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BRIEF FOR MR. CLAUSEN - LATIN AMERICA + CARIBBEAN REGION: LAC Organization Chart, Regional Profile + Prospects, Statistical Tables, Argentina

1

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LAC Regional Briefing Book

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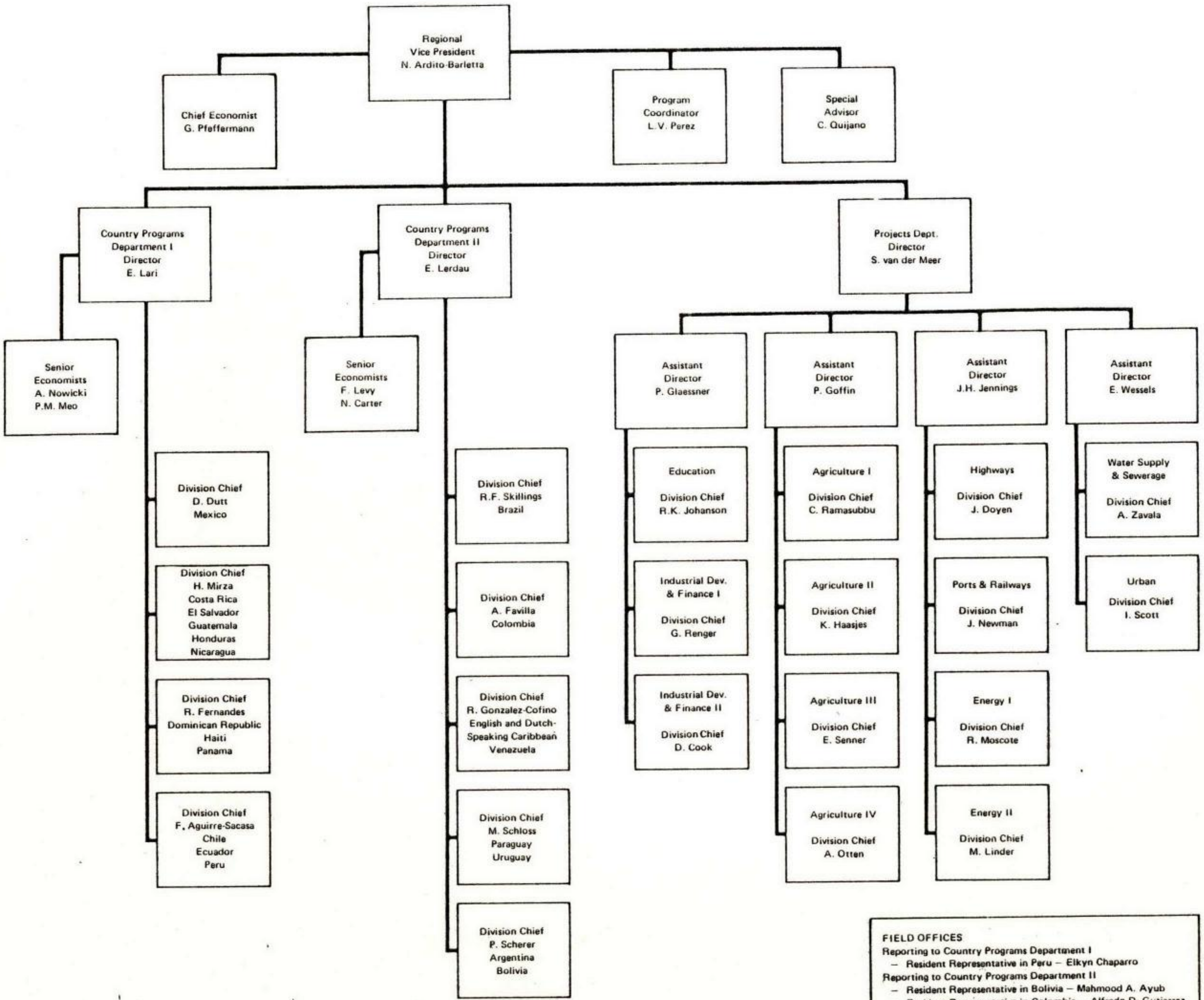
Contents

April 7, 1981

LAC ORGANIZATION
CHART

LATIN AMERICA AND THE CARIBBEAN ORGANIZATION
REGIONAL OFFICE



REGIONAL PROFILE
AND PROSPECTS

REGIONAL PROFILE AND PROSPECTS

I. Past growth performance and social progress

The growth rate of Latin America and the Caribbean has been rapid since 1960. Per capita GDP rose at an annual rate of 2.7 percent during the 1960s and accelerated to an average of 3.5 percent during the 1970s. This contrasts to a fall in per capita growth rates from 3.9 to 2.4 percent per year in the industrialized countries. Of course, growth has been uneven from country to country and has varied over time, but overall the Region's performance during the 1970s has been surpassed only by the capital surplus oil-exporting countries and East Asia and the Pacific.

Nevertheless, widespread poverty, inequality and related social and political tensions are still critical problem areas, despite the considerable social progress made in the last two decades. Illiteracy fell from 48 percent of the population in 1950 to 27 percent in the mid-70s and has continued to decline since then. The number of university students increased fourfold since 1960 in Mexico, Central America and the Caribbean, and more than sixfold in South America. Life expectancy increased on the average from 50 years in 1950 to over 63 years at present. Much of this social progress has been a result of increasing urbanization, because the better jobs and social services are traditionally available mostly in the cities. Latin America and the Caribbean is the most heavily urbanized region among LDCs; the urban population has increased from about 40 percent of the total in 1950 to about 60 percent in 1975, and is expected to reach nearly 80 percent by the end of this century. However, the growth rate of the urban population has gradually fallen from around 5 percent per year in 1950 to around 4 percent today and is expected to continue declining. Likewise, the contribution of rural/urban migrants to urban growth has fallen from 38 percent during the 1950s to 30 percent during 1970-75. Urbanization has undoubtedly contributed to the gradual drop in population growth rates. Still, much poverty and inequality remain in the Region, especially in the rural areas where not enough attention has been paid to basic needs or to policies to increase the productivity of the poor. Project preparation for social development is a relatively new experience, and often policies aimed at improving income distribution have been inconsistent with growth of production. Urbanization, in turn, has brought with it a host of complex and enduring problems, as unfilled expectations combined with modern mass communications contributed to political instability in many countries. On balance, this may be the most difficult part of the transition to self-sustained growth.

Most countries in the Region have mixed economies in which the private sector plays a major role in the productive sectors, more so than in most other developing countries. The public sector, however, is also important and a large part of the national product is either directly controlled by state enterprises or indirectly affected by Government regulations and sector policies. There is a widespread recognition that the weakness of public administration is a major obstacle to economic development in the Region; some programs to improve its quality have been launched, with mixed results. The Bank has made institutional development an integral part of most lending operations to LAC countries, and our economic dialogue normally stresses the need to improve sector policies, management of state enterprises and incentives for private investment. Still, this is a difficult area which will require a sustained effort, including the growing involvement of a highly trained and experienced Bank staff.

Most of the larger LAC countries have shifted from import-substitution to export-promotion in a more open economic system. During and after World War II and also in the aftermath of the Korean War the major countries pursued import-substitution strategies in "basic" industries as well as in consumer durables. Their leading intellectuals felt--and many still do--that the inward-looking policies would help protect their economies from external shocks. However, this resulted in unsustainable balance of payments deficits and a consequent decline in growth rates. For the majority of the region's countries--those with small markets--the policy of import substitution led to a plateau of gains in productivity. Brazil and Colombia broke away from this pattern during the 60s and began instead to liberalize their economic systems, reducing industrial protection somewhat. Both countries were successful in stimulating exports (including the unexpected emergence of manufactured exports as a major foreign exchange earner). Uruguay, Chile, and later Argentina, followed suit during the 70s, opening-up to foreign competition. Peru has joined this group of countries in 1980. The move away from import-substitution has generally been accompanied by greater efficiency and improved growth performance. Lately, however, the Argentine exchange rate has not kept pace with inflation; the same is true in Mexico, and both countries suffer a decline in non-traditional exports. In spite of its good export performance, Latin America has failed to keep up with the growth of world trade; its share fell from 8 percent around 1960 to 5.5 percent in 1978.

Domestic capital formation has increased for the Region as a whole, from about one-fifth of GDP in 1960 to about one-fourth in 1978. The bulk of this investment--nearly 90%--is financed from internal savings. Still, the generation of internal savings could be further increased, thus reducing the need for foreign borrowing, and the efficiency of resource allocation could be improved, by strengthening the capital markets, which in many countries remain segmented and repressed. The Southern Cone countries (Argentina, Chile and Uruguay) have removed most restrictions on the capital markets, with remarkable success in terms of generating financial savings and attracting private foreign capital. Other countries such as Brazil, Colombia and Peru are also beginning to move in that direction.

II. Effect of OECD slowdown and oil price increases

The effect of the recession in industrialized countries and of the oil shocks , coming on top of long-standing social inequalities, has been severe. Brazil represents the largest problem. Apart from Brazil, the problems center mainly on the smaller countries of the Caribbean and Central America. Colombia can be virtually energy self-sufficient; Peru is now a net oil exporter; Mexico and Venezuela are benefiting from oil price increases; Argentina is nearly energy self-sufficient, and Ecuador, Bolivia and Trinidad are net exporters of hydrocarbons. The main medium country severely affected by oil price increases is Chile, where a profound restructing of the economy has been underway and where the growth rate of GDP has recently been very rapid. Likewise Uruguay has improved its development performance in the face of adverse external conditions by liberalizing its economic system after 1973. With the exception of Trinidad, Panama, Barbados and the Bahamas, the external shocks have had the most negative effect in Central America and the Caribbean, not so much per-se (since other small economies without petroleum resources managed to weather the shock) but because external shocks compounded internal mis-management and/or political disruptions. However, the growth of all LAC countries has suffered. This in turn affected the generation of employment at a time when the labor force is expanding at a fast pace. With the exception of Brazil, the more important countries either had sufficient energy resources or adjusted their economic policies in such a way as to mitigate the negative effects on growth. The main policies to this end were additional external borrowing and export promotion. However, the political problems introduced by the adjustments needed in the oil-importing countries, particularly the smaller ones, are far from resolved.

III. Prospects

The countries of the Caribbean and Central America are least able to respond to the 1979 oil shock and the economic and social outlook is clouded in many of the countries of that region by the pre-existing paralyzing political problems. Leaving aside Brazil, 85 percent of LAC's population live in countries where the outlook for the 80s is not necessarily worse than performance during the 70s: Argentina, Mexico, Colombia, Peru, Chile, Ecuador, Venezuela, Paraguay, Uruguay, Bolivia, Trinidad and, perhaps, Jamaica. This is a sharp contrast to most developing areas of the world. Nevertheless, in all countries but the few that are clearly going to remain energy self-sufficient during the decade (Mexico, Venezuela, Trinidad, Paraguay, Ecuador and Argentina) the social costs of the adjustment will remain high, with the resulting political risks. Thus, economic management will need to be skillful and often courageous, especially if further "oil shocks" occur. But on balance the lesson of the 70s is that appropriate economic policies can effectively counteract external shocks to a large extent, albeit at the cost of a setback to social development. We expect this delicate balance to continue during the next few years.

In a longer-term perspective Latin America and the Caribbean's prospects will continue to be dominated by the following factors: while population growth has begun to abate, the labor supply will continue to increase rapidly reflecting the very young age-structure of the population; the population of economically active age (15-64 years) will probably increase from 196 million in 1980 to 329 million by the end of the century. In the same period the urban population of the region will probably double to 400 million. The required rate of employment generation during the next 15-20 years will be greater than in other developing regions, hence rapid growth will continue to be an essential policy objective, both for improving living standards and for seeking political and social stability. Because about one-half of the Region's population today is under 20 years old, investment in human beings (health, education) continues to be essential for future employment and improvements in income distribution. The development challenge will be to design policies to foster sustained growth in a difficult international environment, to further diversify the economic basis, and at the same time to try to achieve a broader sharing of the benefits of growth when population is still growing rapidly (especially in the cities), expectations are rising and the political situation often remains unstable. The persistence of high inflation adds difficulty to this challenge.

In this connection Latin America has not escaped the world-wide debate as to how to distribute the heavy costs of adjustment between income groups, which activities should bear the heavier burdens, or what regions should suffer the most. As the experience of the most advanced countries shows, it is not easy politically to reach consensus regarding the elimination of subsidies, maintaining positive real interest rates, raising the price of public services or reducing protection of ongoing industrial activities.

This problem is particularly acute for the oil importing countries (Brazil, Central America and the Caribbean, Uruguay and Chile), where short- and medium-term adjustment requirements are very tough. For them, increased exports, further opening-up of the economies, better development of agriculture, more efficient use of resources, increased levels of savings and investment will remain crucial issues for the next decade. For the oil exporters (or self-sufficient countries) growth prospects are good but policy needs to focus on constraints in the availability of trained human resources, institutions and administrative capacity, as well as on the misallocation of resources through indiscriminate subsidies. Finally, it is clear that the plight of the small countries -- particularly those in Central America and the Caribbean -- will continue to be the most acute in the Region because all these difficulties are compounded with the normal problems of small economies.

Furthermore, these mixed economies face the added challenge of improving the efficiency of public enterprises, finding new ways for the effective delivery of social services, formulating coherent sector policies and sending consistent signals and appropriate incentives to the private sector. In these difficult and delicate circumstances the Bank staff can and should play a critical role as a respected independent advisor and friend of the Governments.

In light of performance during the past few years prospects for development are probably better in the Region than in most of the developing world. But these prospects will only materialize if policies and institutions continue to improve. The Bank can continue to make an important technical and financial contribution to these efforts. This contribution is particularly worthwhile because several Latin American countries have a chance by the end of the century to join the small group of nations that have achieved self-sustained growth and can themselves contribute to the development of the less developed countries.

IV. Special features of work in LAC

LAC operations have to be planned bearing in mind the lending program of the Interamerican Development Bank (IDB). The Bank lends a larger amount, although the IDB contributes to finance a larger number of projects. While there is a fair amount of coordination between the two institutions, there are, of course, also conflicts. These differences arise mainly because the IDB is not equipped for -- or interested in -- policy dialogue with the countries. During the past few years we have increased co-financing with the IDB, including a number of important operations (such as the Mexican steel mill of Las Truchas and the Yacyreta hydroelectric dam).

IDA represents a very small share of LAC operations. Only Haiti is a straight IDA client and the remaining IDA involvement in "blend countries" (Honduras, Bolivia, Guyana, Nicaragua and the Caribbean LDCs) does not add up to much.

The Region's cooperation with the IMF is close. This goes back 20 years or more and may reflect the particular relevance of macro-economic issues in the Region. While we have differences with the IMF on policy recommendations our collaboration is now closer than ever (a) because short-term management issues more often dominate other issues; (b) because the IMF is seeking our help in designing "supply-side" complements to their programs. Related to this, the economic dialogue with LAC countries has traditionally been quite constructive. To the extent that we are perceived as not being embroiled in local political affairs we have had a privileged role in trying to strengthen the hands of those policy makers who, in our view, make sense. At the margin this advisory role -- usually referred to as the "economic dialogue" -- can have greater effects on economic performance than do transfers of financial resources. But in order to be effective our advice must be backed up by our lending posture.

As of January 31, 1981, the Bank had made $19.6 billion loans to countries in the Region, of which $6.6 billion remained undisbursed. Net of repayments, the Bank's exposure in the Region was $16.5 billion, or one-third of the Bank's portfolio. Brazil and Mexico (the two largest Bank borrowers), and Colombia together represent $11 billion of this exposure. However, although these magnitudes are large for the Bank, we account for less than 6% of the Region's public foreign debt and about 3% of its debt service. Our profile is relatively high only in Colombia and some Central American countries, where the share of public foreign debt due to the Bank is about 20%. In Brazil and Mexico it is less than 6%.

Last but not least, private financial institutions play a large role in LAC. Private foreign financial institutions provided more than two-thirds of the Regions's net capital inflow after 1973. In 10 out of 27 countries in the Region these institutions have accounted for more than 50 percent of the increase in external public debt since 1973. The Region makes up the bulk of commercial bank claims on developing countries (with Brazil, Mexico, Venezuela and Argentina alone making up about 40 percent of claims outstanding to developing countries). Furthermore, private financing channeled to Bank projects is also becoming increasingly important, although the amounts still represent only a small fraction of total private flows.

LAC cofinancing operations, including both other official entities and commercial institutions, have climbed to a level that now approximately matches total annual Bank lending in the region. External financing from these sources is being made available to help finance about one-third of the projects approved in FY1980. The LAC Region pioneered the private cofinancing technique now used throughout the Bank. The Region also continues to account for the largest share of cofinancing operations with both commercial sources and export credit institutions.

STATISTICAL TABLES

A. LENDING VOLUME--LAC REGION

	Annual					5-Year Totals				Memo
	FY79	FY80	FY81	FY82	FY83	Thru FY68	FY69-73	FY74-78	FY79-83	FY81-85
Dollar Millions										
IBRD	2,232.8	2,595	2,963.5	3,088	3,387	3,305.3	3,415.4	7,316.5	14,266.3	17,467
IDA	32	89	63.2	42.5	94	119.1	116.5	205.9	320.7	314.2
TW	-	-	-	-	-	-	-	67.5	-	-
Total	2,264.8	2,684	3,026.7	3,130.5	3,481	3,424.4	3,531.9	7,589.9	14,587	17,781.2
Constant FY80 $	2,437.9	2,684	2,828.7	2,743.6	2,867.4	-	9,092.5	10,563.4	13,561.6	14,569.9
No. of Operations										
IBRD	47	46	50	53	51	198	121	183	247	262
IDA	3	3	4	2	3	11	16	18	15	13
TW	-	-	-	-	-	-	-	4	-	-
Total	50	49	54	55	54	209	137	205	262	275

Memo: No. of Countries in Region 1/

IBRD only	19
IDA only	1
IBRD/IDA blend	5
Total	25

Median per capita income:

1/ Including Caribbean Region - excluding Venezuela.

B. AMOUNT OF IBRD/IDA LENDING BY SECTOR - L. A. C. REGION
(NOMINAL $ MILLION)

SECTOR	ANNUAL					5-YEAR TOTALS				MEMO
	FY79	FY80	FY81	FY82	FY83	THRU 68	FY69-73	FY74-78	FY79-83	FY81-85
AGRIC. & RURAL DEVT.	405.0	408.0	951.7	686.5	938.0	337.2	545.8	2032.5	3389.2	4460.2
URBANIZATION	176.5	88.0	140.0	240.0	255.0	.0	25.4	220.6	899.5	1420.0
SMALL SCALE INDUSTRY A/	7.0	202.0	.0	.0	50.0	.0	.0	152.5	259.0	431.0
POP., HEALTH & NUTRITION	.0	.0	.0	20.0	.0	.0	5.0	55.8	20.0	192.0
WATER SUPPLY & SEWERAGE	169.8	316.0	328.5	210.0	360.0	38.3	256.5	364.2	1384.3	1728.5
EDUCATION	52.5	32.0	123.0	85.0	87.0	21.3	95.5	243.4	379.5	489.0
OIL, GAS & COAL	.0	78.5	146.5	170.0	510.0	21.8	.0	.0	905.0	1911.5
POWER	346.0	708.0	303.0	644.0	401.0	1918.5	1009.1	1291.7	2402.0	2337.0
NON-FUEL MINERALS	7.5	80.0	.0	50.0	.0	.0	75.0	73.0	137.5	50.0
DFC B/	245.0	269.0	177.0	205.0	360.0	47.5	215.0	619.2	1256.0	1059.0
INDUSTRY C/	230.5	7.5	405.0	130.0	.0	84.5	214.0	764.0	773.0	905.0
TRANSPORTATION	468.5	371.0	411.5	560.0	435.0	881.6	931.1	1512.1	2246.0	2397.5
TELECOMMUNICATIONS	.0	44.0	.0	100.0	85.0	73.7	99.5	176.1	229.0	235.0
PROGRAM LENDING & SAL	156.5	80.0	39.0	30.0	.0	.0	60.0	60.5	305.5	119.0
OTHER D/	.0	.0	1.5	.0	.0	.0	.0	24.3	1.5	46.5
TOTAL REG 6	2264.8	2684.0	3026.7	3130.5	3481.0	3424.4	3531.9	7589.9	14587.0	17781.2

A/ INCLUDES SMALL SCALE ENTERPRISES AND SMALL SCALE INDUSTRY.
B/ EXCLUDES LENDING FOR SMALL SCALE ENTERPRISES.
C/ EXCLUDES SMALL SCALE INDUSTRY, MINING AND COAL PRODUCTION; INCLUDES TOURISM LENDING THROUGH FY79.
D/ MULTISECTORAL TECHNICAL ASSISTANCE LOANS AND CREDITS.

C. LENDING BY COUNTRY - L. A. C. REGION

COUNTRY	1979 GNP PER CAPITA	1979 POPULATION (MILLION)		AVERAGE ANNUAL LENDING FY78-80 $ MILLION	LENDING PER CAPITA FY78-80 ANN. AV. (US$)	LENDING PER CAPITA FY81-83 ANN. AV. (US$)
BRAZIL	1690	122.879	IBRD	691.3	5.63	7.68
			IDA	.0	.00	.00
MEXICO	1590	67.621	IBRD	440.5	6.51	10.40
			IDA	.0	.00	.00
COLOMBIA	1010	26.122	IBRD	394.7	15.11	20.81
			IDA	.0	.00	.00
ARGENTINA	2280	26.740	IBRD	166.0	6.21	7.02
			IDA	.0	.00	.00
PERU	730	17.293	IBRD	78.3	4.53	8.87
			IDA	.0	.00	.00
PARAGUAY	1060	2.987	IBRD	46.3	15.51	18.52
			IDA	.0	.00	.00
NICARAGUA	660	2.587	IBRD	11.0	4.26	16.04
			IDA	10.7	4.12	4.51
ECUADOR	1050	8.068	IBRD	58.3	7.23	12.95
			IDA	.0	.00	.00
BOLIVIA	550	5.444	IBRD	33.7	6.18	9.49
			IDA	14.8	2.72	2.14
CHILE	1780	10.912	IBRD	12.7	1.16	5.59
			IDA	.0	.00	.00
DOMIN. REP.	990	5.286	IBRD	57.3	10.85	9.14
			IDA	.0	.00	.00
URUGUAY	2090	2.917	IBRD	44.7	15.34	16.57
			IDA	.0	.00	.00
PANAMA	1350	1.858	IBRD	34.7	18.66	18.21
			IDA	.0	.00	.00
JAMAICA	1240	2.184	IBRD	44.8	20.53	12.97
			IDA	.0	.00	.00
GUATEMALA	1020	6.825	IBRD	29.7	4.35	4.64
			IDA	.0	.00	.00
HONDURAS	530	3.565	IBRD	67.8	19.03	9.16
			IDA	10.0	2.81	2.52
COSTA RICA	1820	2.163	IBRD	35.4	16.35	14.25
			IDA	.0	.00	.00
GUYANA	570	.843	IBRD	5.0	5.93	13.84
			IDA	5.0	5.93	6.52
HAITI	260	4.963	IBRD	.0	.00	.00
			IDA	16.0	3.23	5.12
BARBADOS	2400	.253	IBRD	9.0	35.57	34.26
			IDA	.0	.00	.00
BAHAMAS	2780	.231	IBRD	.0	.00	23.09
			IDA	.0	.00	.00
SURINAME	2360	.402	IBRD	.0	.00	8.29
			IDA	.0	.00	.00
CARIBBEAN			IBRD	7.7	.	.
			IDA	2.3	.	.
EL SALVADOR	670	4.424	IBRD	18.5	4.18	2.26
			IDA	.0	.00	.00
TRI. & TOB.	3390	1.152	IBRD	6.7	5.79	.00
			IDA	.0	.00	.00
L. A. C.	1499	327.718	IBRD	2294.1	7.00	9.60
			IDA	58.9	.18	.20

D. Economic and Sector Work Program - LAC Region

Functional Classification of Economic and Sector Reports[a/], FY80-82
(in staffweeks)

	FY80 (Actual)	FY81 (Estimate)	FY82 (Budget)	No. of Formal Reports In Period Completed [f]
Economic [b/]				
I. Basic Economic Reports	-	-	-	-
II. Country Economic Memoranda[c/]	621.7	671	682	60
III. Special Economic Reports				
Poverty, Employment, Income Distribution and Basic Needs	96.8	83	82	7
Resource Mobilization and Allocation	163.6	325	313	9
International Trade and Finance	-	24	44	3
External Debt and Creditworthiness[c/]	-	-	-	-
Development Planning	8.0	2	18	-
Public Enterprises	39.7	54	77	1
Development Administration	4.2	24	-	-
Other Topics	1.2	9	8	-
Total Economic	935.2	1192	1224	80
Sector				
I. Rural Development and Agriculture	395.3	144	143	6
II. Industry	192.6	148	91	6
III. Small Scale Industries[d/]	-	-	-	-
IV. Energy and Power	61.4	133	151	7
V. Urban and Regional Development	47.0	44	138	3
VI. Population, Health and Nutrition[e/]	4.0	50	130	2
VII. Water Supply and Sewerage	21.6	-	20	4
VIII. Education	223.9	114	126	13
IX. Telecommunications	0.4	5	10	4
X. Transportation	75.3	87	93	6
XI. Other Topics	23.9	41	95	2
Total Sector	1045.4	766	997	53

a/ Includes COPD managed.

b/ There is considerable overlap between different categories in this table.

c/ "External Debt and Creditworthiness" analyses are included under CEMS.

d/ Included under "Industry".

e/ Includes Basic Needs.

f/ PAB definition of Formal Reports (by date of final internal cover)

E. Budget by Major Function - Region - LAC

Staff Year Applications

	FY79 Actual	FY80 Actual	FY81 Program
1. Lending	121.0	130.6	130.3
2. Supervision	56.0	67.4	70.6
3. Economic and Sector	50.3	48.6	48.6
4. Other Direct Output	14.0	14.8	13.6
5. Support to other units 1/	6.8	5.2	5.1
6. Management and Admin.	40.0	41.3	37.6
7. Overhead	46.7	51.3	54.9
8. Total	334.8 3/	361.9 2/	360.7

Memo: Admin. expenses ($000)

Total Discretionary Expenses ($000)

FY79	FY80	FY81
15,320 3/	18,832	21,177

Staff Year Sources

	FY79 Actual	FY80 Actual	FY81 Program
1. Professional Staff 1/	269.3	289.0	285.4
2. Consultants	30.2	38.6	40.7
3. Cooperative Programs	15.4	18.9	15.9
4. CPS	7.5	8.1	5.6
5. DPS	4.9	1.4	2.6
6. Other	7.5	5.9	10.5
7. Total	334.8	361.9	360.7

Memo: Authorized positions

	FY79	FY80	FY81
Professional	249	271	277
Assistant	19	24	29
Secretarial +	140	151	157
TOTAL:	408 3/	446	463

1/ To COPDs, other regions, DPS, etc., IFAD
2/ Including 2.7 SY's of missing time

1/ Including overtime
3/ Excluding the Urban Division

F. STAFFING - LAC REGION

(Numbers by Grade and by Discipline)

Discipline	No. of Staff (Budgeted)	Grade (Staff on Board as of 01/31/81)								
		Q	P	O	N	M	L	K	J	TOTAL
Management	8									
Administrative Officers	3									
Loan Officers and Op. Officers	62									
Economists	83									
Technical Specialists	81									
Financial Analysts	30									
Specialized Department Staff	10									
Total Professional Staff	277	1	3	6	29	71	130	25		265

Information Provided by PAB

ARGENTINA

ARGENTINA

A. Political Overview

1. Background. By 1973, when Peron returned from exile, the country's social fabric had seriously disintegrated. Peron proved unable to weld together the disparate factions and reconcile competing claims; his death and the succession of his inept wife to the Presidency plunged Argentina into its deepest political crisis. The military takeover in March 1976, marked the dawn of a new political era. During General Videla's term as President, which will end March 29, 1981, public political activity was virtually suspended. Efforts were placed on establishing civic order, stabilizing the economy, and calming down political rhetoric. President-elect General Viola, is expected to open a dialogue with the traditional political parties. Unlike his practical, apolitical predecessor, General Viola is said to be a shrewd politician with liberal tendencies, not fully shared by a number of ranking fellow officers. It is said that General Viola wants to initiate a transition to a stable civilian government and to get the army to return to the barracks for good.

2. Issues. The change in governments raises several issues: (a) "political opening" - economic decision making is likely to become more politicized, subject to increasing influence of interest groups. Unpopular policies aimed at increasing efficiency may be watered down. Possibilities of conflict between military and civilian groups may well increase; (b) conflict with Chile - the sharpening conflict over the Beagle islands will strengthen the hand of the military; it could become a nationalistic ploy to rally the populace if the economy deteriorates; it could also provide an excuse for the military to keep a grip on key industries and reverse the existing trend of privatization of the economy; (c) decentralization of economic team - Martinez de Hoz's ministry has been split into five. Whereas Martinez de Hoz always had the upperhand to convince military leaders to accept his decisions, there is now a power dispersion with a number of players, making it more difficult to pursue homogenous policies.

B. Economic Overview

3. Background. Frequent and drastic reversals in economic policies, sharp conflicts among interest groups, inefficiency in the public sector and excessive protection of industry are among the factors responsible for Argentina's unsatisfactory slow rates of growth since World War II. The economy reached bottom in early 1976; the inflation rate approached 800 percent, foreign exchange reserves were exhausted. President Videla's economic team was able to improve the balance of payments within a short period, restructure the external debt and reduce hyperinflation. After the initial stabilization success, a new program was introduced in late 1978 which gave priority to lowering inflation further while modernizing the economy. It differed from previous ones by relying heavily on foreign trade policy as a deflationary tool: the exchange rate was devalued according to a predetermined schedule, leading to a revaluation in real terms, and protective tariffs were reduced gradually. Thus external competition was used to make industry more efficient and constrain its ability to raise prices. The program's initial results were impressive. Inflation slowed down markedly (wholesale price increased by only 60

percent in 1980) real fixed investment increased, GDP expanded and the public sector deficit decreased. These gains, however, were not without costs: the industrial sector has experienced record bankruptcies; excessive debt financing, combined with high interest rates, has led to mounting liquidity problems for both public and private enterprises; the banking system may be on the verge of a severe crisis as a result of bad loans and business failures. During 1978 and 1979, surpluses on both trade and capital accounts produced large increases in reserves. By 1980, however, the peso was becoming increasingly overvalued as inflationary movements exceeded the pegged devaluations by a substantial margin, and the trade balance turned negative. High domestic interest rates and the country's large reserve cushion continued attractive to foreign lenders, but nervousness about the stability of the peso grew perceptibly during the second half of the year. Instead of relieving this pressure, the 10 percent devaluation of the peso in February 1981 exacerbated speculative fears of a further large exchange rate adjustment. The flight into dollars caused a massive drain on the Central Bank's reserves which halted only after interest rates rose to levels approaching 60 percent in real terms. While effective in the short term, this policy cannot be pursued over a longer period without risking depression.

4. Issues. The new cabinet includes representatives of major interest groups who have been critical of Martinez de Hoz; as a consequence, the transition may not be as smooth as expected, and policies could be relaxed or reversed. The new economic team faces major issues in three key areas: (a) tariff policies - interest groups are exerting pressure to reverse the present policy of reducing import tariffs; drastic changes would jeopardize progress made in restructuring the industrial sector and hamper anti-inflationary efforts; (b) exchange rate policy - a large devaluation would help exporters but seriously hurt enterprises holding foreign currency liabilities, and, unless accompanied by firmer aggregate demand management and further trade liberalization measures, the consequence would be renewed inflationary pressures and a restoration of former levels of import protection; (c) monetary and fiscal policies - the fiscal deficit will have to be reduced as part of a credible anti-inflation program, permitting interest rates to fall and avoiding a serious private sector liquidity crisis.

C. Role of the World Bank

5. Volume and Strategy. Past Bank lending to Argentina has been sporadic because of periodic macroeconomic difficulties and unsatisfactory sector policies. After a hiatus of five years, lending resumed in September 1976 Since then, the Bank has approved 10 loans amounting to US$886 million with two loans totaling $250 million ready for negotiations. The Bank's lending strategy, in support of Argentina's stabilization efforts, has had three objectives: (i) to rationalize public sector policies; (ii) to promote public sector decentralization and transfers to the private sector; and (iii) to restructure the industrial sector.

6. Past Performance. The overall performance of Bank financed projects has not been satisfactory: (a) a $60 million loan for Agricultural Credit was cancelled and the Grain Storage Loan is being restructured; (b) on average, project execution has been delayed by about 26 months compared to appraisal estimates; and (c) only 20 percent of the Bank loans commited since 1976 have been disbursed. The problems can be traced to a combination of: (a) institutional weaknesses and cumbersome administrative procedures; (b) limitations on Government contributions in order to contain fiscal deficits; (c) ceilings on public sector tariff increases in order to control inflation; (d) acceleration of Government policies to increase

private sector participation; (e) revaluation of the exchange rate as major instrument of stabilization policies. While Bank lending has constituted only a small part of Argentina's financial flows, the Bank's presence has contributed significantly in several areas: (a) institution building - the National Development Bank has streamlined operating procedures; responsibilities in the power sector have been redefined; management procedures and organization in the railways, highways and power entities have been changed and strengthened; a comprehensive hydrocarbon pricing policy has been prepared and the state oil company will be significantly strengthened; (b) investment planning - a long term power investment plan has been completed which rationalizes development of hydro, thermal and nuclear development; the National Transport Plan is beginning to have an impact on sector organization and investment allocation for individual modes; and (c) operating efficiency - most impressive are the achievements in the railways. Closure of uneconomic lines and staff reductions are ahead of schedule, operating targets except for financial parameters are being exceeded. The highway agency has been able to lower significantly unit construction and maintenance costs, and the power company shows improved efficiency parameters.

7. Outlook. The scope of the Bank's future role depends on several factors: (a) improved implementation - recent developments are positive; the disbursement rate is picking up, agreed execution schedules are generally adhered to, and major issues relating to the large Yacyreta hydroelectric project are being resolved, although some others, related to procurement, are expected to emerge; (b) per capita income - at $2300 per capita GNP (1980), Argentina is one of the Bank's more developed borrowers; however this figure masks chronic institutional weaknesses that are among the main factors constraining growth, justifying continued Bank assistance; (c) future economic policies - the biggest unknown concerns future economic policies, particularly those relating to public sector tariffs, petroleum pricing, and monetary exchange rate and trade policies. If no major issues surface, proposed Bank assistance would be on the order of 2-3 projects and $200-300 million per annum. Major areas of assistance include hydrocarbon and energy development (52%), infrastructure lending (22%), industrial credit assistance (15%), and assistance for education and agriculture (11%).

8. In conclusion, the new Government faces a rough road ahead. In response to public pressure, it will probably modify some of the previous policies; the degree of relaxation and the accompanying monetary and fiscal policies will determine the inflationary impact and the degree, if any, to which long-term structural reform objectives are sacrificed. It will be important that the new administration establish a degree of confidence early on; the decentralization of the economic ministry could complicate this task. The country's foreign exchange position at present is still strong and export prospects for the coming year are good; the Government will have some breathing space. There is a risk that Argentina will once again abort stabilization policies prematurely and revert to expansionary and protectionist measures.