingent upon the existence of a macroeconomic framework consistent with loan objectives, and this is itself a condition of effectiveness of these loans.

3. We welcome the recent economic policy initiatives announced by the Argentine authorities and note the intent of Argentina to seek a new standby arrangement with the IMF. We are closely monitoring developments and are in continued contact with the Argentine Government to assess progress toward meeting these objectives, as well as progress toward meeting the conditions of effectiveness of the two loans referred to below.

4. The status of the particular loans being considered as potential sources of repayment under the proposed U.S. Treasury/B.I.S. bridge loan for Argentina is as follows:

5. Banking Sector Loan. This \$400 million loan was approved by the Bank's Board of Executive Directors in March 1988. It is divided into two tranches, the first of which totals \$199.5 million. Of this, \$80 million will be released immediately upon effectiveness of the loan and the remainder of the first tranche (\$119.5 million) is to be disbursed upon receipt by the Bank of adequate documentation on invoices for eligible imports, which is expected over the 2 to 4 weeks following loan effectiveness. Availability of the first tranche awaits the signature of the loan and compliance with certain conditions of effectiveness. The Presidential Decree authorizing the signature of the loan documents has been issued and signature is now only a matter of scheduling. In addition to the existence of an appropriate macroeconomic policy framework (para. 2), the effectiveness conditions of the loan are:



- Banco Central program for reducing rediscounts.
- 1988 rediscounts to be presented to Congress with the National Budget.
- Taking measures to discourage public banks from increased use of overdrafts from Banco Central.
- Initiating implementation of plan of action to strengthen Banco Central's Superintendencia de Bancos.
- New Banco Central regulation establishing revised system of loan loss provision for banking institutions.

6. In addition to the above conditions of effectiveness, to ensure compliance with other provisions of the loan, the level of Central Bank reserve requirements and of forced investments on incremental deposits must be brought back to the levels permitted in the loan agreement.

7. Release of the second tranche of the loan (\$200 million) is contingent upon: (i) the continued existence of a macroeconomic framework consistent with the loan objectives; (ii) submission to Congress of draft legislation to establish the Deposit Insurance Corporation; (iii) communication to all financial institutions that their financial statements will henceforth be published; and (iv) compliance by Banco Central with a program for further reductions of rediscounts and for limiting the use of overdraft facilities by public banks.

8. Trade Policy and Industrial Deregulation Loan. This loan, and its policy content, are currently under discussion with the Argentine authorities. Subject to satisfactory completion of negotiations, it is anticipated that the loan will be ready for Board consideration towards end September. The loan amount could be on the order of \$400 million to \$500 million, depending upon the policy reforms to be enacted by the Government and supported by the loan. Roughly half of this amount would be available in the first tranche once the loan is effective and would be released upon receipt by the Bank of adequate documentation on invoices for eligible imports, which is expected over the 2 to 6 weeks following loan effectiveness. While the precise policy measures to be supported by the loan are still under discussion, it can be expected that the effectiveness conditions will include the conditions indicated in paras. 1 and 2 above. In addition, and more specifically, effectiveness conditions are likely to include steps to further reduce quantitative restrictions on imports, decrease tariff surcharge levels and tariff dispersion, and lessen the tax losses and distortive effects of the existing industrial promotion regime.



cc: H. Dubey

August 10, 1988

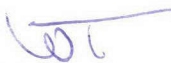
To: Mr. Qureshi

Re.: ARGENTINA - Statement for US  
Treasury on Bridge Loan

Per your request, attached for your approval (in the first attachment) is the statement for the US Treasury. If you agree, I will send it to Mr. McCoy.

I am also attaching the statement drafted by Treasury (second attachment).

The US Treasury requests that it ultimately take the form of a telex from the Bank to the BIS. Alternatively, it might be in the form of a statement from the Bank to the US Treasury, which then could be transmitted to the BIS. Do you have view on this?

  
William Tyler

Attachments

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SVPOP

Attachments

For your request, attached for your approval  
in the first attachment, is the statement for  
the US Treasury. If you agree, I will send it to  
the US Treasury.  
I am also attaching the statement for the US  
Treasury (second attachment).

The US Treasury requests that it should  
take the form of a letter from the US Treasury.  
Alternatively, it might be in the form of a statement  
from the Bank to the US Treasury, which would be  
transmitted to the US Treasury.

Re: ARGENTINA - Statement for US  
Treasury on Indico Form

For Mr. Gurnea

August 10, 1988

NOTE ON ARGENTINA

1. This is to advise you of the status of certain policy-based World Bank loans for the benefit of Argentina. It should be noted that World Bank adjustment loans are generally subject to certain conditions which differ from conditions required under investment loans. These include the following:

(a) a letter of development policy from the government is usually required, which addresses the macroeconomic environment as well as the sector policies intended to be pursued by the government;

(b) a set of sector-specific conditions which are expected to be met in the course of loan implementation; and

(c) specific conditions which must be met before the loan agreement becomes effective, and before release of any second tranche of the loan.

2. It should also be noted that any disbursements under these policy-based loans are contingent upon the existence of a macroeconomic framework consistent with loan objectives, and this is itself a condition of effectiveness of these loans.

3. We welcome the recent economic policy initiatives announced by the Argentine authorities and note the intent of Argentina to seek a new stand-by arrangement with the IMF. We are closely monitoring developments and are in continued contact with the Argentine Government to assess progress toward meeting these objectives, as well as progress toward meeting the conditions of effectiveness of the two loans referred to below.

4. The status of the particular loans being considered as potential sources of repayment under the proposed U.S. Treasury/B.I.S. bridge loan for Argentina is as follows:

5. Banking Sector Loan. This \$400 million loan was approved by the Bank's Board of Executive Directors in March 1988. It is divided into two tranches, the first of which totals \$199.5 million. Of this, \$80 million will be released immediately upon effectiveness of the loan and the remainder of the first tranche (\$119.5 million) is to be disbursed upon receipt by the Bank of adequate documentation on invoices for eligible imports, which is expected over the 2 to 4 weeks following loan effectiveness. Availability of the first tranche awaits the signature of the loan and compliance with certain conditions of effectiveness. The Presidential Decree authorizing the signature of the loan documents has been issued and signature is now only a matter of scheduling. The effectiveness conditions of the loan are:

- Banco Central program for reducing rediscounts.
- 1988 rediscounts to be presented to Congress with the National Budget.



- Taking measures to discourage public banks from increased use of overdrafts from Banco Central.
- Initiating implementation of plan of action to strengthen Banco Central's Superintendencia de Bancos.
- New Banco Central regulation establishing revised system of loan loss provision for banking institutions.

6. In addition to the above conditions of effectiveness, to ensure compliance with other provisions of the loan, the level of Central Bank reserve requirements and of forced investments on incremental deposits must be brought back to the levels permitted in the loan agreement.

7. Trade Policy and Industrial Deregulation Loan. This loan, and its policy content, are currently under discussion with the Argentine authorities. Subject to satisfactory completion of negotiations, it is anticipated that the loan will be ready for Board consideration towards end September. A first tranche, expected to be of \$200 million, would become available upon loan effectiveness. Of the first tranche, \$80 million would be released immediately upon loan effectiveness and the remainder (expected to be \$120 million) is to be disbursed upon receipt by the Bank of adequate documentation on invoices for eligible imports, which is expected over the 2 to 6 weeks following loan effectiveness. The conditions of effectiveness for this proposed loan, currently being discussed with the Argentines, are likely to require action to reduce trade restrictions further, and will be stated in the loan documents.

LA4CO  
08/10/88

ARGENTINA  
Needed Telex from IBRD to B.I.S.  
August 10, 1988

Attachment 2  
US Treasury Draft

"This is to advise you of the status of certain pending policy-based sector loans for the benefit of the Government of Argentina. It should be noted that any disbursements under policy based sector loans for Argentina are contingent upon the presence of a sound macroeconomic policy environment, which is itself a condition of effectiveness.

We welcome the recent initiatives by the Argentine authorities and note the intent of those authorities to seek a new stand-by arrangement with the IMF. We will be closely monitoring developments and will be in continued contact with the Argentine authorities to better assess progress towards meeting these conditions of effectiveness.

The status of the particular loans being considered as potential sources of repayment under the proposed U.S. Treasury/B.I.S. loan for Argentina is as follows:

Banking Sector Loan. This loan was approved by the Executive Board in March 1988. It provides for a total of \$400 million to be released in two tranches. The first tranche totals \$199.5 million, of which \$80 million will be released immediately upon the loan becoming effective. The remaining \$119.5 million of the first tranche is expected to be released over the following 2 to 6 weeks as the GOA provides to the World Bank adequate documentation on invoices of eligible imports. Availability of the first tranche awaits the completion of certain conditions for effectiveness as noted below....

Trade Sector Loan. This loan is currently under discussion with the Argentine authorities. It is anticipated that it will be ready for Board consideration on <insert date> and that a first tranche of \$200 million would become available once conditions of effectiveness are met. Of the \$200 million first tranche, \$80 million would be released immediately upon the loan becoming effective, and the remaining \$120 million of the first tranche is expected to be released over the following 2 to 6 weeks as the GOA provides to the World Bank adequate documentation on invoices of eligible imports. The conditions for effectiveness for this loan will be stated in the loan document according to normal practice. The policy content of the conditions are still a matter of discussion and negotiation with the Argentine authorities.

<NOTE: The list of conditions of effectiveness probably can be provided by Mr. Egbert Gerken (473-9197) for the Trade Sector Loan and by Mr. Mauricio Larrain (473-8615) for the Banking Sector Loan.>





# Record Removal Notice



|                                                                                                |                                                 |                                                                                                                                                                                                                                                                                                 |                                |                          |
|------------------------------------------------------------------------------------------------|-------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|--------------------------|
| <b>File Title</b><br>Argentina - Debt - 1987-1990- Correspondence                              |                                                 | <b>Barcode No.</b><br><br>1660370                                                                                                                                                                                                                                                               |                                |                          |
| <b>Document Date</b><br>August 10, 1988                                                        | <b>Document Type</b><br>Memorandum w/attachment |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Correspondents / Participants</b><br>To: Distribution<br>From: Thomas A. Duvall, III, LEGOP |                                                 |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Subject / Title</b><br>Argentina: Third Bridge Loan                                         |                                                 |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Exception(s)</b><br>Attorney-Client Privilege                                               |                                                 |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Additional Comments</b>                                                                     |                                                 | <p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.</p> <table border="1"><tr><td><b>Withdrawn by</b><br/>S. Alon</td><td><b>Date</b><br/>4/17/2025</td></tr></table> | <b>Withdrawn by</b><br>S. Alon | <b>Date</b><br>4/17/2025 |
| <b>Withdrawn by</b><br>S. Alon                                                                 | <b>Date</b><br>4/17/2025                        |                                                                                                                                                                                                                                                                                                 |                                |                          |



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*cc: Mr. Dubey*  
August 10, 1988

APR 17 2025

CONFIDENTIAL

To: Mr. Qureshi

*WBG* **WBG ARCHIVES**  
(through Mr. Steckhan, Acting RVP, LAC)

re: ARGENTINA - Commercial Bank Steering Committee Meeting

1. This note is to report to you a phone conversation I had this morning with Jim Nash, who is a Morgan Guaranty Bank VP and the chairman of the Economics Subcommittee of the Commercial Bank Steering Committee for Argentina. There was a meeting of the latter committee yesterday in New York to discuss the recent economic measures and to initiate negotiations on the 1988-89 international financing program with the commercial banks. Daniel Marx, a Central Bank director, made the presentation on the part of the Argentine government.
2. The reception of Economics Subcommittee to the measures has been one of skepticism. Nash, for example, did not think that the recently announced program is either credible or substantive. He stressed the temporary nature of the fiscal measures announced in the program, indicating that more fundamental fiscal issues were not being addressed.
3. The interest arrears to the commercial banks, according to Nash, now amount to about US\$ 850 million, of which \$200-250 million is now over 90 days due. Nash believes that the cash reserves of the Government now exceed US\$ 2 billion, although Marx has denied this. (As yet, we have no basis to judge this.)
4. The Steering Committee requested that the Government make a demonstration of good faith by paying immediately US\$ 174 million, which corresponds to overdue interest on the "old new money." Mr. Marx was unable to make any commitment on this question.
5. In the Government's presentation there was no specification of a gap or financing request amount. Nash says that his projections show an unfinanced gap of about US\$ 2 billion for 1988-9 (as compared to the US\$ 3 billion specified in the Government's document we have seen).
6. Partly in order to help define the gap and begin discussions on amounts, the Government requested that the Economic Subcommittee visit Buenos Aires as soon as possible. While there was concern expressed by many of the individual banks represented in the Steering Committee that sending a mission would be transmitting the wrong signal, there will probably be a visit arranged in a couple of weeks.
7. The banks were told that the Government will release its Medium Term Economic Program document next week.

*W. Tyler*  
W. Tyler

cc: Messrs. Steckhan, Bottelier (o/r), Bery (o/r), Moreau, Newfarmer (o/r)  
Ms. Jones-Carroll



FORM NO. 1599  
(8-80)

THE WORLD BANK

| ROUTING SLIP                                    |  | DATE                 |
|-------------------------------------------------|--|----------------------|
|                                                 |  | August 8, 1988       |
| OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS |  |                      |
| NAME                                            |  | ROOM NO.             |
| Mr. Husain                                      |  |                      |
|                                                 |  |                      |
|                                                 |  |                      |
|                                                 |  |                      |
|                                                 |  |                      |
|                                                 |  |                      |
| To Handle                                       |  | Note and File        |
| Appropriate Disposition                         |  | Note and Return      |
| Approval                                        |  | Prepare Reply        |
| Comment                                         |  | Per Our Conversation |
| Full Report                                     |  | Recommendation       |
| Information                                     |  | Signature            |
| Initial                                         |  | Send On              |
| REMARKS                                         |  |                      |
|                                                 |  |                      |
| FROM                                            |  |                      |
| Moeen A. Qureshi                                |  |                      |



DECLASSIFIED

CONFIDENTIAL

APR 17 2025

July 26, 1988

Mr. Husain:

WBG ARCHIVES

RE: Argentina's Trade Discrimination Against the U.K.

1. Regarding Mr. Cassell's memo to you of July 20, I met with him this afternoon. I proposed that, in view of his Government's continued unhappiness about the Bank's release of the second tranche of the first Argentina trade loan and its reluctance to support a proposed follow-up trade loan as long as Argentina continues to discriminate against imports from the U.K., we would try to persuade the Argentines to stop such discrimination altogether. Such efforts had to be undertaken quietly and at the right time. Success was not guaranteed, and, if the Argentines would be willing to lift their restrictive trade practices against the U.K. we should not expect them to give any publicity to this.

2. I agreed with Mr. Cassell that we would not formally respond to his memo to you of July 20 until we had tried this course of action. In any event, the second trade loan is not scheduled to go to the Board until mid-October and that schedule is, of course, dependent on adequate improvement in Argentina's macro environment. Mr. Cassell was understanding of the Bank's position and agreed not to raise the matter again until he had heard from us. He expressed the hope that the issue could be resolved before the Annual Meetings in Berlin.



Pieter Bottelier

cc: Messrs. Qureshi  
Scherer  
Bery (o/a)  
Moreau  
Newfarmer

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# Record Removal Notice



|                                                                                                                                               |                                |                                                                                                                                                                                                                                                                                                 |                                |                          |
|-----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|--------------------------|
| <b>File Title</b><br>Argentina - Debt - 1987-1990- Correspondence                                                                             |                                | <b>Barcode No.</b><br><br>1660370                                                                                                                                                                                                                                                               |                                |                          |
| <b>Document Date</b><br>August 3, 1988                                                                                                        | <b>Document Type</b><br>Report |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Correspondents / Participants</b><br>Ministry of Economy of Argentina [with the compliments of Félix Alberto Camarasa, Executive Director] |                                |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Subject / Title</b><br>Anti-Inflationary Program                                                                                           |                                |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Exception(s)</b>                                                                                                                           |                                |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Additional Comments</b><br>Declassification review of this record may be initiated upon request.                                           |                                | <p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.</p> <table border="1"><tr><td><b>Withdrawn by</b><br/>S. Alon</td><td><b>Date</b><br/>4/17/2025</td></tr></table> | <b>Withdrawn by</b><br>S. Alon | <b>Date</b><br>4/17/2025 |
| <b>Withdrawn by</b><br>S. Alon                                                                                                                | <b>Date</b><br>4/17/2025       |                                                                                                                                                                                                                                                                                                 |                                |                          |



8/4/88 Statement by Mr Qureshi  
in Board Meeting

The Argentine authorities announced last evening a comprehensive program designed to achieve domestic economic stabilization and major structural reforms. The measures that have already been announced will aim at:

- 1) exchange market and trade deregulation in order to promote a closer integration of Argentina with the international economy, promote economic efficiency and better resource allocation;
- 2) a substantial reduction in the fiscal deficit, by cutting expenditures and mobilizing additional resources in order to control inflation;
- 3) implementation of a monetary policy consistent with the achievement of stabilization;
- 4) implementation of an income policy to provide the underpinnings for stabilization and resumption of economic growth; and
- 5) acceleration of a program of structural reforms, specially in the public sector and in trade and industrial policies.

Most of the measures announced yesterday fit into a medium-term structural adjustment program which the Government will publish early next week.

While we do not yet have the official report of the announcements made yesterday, let me now try to be a little more

specific about some of these policy objectives. In the fiscal area, the objective of the Government is to reduce the budget deficit in the second semester of 1988 to 2% of the Gross Domestic Product and to try to achieve even further improvement in 1989. In the exchange field, the Government will move all commercial transactions to the "free exchange market" except agricultural exports, pharmaceuticals and about 50% of the industrial exports -- these will continue to be transacted in the "official exchange market". The Government plans to eliminate by the end of September quantitative restrictions on a large number of imports, leaving only luxury goods, sugar, automobiles and garments (representing about 10% of goods subject to tariffs) that will remain subject to quantitative restrictions. The Government's objective is to move rapidly towards exchange rate unification and a liberal trading regime. As regards incomes policy, the Government has reached an agreement with business and industrial leaders on a voluntary restraint of prices and wages to no more than 3% per month.

The Government has consulted with the staff of both the Bank and the Fund in preparing this program of economic stabilization and structural reforms. The Bank staff welcomes the actions already taken by Argentina to strengthen its economic and financial situation, and the various corrective measures and reforms that are planned in the coming weeks and months. The effective implementation of the stabilization and structural adjustment programs that have been prepared by the Argentine Government should go a long way towards

stimulating economic growth in a much sounder and more stable economic framework.

The Argentine Government has requested the Bank to review urgently the steps that are required to make the Banking Sector Loan, which was approved by the Board last March, effective. We have also a Trade and Industrial Policy Sector loan at an advanced stage of preparation. The Argentine Government has asked the Bank to accelerate the processing of these loans in order to provide support for its adjustment program. I believe, Mr. Chairman, that the announcement by the Argentine Government of its Economic Program, and the measures already adopted, should enable us to move quickly with Bank lending. The Bank will send a mission to Argentina this coming week-end to evaluate the overall program, and to pursue the further processing of the loans I have mentioned.

I should also mention that Argentina has approached, on a bilateral basis, certain OECD Governments for a Bridge loan to provide immediate financial support for its adjustment program, particularly in the exchange field. The Argentine Government also intends to initiate discussions very soon with commercial banks.



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APR 1 / 2025

WBG ARCHIVES

8/3/88  
Confidential

1. The Bank's present position on the proposed bridge-loan (with background information on this matter).
2. How the Bank is to proceed with this matter?
3. The Bank's loans to be used for repayment of the proposed bridge-loan.
  - (a) The names of the projects:  
("Banking Sector Reform I" - \$400 million and  
"Trade Policy and Industry Deregulation" - \$400 million?)
  - (b) Schedule of disbursement.
4. Current economic situation and prospect, in particular,
  - (a) Balance of Payment
  - (b) Foreign Reserve and Financial Gap
  - (c) Impact of Commodity (Grain) Price.



# Record Removal Notice



|                                                                                                       |                                     |                                                                                                                                                                                                                                                                                                 |                                |                          |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|--------------------------|
| <b>File Title</b><br>Argentina - Debt - 1987-1990- Correspondence                                     |                                     | <b>Barcode No.</b><br><br>1660370                                                                                                                                                                                                                                                               |                                |                          |
| <b>Document Date</b><br>May 5, 1987                                                                   | <b>Document Type</b><br>Board Paper |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Correspondents / Participants</b><br>From: Vice President and Secretary                            |                                     |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Subject / Title</b><br>Executive Directors' Meeting - April 14, 1987 - Argentina Financing Package |                                     |                                                                                                                                                                                                                                                                                                 |                                |                          |
| <b>Exception(s)</b>                                                                                   |                                     |                                                                                                                                                                                                                                                                                                 |                                |                          |
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| <b>Withdrawn by</b><br>S. Alon                                                                        | <b>Date</b><br>4/17/2025            |                                                                                                                                                                                                                                                                                                 |                                |                          |